

# The Budget & Business Travel

UK, 24 JUNE 2010

## INTRODUCTION

On Tuesday The Chancellor of the Exchequer delivered his highly anticipated Emergency Budget. The fiscal deficit is not only the largest in Britain's post-war history, but provides the UK with the toughest financial assignment of any G20 country. The Economist said that on the timing of the retrenchment, "Mr Osborne must show caution" and on its substance, "he must show courage." Arguably it was bold on both counts.

In line with expectations it was slim on detail, instead mapping out the 'overall path' of public spending. We can expect an in-depth, comprehensive Autumn Spending Review on October 20. This review will assess individual projects and provide clarity on where the axe will fall and the size of cuts. In coming months, departments will be eager to prove their worth to the Treasury, making efficiency savings as quickly as possible, particularly in departments most vulnerable to the axe; high amongst them, the Department for Transport (DfT). Transport Secretary Philip Hammond, speaking post-Budget, stated that the DfT will not be carrying out a "salami slicing exercise", saying that the deficit is too large for that to be effective. DfT is already making £683million of efficiency savings, announced shortly after the election. This week the Chancellor announced spending reductions across all departments of a further 25%. Although, according to the Social Market Foundation the DfT's 25% contribution to cuts could look more like 35%.

## "Every transport project to be viewed through the 'jaundiced eye' of the Treasury"

**Philip Hammond, Transport Secretary**

## CAPITAL SPENDING

In line with The Confederation of British Industry (CBI) and London Chamber of Commerce and Industry (LCCI) thinking, the Chancellor announced that capital spending will be subject to no further cuts beyond those included in the £6.2billion savings already announced. Note 'no further cuts': according to the Financial Times capital expenditure is still severely constrained because the Government accepted Labour's pre-election capital spending cuts. These are actually more severe than equivalent cuts that occurred under Thatcher. 'No further cuts' is a victory for Business Secretary Vince Cable, he has convinced the Chancellor to stick with existing plans to bring capital spend down from 3% GDP to 1.25% in 2013-2014, and no further.

The Budget says that the Government 'recognises the important role investment in infrastructure plays in supporting economic growth and UK competitiveness' and will, therefore, continue to encourage private sector investment in existing and future projects. This recognition is formalised in the creation of Infrastructure UK (IUK), a body to be chaired by Terry Hill, Chair of Transport Market Arup, responsible for the planning, delivery and cost management of priority private and public projects.

Although determined not to fall into the trap of making blanket cuts by simply stopping construction of new projects, the Chancellor did advise that value for money remains the guiding principle. Public sector investment is to be targeted only at projects that can produce 'significant economic return for the country'. This was made clear by the Chief Secretary's cancellation of 12 national projects worth £1.9bn last week, and has been a constant feature of the Department of Transport's ministerial messaging. The CBI recommends a review of project expenditure to be carried out prior to October's comprehensive spending review to ensure that the implications for growth are fully understood.

## BUDGET SUMMARY

- ▶ Government departments face an average of 25% in budget cuts over the next 4 years.
- ▶ From January 4 2011, the main rate of VAT will rise from 17.5% to 20%.
- ▶ Public sector debt should be in balance by 2015/16.
- ▶ Growth estimate to be 1.2% this year, 2.3% next year.
- ▶ Unemployment to peak this year at just over 8%.
- ▶ Inflation to remain at 2%.
- ▶ Public sector net borrowing to reach 1.1% of GDP in 2015/16.
- ▶ Debt interest payments to be £3bn lower by the end of this parliament.
- ▶ The Chancellor proposes extra spending cuts of £30bn by 2015/16.





