

OVERVIEW

The Government's objective is to deliver high and stable levels of growth and employment, with opportunity and rising living standards for all – a Britain of economic strength and social justice. Against a backdrop of global uncertainty, Budget 2003 describes how the Government is seeking to meet the long-term challenges of globalisation, achieving both flexibility and fairness together.

Budget 2003, *Building a Britain of economic strength and social justice*, presents updated assessments and forecasts of the economy and the public finances, reports on how the Government's policies are helping to deliver its long-term goals and describes the further steps that the Government is now taking to advance its goals. The Budget:

- demonstrates that the economy is on course to maintain stability and that the Government is on track to meet its fiscal rules over the economic cycle, while meeting its international and public spending commitments;
- sets out new proposals to promote greater flexibility in the housing market and to streamline and simplify the planning regime;
- strengthens the drivers of enterprise and productivity, improving flexibility with further support to reduce regulatory burdens, simplify tax, boost research and development and improve access to finance for small businesses;
- takes further steps to increase flexibility in the labour market, with additional measures to raise workforce skills, new support to help people master change, and reforms to spread employment opportunity to disadvantaged groups;
- introduces a new Child Trust Fund to strengthen the saving habit of future generations, and provides further support for pensioners;
- advances fairness within the tax system, to ensure that businesses and individuals contribute fairly to the public services from which they benefit; and
- describes a range of further action to protect and enhance the environment, including through more sustainable waste management.

BUILDING ECONOMIC STRENGTH AND SOCIAL JUSTICE

1.1 The Government's objective is to deliver high and stable levels of growth and employment, with opportunity and rising living standards for all – a Britain of economic strength and social justice.

1.2 Globalisation has brought new opportunities for individuals, businesses and countries to develop and prosper, but it has also brought new risks. In the modern global economy, the challenge for governments is to devise ever more effective ways of achieving high and stable levels of growth and employment, with policies for stability, employment and fairness matched with greater flexibility in labour, product and capital markets. New technologies, global competition and evolving demands for skills require businesses and individuals to adapt quickly to change so that growth and prosperity can be maintained. Flexible and dynamic markets are a precondition for economic strength and for securing fairness and social justice.

I.3 Just as the long-term forces of globalisation create significant challenges for policy-makers, so recent international developments demonstrate the need for vigilance. Weakened global growth and protracted uncertainty highlight the risks of global markets and pose threats to the prosperity and living standards of many. Events leading up to hostilities in Iraq have heightened economic uncertainty, dented confidence and brought further volatility to financial markets, posing new and immediate challenges to the delivery of high and stable levels of growth and employment around the world.

I.4 Over the past six years, the Government has recognised the importance of increasing productivity and flexibility in the UK economy:

- in labour markets, through investment in skills, additional help with jobsearch, and increased work incentives from tax credits, to equip people to adapt to change and deliver employment opportunity for all;
- in product markets, with reforms to strengthen the competition regime and to boost enterprise and innovation to ensure that firms can seize the opportunities created by change and technological improvements; and
- in capital markets, with reforms to modernise financial regulation and improve the financing options for investment and new businesses.

I.5 Budget 2003 builds on these reforms to meet the long-term challenges of globalisation and ensure that the UK is well placed to take advantage of opportunities as the global recovery takes hold. The Budget sets out the next steps in the Government's programme of economic reform to build a stronger, more enterprising economy based on dynamic and flexible markets and underpinned by fairness and social justice. It describes how, through this programme of reform, the Government will advance its long-term goals of:

- maintaining economic stability, ensuring that the fiscal rules are met and that inflation remains low;
- raising the sustainable rate of productivity growth through reforms to enhance the flexibility of product and capital markets and to promote enterprise, innovation and skills;
- sustaining a higher proportion of people in work than ever before on the basis of a flexible labour market that adjusts rapidly to changing conditions and delivers employment opportunity for all;
- creating a fairer, more inclusive society with opportunity and security for all, eradicating child poverty and tackling pensioner poverty;
- establishing world class public services to underpin a flexible and high productivity economy, through investment and reform; and
- tackling the global challenges of poverty and climate change through steps to achieve the Millennium Development Goals and to deliver the UK's commitments under the Kyoto Protocol.

MAINTAINING MACROECONOMIC STABILITY

1.6 The Government's macroeconomic goal is to maintain economic stability, ensuring that the fiscal rules are met and that inflation remains low. Chapter 2 describes how the Government is working to achieve this goal and summarises prospects for the UK economy and the public finances, full details of which are set out in Chapters B and C of the *Financial Statement and Budget Report* (FSBR).

The policy framework **1.7** The Government's macroeconomic policy framework is based on the principles of transparency, responsibility and accountability, and is designed to ensure lasting economic stability so that businesses, individuals and the Government may plan effectively for the long term. The Bank of England has operational independence to meet the Government's symmetrical inflation target, while fiscal policy is underpinned by two strict fiscal rules which ensure sound public finances over the medium term. The fiscal rules underpin the Government's public spending framework which ensures that public resources are used productively and delivers a sharper focus on the quality of outcome of public service provision.

1.8 The macroeconomic policy framework has successfully delivered stability and growth, proving flexible and responsive in the face of global weakness and uncertainty. The economy continues to enjoy the longest period of economic expansion on record, with employment at record levels and unemployment at its lowest for a generation. Sustained economic growth and tough decisions on taxation and spending have placed the public finances on a sustainable footing, generating additional resources for investment in public services and allowing fiscal policy to support monetary policy in limiting the impact of global weakness on the UK economy. The monetary policy framework has also ensured that inflation has remained lower and more stable than in the past.

Economic prospects **1.9** Since the Pre-Budget Report, geo-political risks, particularly surrounding hostilities in Iraq, have compounded global economic uncertainties. Despite recent action by policy-makers, sharp declines on equity markets and rising oil prices have prompted falls in consumer confidence and the continued deferral of business investment plans, restraining global economic activity still further. Consequently, G7 growth this year is forecast to be weaker than expected at the time of the Pre-Budget Report, with prospects for the Euro-area particularly badly affected. Following growth of 1½ per cent last year, GDP in the G7 economies is expected to grow by just 1¾ per cent this year, before accelerating to 2¾ per cent in 2004 and to 3 per cent in 2005. Growth in the Euro-area is expected to be just 1 per cent in 2003, rising to 2¼ per cent next year.

I.10 International developments continue to be a key influence on prospects for the UK economy, and persistent uncertainty and subdued global growth have affected business confidence and investment recently. Nonetheless, low inflation and sound public finances have allowed macroeconomic policy to support the economy during this period of global weakness, leaving the UK better placed than in previous world slowdowns to maintain economic stability. The economy grew by 1.8 per cent in 2002, above the Pre-Budget Report forecast and behind only North America among the G7 economies. In the Budget 2003 forecast:

- **GDP** is expected to grow by between 2 and 2½ per cent this year as ongoing uncertainty contributes to weaker global demand and subdued private investment in the first half of the year. Thereafter, reduced uncertainty and a subsequent strengthening of the global recovery should allow growth of 3 to 3½ per cent in 2004 and 2005 as the economy returns to trend;
- **growth is expected to become steadily more balanced** over the forecast period as deferred business investment is brought back on stream, exports pick up in response to stronger external demand, and private consumption growth continues to moderate;
- **RPIX inflation** is expected to remain close to the Government's 2½ per cent target throughout the forecast period; and
- **prospects for the UK economy** remain dependent on the turn of global events. The Budget forecast assumes that current economic uncertainties diminish in the second half of the year, prompting a steady recovery in business and consumer confidence. While the pace of global recovery in the short term, and of European economic reform in the medium term, will both influence the future pattern of UK growth, with sound economic fundamentals in the UK, policy remains well placed to respond to risks in either direction.

The public finances **I.11** Global uncertainty affected the fiscal balances last year, as receipts weakened due to cyclical or otherwise temporary factors and the Government made a special contingency provision of £3 billion to cover the full cost of the UK's military obligations in Iraq. The estimated outturn for the current budget in 2002-03 shows a deficit of £11.7 billion, compared with a projected deficit of £5.7 billion in the Pre-Budget Report and a surplus of £3.2 billion in Budget 2002. Net borrowing is estimated to have been £24.0 billion in 2002-03, compared with £20.1 billion projected at the time of the Pre-Budget Report and £11.2 billion in Budget 2002. The provisional outturns demonstrate that fiscal policy supported monetary policy through the operation of the automatic stabilisers, helping to maintain stability during a period of weaker global demand.