## REBALANCING THE ECONOMY

Although the London lobby has been extremely vocal on the critical value of the capital's economic contribution, the rebalancing of the economy beyond the Greater South East was central to the Chancellor's Budget announcement. In David Cameron's first speech as Prime Minister he stated that the transformation of the British economy does not mean ignoring London, "but it does mean having a plan to breathe economic life into towns and cities outside the M25". In order to support employment and growth in areas particularly dependent on the public sector, the Chancellor announced the creation of a Regional Growth Fund that will operate in England only, stimulating private sector-led growth. As part of this rebalancing the Chancellor announced that the Government will back four regional rail projects, including improving rail links between Sheffield and Leeds and revamping Birmingham New Street station. Damian Waters, north-west regional director of the CBI employers' body, said east-west transport links needed to match the improved north-south ones:

**"The coalition has talked about rebalancing the economy away from the public sector and financial services. There has to be a geographic rebalancing too."** **Damian Waters, CBI**

## AVIATION

For aviation, the Budget presented two challenges. Firstly, an announcement on the sale of the national air traffic provider, NATS, and secondly the lack of an announcement on Air Passenger Duty (APD). Transport has been hit hardest by the Chancellor's sale of public sector assets, first HS1 and now NATS. Prospect, the union representing over 3,000 air traffic controllers, has hit out at the Treasury's "knee jerk" reaction saying that, "NATS receives no public subsidy, is a net contributor to the Exchequer and provides an invaluable public service." Airlines have also come out in opposition to the move, fearful that private sector providers will increase the cost of the service further.

### AIR PASSENGER DUTY

The absence of any announcement on a new passenger tax has been subject to serious critique since the Budget. A switch from Air Passenger Duty (APD) to Per Plane Duty (PPD) featured in the coalition's first policy document and yet the Budget yielded no further developments, the text stating that, "The Government will explore changes to the aviation tax system...Major changes will be subject to public consultation". Whether reform happens or not the Treasury's budget report projects that the take from APD (£1.9billion in 2009/10), will double to £3.8billion in 2015/16.

The absence of a concrete announcement means that the planned rises in APD, announced by the previous Government, will go ahead this November. The new public consultation process will take approximately 12 weeks, and it's likely we will see legislation in the next Parliament.

## EXECUTIVE SUMMARY - TRANSPORT

- ▶ As expected, the Coalition's Emergency Budget was short on detail but there was some additional clarity. For the travel management sector the pain must be deferred until the Comprehensive Spending Review in October.
- ▶ The Chancellor, in line with international experience, announced spending cuts and tax rises in a 4:1 ratio.
- ▶ Government spending in 2010-2011 on Transport in £22 billion; a 25% spending cut based on this year's numbers would reduce departmental spending to £16.5billion, a reduction of £5.5billion.
- ▶ The Treasury has committed to keep capital spending at levels set by Labour; this still means a drop from 3% of GDP 2009-2010 to 1.25% 2013-2014. Capital spending is often the first target in spending cuts so this is encouraging news for the travel sector.
- ▶ Key infrastructure projects will be increasingly reliant on private sector investment, the future of Crossrail and HS2 depend upon their ability to deliver efficiency and adhere to existing budget plans.
- ▶ The Budget announced the creation of Infrastructure UK (IUK), to encourage private sector investment in infrastructure projects. This highlights the Government's recognition of the value of infrastructure to future growth and the Treasury's determination to keep a watchful eye on individual timetables and budgets.
- ▶ The establishment of a Regional Growth Fund may be good news for regional transport projects. Rail links from Sheffield to Leeds were earmarked in the Budget for funding.
- ▶ A new passenger tax regime on flights will be subject to public consultation before the Government introduces legislation. Consequently, the last Government's plans to raise Air Passenger Duty will still go ahead in November 2010 as scheduled, pending the new review.
- ▶ Projects will only be considered for funding if they can demonstrate value for money. If not, expect cuts to budgets and / or delays in scheduling.