I.12 While the full amount of the Government's contingency provision for military obligations in Iraq has been allocated to 2002-03, there is considerable uncertainty over when these costs will fall. In the light of this uncertainty, and to protect committed investment while responding prudently to heightened global risks, the Government has decided to make no further allocations from the Capital Modernisation Fund (CMF). Instead, unallocated CMF funding will contribute to rebuilding the Annually Managed Expenditure margin, to ensure that the Government's public spending projections include a prudent and cautious safety margin against unexpected events.

I.13 Against this backdrop, and in addition to the steps already taken to meet international and public spending commitments, Budget 2003 announces further decisions to build a Britain of economic strength and social justice, including:

- a package of reforms to promote flexibility in labour, product and capital markets, including measures to promote enterprise, innovation and skills, and support to help people find and succeed in work;
- further steps to advance flexibility and fairness together, with a new Child Trust Fund to strengthen the saving habit of future generations, and further support for pensioners; and
- reforms to tackle avoidance and advance fairness in the tax system, to ensure that everyone contributes fairly to the public services from which they benefit.

I.14 Table 1.2 lists the key Budget policy decisions and their impact on the public finances.

I.15 Prolonged uncertainty in the world economy and the decisions taken in this Budget mean that the near-term outlook for the public finances has deteriorated slightly since the time of the Pre-Budget Report. While a current budget deficit of £8 billion is now expected this year, a decline in global uncertainty and a cyclical recovery in the world economy mean that the current budget is restored to surplus from 2005-06. The forecast demonstrates that fiscal policy is expected to continue providing support to monetary policy as the economy remains below trend.

The fiscal rules I.16 The forecast also demonstrates that the Government remains firmly on track to meet its strict fiscal rules over the economic cycle, including in the cautious case. As shown in Table 1.1, the average surplus on the current budget since the start of the current cycle in 1999-2000 remains positive throughout the forecast period, leaving the Government on track to meet the golden rule. Public sector net debt is projected to rise slightly to just under 34 per cent of GDP by 2007-08, comfortably meeting the sustainable investment rule, and the lowest level of debt as a proportion of national income in the G7.

Table 1.1: Meeting the fiscal rules

	Outturn 2001-02	Estimate 2002-03	Per cent of GDP				
			2003-04	2004-05	Projections 2005-06 2006-07 2007-08		
Golden rule							
Surplus on current budget	1.0	-1.1	-0.8	-0.1	0.2	0.4	0.6
Average surplus since 1999-2000	1.8	1.1	0.7	0.6	0.5	0.5	0.5
Cyclically-adjusted surplus on current budget	0.9	-0.5	0.2	0.5	0.4	0.4	0.6
Sustainable investment rule							
Public sector net debt	30.2	30.9	32.2	32.7	33.2	33.5	33.8

I.17 The public finances are also sustainable over the long term. Consistent with the requirements of the *Code for fiscal stability*, Annex A of the *Economic and Fiscal Strategy Report* presents illustrative long-term fiscal projections and examines the long-term sustainability of the public finances. The projections indicate that the UK is well placed to deal with future fiscal challenges, such as those arising from an ageing population, and that current policies impact fairly between generations.

MEETING THE PRODUCTIVITY CHALLENGE

I.18 Productivity growth, alongside high and stable levels of employment, is an important driver of long-term economic performance and rising living standards. In the modern global economy, faster productivity growth demands new flexibility in product, capital and labour markets. With global markets for business, investment and skills, governments, individuals and firms must be able to respond quickly and adapt rapidly to change. Failure to do so risks an unproductive use of resources, with long-term costs to growth, employment and prosperity. The Government's long-term goal is to raise the sustainable rate of productivity growth in the economy, closing the gap that exists between the UK and other advanced industrialised countries.

Action so far I.19 The Government's strategy is described in detail in Chapter 3 and focuses on five important drivers of productivity performance:

- **improving competition** to increase flexibility in product markets and promote business efficiency and consumer choice. The Enterprise and Competition Acts, as well as substantial increases in resources for the competition authorities, have increased the powers of the Office of Fair Trading and strengthened the UK's overall competition regime. Action has also been taken to promote competition in specific markets, including small business banking and the professions;
- **promoting enterprise** by removing market barriers to entrepreneurship, especially in disadvantaged areas. Reforms to the business tax regime have increased the support to new and growing businesses and helped all businesses to compete more effectively in global markets. Two thousand Enterprise Areas have been designated in the most deprived communities in the UK, and additional support made available to help businesses in these areas start up, develop and grow. Resources have also been allocated to promote understanding of business, the economy and enterprise throughout the school and further education systems;
- **supporting science and innovation** to open up new markets and opportunities. Record increases in science spending and funding for knowledge transfer are supporting improvements in the UK science base and stronger collaboration between businesses and universities. Tax credits are also rewarding research and development by the private sector;
- **raising UK skills** to deliver a more flexible and productive workforce. Substantial increases in resources are helping to improve standards throughout the school and further education systems and to advance the Government's ambitious long-term goal to raise participation in post-16 education and training. Employer Training Pilots are testing new means of support to help those already in the workforce acquire new skills; and
- **encouraging investment** and better investment decision-making, on the basis of stronger, more efficient capital markets. Radical reform of the land use planning system and increased resources to improve the supply of housing are helping to tackle inflexibilities in the housing market, while comprehensive reviews into institutional investment and the market for long-term savings have sought to promote greater flexibility in capital markets, helping businesses to manage risk more efficiently.

Next steps I.20 Budget 2003 introduces further measures to promote productivity growth through a more enterprising and highly skilled economy, including:

- **new proposals to promote greater flexibility in the housing market and to streamline and simplify the planning regime;**
- **a package of reforms to improve access to finance for small businesses,** including consultation on the scope for introducing Small Business Investment Companies in the UK;
- **improvements to research and development (R&D) tax credits** to enable more businesses to claim a wider range of relief, and consultation on the definition of R&D to ensure it remains competitive internationally;
- **deregulatory reforms to ease the regulatory burden,** especially on small businesses;
- **additional measures to improve skills in the UK,** including the launch of six new Employer Training Pilots and a new package of training support for small businesses;
- **further improvements to the Highly Skilled Migrants Programme** and other migration schemes to make the UK migration system a more effective source of highly skilled labour for the UK economy;
- **£16 million over two years to fund Enterprise Advisers** to work alongside head teachers in around 1,000 secondary schools in deprived areas, ensuring that pupils in these areas gain a better knowledge of business and enterprise;
- **an extension of 100 per cent first year capital allowances** for small businesses investing in ICT, for one further year; and
- **further steps to support a modern and competitive business tax system,** with reforms to VAT for small business, simplification of employee share schemes, and abolition of Petroleum Revenue Tax on new third party tariffing business.

INCREASING EMPLOYMENT OPPORTUNITY FOR ALL

I.21 The Government's long-term goal is employment opportunity for all – the modern definition of full employment. Its aim is to ensure a higher proportion of people in work than ever before by 2010. Worklessness, particularly on a long-term basis, is a constraint on Britain's growth potential and a major cause of poverty and deprivation for many individuals and their families. A dynamic and flexible labour market that equips people to adapt to changes in global and domestic demand, and which has the institutional flexibility to deliver high employment and low unemployment across the economic cycle, is key to achieving the Government's goal.

Action so far I.22 Chapter 4 describes the steps the Government has already taken to ensure that the labour market remains dynamic and flexible and that employment opportunity is extended to all groups and regions in the country, including by:

- **equipping people to cope with change** through investment in skills and training and transitional help for people moving between jobs. Since 1997, the New Deal programmes have helped to deliver substantial reductions in the numbers of young and older long-term unemployed people. Employment Zones are also testing a new and innovative approach to helping long-term unemployed people back to work, by allowing jobseekers and their personal advisers to use funds with complete flexibility to overcome individual barriers to work;
- **reforms to make work pay** and to strengthen incentives to move into and progress within employment. Reforms to the tax and benefit system, underpinned by the National Minimum Wage and the Child and Working Tax Credits, improve work incentives for families with children, people with disabilities and those in low-paid work, helping the labour market to respond flexibly to economic shocks, while preserving a degree of stability in workers' incomes; and
- **reforms to improve institutional and structural flexibility** in the labour market to ensure that employment opportunity is extended to all. Over the past five years, the Government has extended assistance under the New Deal to workless benefit claimants, including lone parents, disabled people and partners of the unemployed. Action Teams have been introduced to tackle serious employment problems in some of Britain's most disadvantaged areas, while the national roll-out of Jobcentre Plus is providing work-focused support to all working age benefit recipients, whether unemployed or economically inactive.