## RAIL

The Transport Secretary has been proactive in his review of the portfolio, under pressure to deliver the required £683million efficiency savings as quickly as possible. The DfT's largest expenditure is in grants to Network Rail, local authorities and Transport for London. Accordingly, these are first up for review. In line with advice from the CBI regarding expenditure assessment prior to the October Spending Review, Philip Hammond announced an independent review of value for money in the rail industry. He said it is essential that the industry "drive out inefficiencies and reduce costs". He went on to state that better value for money was the only way to protect train services and "avoid very high rises in train fares." It is clear that the Government is avoiding committing to reduced, or even, stabilised fares which will inevitably have an impact on corporate travellers. Indeed, Hammond has said it would be "very difficult" to achieve fare reductions.

A report by the National Audit Office, released on June 4, was critical of the cost of new trains and announced that in light of the economic downturn the growth in passenger numbers had not matched predictions. So Hammond has taken steps to review the last Government's spending commitments into increasing rail capacity. The rail carriage procurement scheme, initially established by Labour to tackle overcrowding, and later to account for Thameslink and Crossrail, is set to cost at least £4billion. This is now on hold and will be subject to review.

## HIGH SPEED RAIL

A topic of considerable speculation, sceptics had earmarked HS2 for cancellation in the Emergency Budget. The Transport Secretary's announcement on the sale of the rights to HS1 last week was held up by the Chancellor as an example of disposing of assets "which should rightly be in private ownership". Hammond described it as the "first step to restoring public finances" as it could potentially contribute £2billion to offset public sector debt. The National Union of Rail, Maritime and Transport Workers (RMT) was less welcoming, saying that this was the "clearest indication possible" that the Coalition "will flog off every public asset that's worth a few quid." The RMT intends to launch an "all-out fight" in response.

This announcement will now put the future of HS2 into question. Transport Minister Theresa Villiers stated that the Government supports the creation of a "genuinely national high-speed network, although we recognise that that will have to be achieved in phases over a number of years". Once again, it's commitment with caution. Meanwhile, Hammond in his post-Budget comments stated that HS2 remains on his agenda and that he anticipates work to start in 2015. Although, it is unlikely to take passengers until 2020 at the earliest.

## CROSSRAIL

Subject to concerted speculation in the run up to the Emergency Budget, Theresa Villiers has continued expressing the Government's commitment to the project, albeit with efficiency provisos. Similarly, during a visit to the Canary Wharf site last week, Philip Hammond said his presence signalled his intention to "press ahead with the major improvements" to the transport system. He said that the work being carried out at Canary Wharf was "an excellent example of how this can be done in an innovative and efficient way, so that we get value for taxpayer's money". The LCCI has warned against scaling back the project with fears that the removal of key stations or the reduction of train frequency will dilute Crossrail's contribution to growth. There has been some disquiet amongst the business community over potential short term cuts to the project that they say could jeopardise vital private sector investment. Jo Valentine, Chief Executive of London First, warned that "if business is not consulted, or the scheme becomes unrecognisable, don't count on business support". In a speech to London First on June 15 Hammond did offer his assurances: "The challenge for all of us...is to absorb budget reductions through efficiency gains, not by cutting services and projects".



## WHAT DOES THIS SPELL FOR THE FUTURE OF THE COALITION?

For the travel management sector the pain is yet to come, but Philip Hammond understands the value of the sector in stimulating the recovery, promising to take the DfT's case directly to the Chief Secretary to the Treasury. Speaking after the Budget, Hammond praised the Chancellor for protecting capital spending and his recognition of the country's infrastructure in the Budget announcement. With Hammond at the helm, the sector has a powerful voice in Government and someone with expertise and close links to the Treasury. However, major projects could still be subject to scale backs and for corporate travellers a rise in aviation taxes and rail fares will make business travel an expensive exercise.

Clarity will come with the Spending Review in October, but we should expect the DfT to be one of the worst hit. The silver lining? This has been coined the 'Big Bang Budget' by commentators; the Chancellor does not plan to come back for more. It is the Government's intention to rip the plaster off in one go. But leading economist Andrew Lilico warns that no other government in the world has successfully dealt with their deficit first time round. Can we buck the trend? We have the course of one Parliament to find out.