Next steps 1.23 Building on measures to raise levels of skills in the workforce, Budget 2003 describes the additional steps the Government is taking to strengthen flexibility and fairness in the labour market to ensure it can adapt to changing circumstances and deliver high and sustainable employment, including:

- **extra help for unemployed people searching for jobs**, with additional interventions in the first six months;
- **greater flexibility for Jobcentre Plus districts** to respond to local conditions, with a new discretionary fund, more flexible options within the New Deal for young people, and greater rewards for successful managers;
- **significant reform of Housing Benefit** to improve financial gains to work, facilitate labour mobility, and deliver greater reliability in the service to claimants;
- **extension of Employment Zones** to lone parents and people returning to the New Deal for a second time, and the introduction of multiple providers;
- **increases in the National Minimum Wage** from October 2003 for adult and youth workers and for those in approved training;
- **improved support for lone parents**, with a flexible fund to improve access to debt advisory services, and pilots of a new worksearch premium to cover the extra costs of looking for work;
- **an enhanced New Deal for partners** from April 2004, bringing support for partners of benefit claimants into line with that available to lone parents; and

- **extra support to help people from ethnic minorities**, with a new £8 million policy fund for Jobcentre Plus managers, and specialist advisers in Jobcentre Plus areas with high ethnic minority populations.

BUILDING A FAIRER SOCIETY

I.24 The Government is determined to ensure that flexibility and fairness work together so that every individual has the chance to fulfil their potential, regardless of their circumstances. Policies for flexibility need not be implemented at the expense of those for fairness, but must be pursued together so that concerns about social justice are recognised and addressed. Chapter 5 describes the steps the Government is taking to eradicate child poverty and tackle pensioner poverty, extending opportunity to all children and ensuring security for all in old age. It also describes the Government's wider strategy for rewarding and encouraging saving, establishing a modern and fair tax system and promoting international efforts to reduce global poverty.

Action so far I.25 The Government has already introduced significant reforms to address its priorities, including:

- **enhanced support for families with children** in recognition of the costs and responsibilities that come with parenthood and to help tackle child poverty. Financial support through the tax and benefit system has been increased, with record rises in Child Benefit, improved maternity and paternity provision and the introduction of the new Child Tax Credit. To tackle the underlying causes of poverty and their effects, the Government has also delivered substantial investment in child-focused public services, including schools, preventative healthcare services and the Children's Fund;
- **improved support for pensioners** to tackle poverty and ensure security for all in retirement. The Minimum Income Guarantee has improved the living standards of more than two million pensioners, while the Pension Credit – delivered by a modern and integrated Pension Service – will reward saving for pensioners on low and modest incomes from October 2003. The basic state pension has risen by more than inflation in each of the last three years, and will rise by at least 2½ per cent in 2004-05. Around 11 million people aged 60 or over also benefit from winter fuel payments, worth £200 per household per year; and
- **steps to encourage saving** including through the introduction of stakeholder pensions and Individual Savings Accounts. The Government has also published a Green Paper setting out proposals to help those of working age plan more effectively for a secure retirement and is consulting on options for radical simplification of pensions tax. Saving Gateway pilots are testing a new approach of Government-funded matched contributions to help people on low incomes develop a regular saving habit.

Next steps I.26 Building on this comprehensive programme of reform, Budget 2003 announces further steps to promote social justice and establish a modern and fair tax system, ensuring that a flexible economy is matched by a fairer society, including:

- **a new Child Trust Fund** providing every child born from September 2002 with an initial endowment at birth of £250, rising to £500 for children in the poorest third of families, a reform which is progressive and universal and will strengthen the saving habit of future generations;

- **an extra £100 for households with a pensioner aged 80 or over in addition to the £200 winter fuel payment**, for the lifetime of this Parliament;
- **extending, to 52 weeks, the period over which all pensioners in hospital receive their full state pension**;
- **a cross-government review of financial support for 16 to 19 year olds**, including the financial incentives to participate in education or training and the case for extending the National Minimum Wage;
- **a new income tax exemption for foster carers**, to facilitate the recruitment and retention of these carers;
- **measures to protect tax revenues**, including a compliance and enforcement package for direct tax, expected to produce an additional £1.6 billion over the next three years;
- **details of the modernised regime for stamp duty**, announced in Budget 2002, to tackle avoidance and distortions while protecting small business and paving the way for e-conveyancing;
- **further steps to ensure a fair system of alcohol and tobacco taxation**;
- **the abolition of bingo duty, to be replaced by a new gross profits tax on bingo companies**; and
- **further work to establish an International Finance Facility** to secure the additional resources needed to tackle global poverty.

DELIVERING HIGH QUALITY PUBLIC SERVICES

I.27 The Government's long-term goal is to deliver world class public services through sustained increases in investment and reforms to deliver efficient and responsive services which meet public expectations throughout the country. Strong and dependable public services lay the foundations for a flexible, high productivity economy, supporting greater efficiency among businesses and adaptability within the workforce. They also promote opportunity and security for all, helping to tackle poverty and social exclusion and improving the quality of life.

Action so far I.28 Chapter 6 describes the Government's approach to strengthening the delivery of public services, including:

- **a new framework for managing public spending** to ensure that resources are used as efficiently and effectively as possible. The Government's reforms to the public spending framework have removed unnecessary controls on departmental finances, strengthening incentives to plan for the long term and giving departments the freedom and flexibility they need to ensure improvements in public service delivery;
- **significant extra resources** for public services, consistent with the fiscal rules. The 2002 Spending Review planned an additional £63 billion of departmental spending by 2005-06 compared with 2002-03 plans, while total investment in public service infrastructure by the public and private sectors is set to rise to more than £47 billion by 2005-06 – the largest sustained increase in public sector investment for more than 20 years. Provision of £3 billion has been set aside to cover the full cost of the UK's military obligations in Iraq, while continuing to meet the fiscal rules; and

- **targeting resources on priority services.** Prudent management of the economy has generated savings in social security and debt interest payments and allowed additional resources to be devoted to improving front line public services. More than 75 per cent of the planned additional resources allocated in the 2002 Spending Review have been directed to the Government's priorities of education, health, transport, housing and the fight against crime.

Next steps I.29 Budget 2002 delivered the largest ever sustained increase in spending on the UK National Health Service (NHS) – 7.2 per cent annual average real terms growth over five years – funded by a one per cent increase in national insurance contributions (NICs) on all earnings above the NICs threshold from this month, and a freeze in the income tax personal allowance for those aged under 65 in 2003-04. Matched with comprehensive plans for reform, these resources reverse past decades of underinvestment in health and will help to secure the future of an NHS that is free at the point of use, and available to all on the basis of clinical need and not ability to pay. Budget 2003:

- **provides £332 million to invest in further counter-terrorism measures** over the next three years, to ensure that UK citizens are protected within the UK from the threat of international terrorism;
- **sets out key issues to be investigated in the run-up to the next Spending Review**, including a new study into the scope for relocating public service staff from London and the South East to other parts of the country, and an update of the long-term challenges in implementing the 'fully engaged' scenario set out in last year's Wanless Review of long-term health trends, with a particular focus on preventative health and health inequalities; and
- **provides details of the next steps in reform**, with action to increase regional and local flexibility in public service pay systems and to increase transparency about performance, including through the introduction from April 2003 of regular reporting on the Treasury website of performance against all new Public Service Agreement targets.

PROTECTING THE ENVIRONMENT

I.30 The aim of sustainable development is to ensure a better quality of life for everyone – today and for generations to come. Economic growth and social progress must go hand-in-hand with action to protect and improve the environment, and policy must balance the need to meet these separate objectives. The Government is using a range of economic instruments to address the challenge of sustainable development, tackling local environmental threats and controlling and reducing emissions of the gases responsible for climate change and poor air quality.

Action so far I.31 Chapter 7 describes the steps the Government has already taken to deliver its environmental objectives:

- **tackling climate change and improving air quality** to ensure that the UK meets its commitments under the Kyoto Protocol. The climate change levy is encouraging business to use energy more efficiently, while the world's first economy-wide emissions trading scheme is helping companies to reduce their emissions at the lowest possible cost. Reforms to the tax system are stimulating investment in the development of environmentally-friendly fuels and technologies and promoting the take-up of cleaner fuels and vehicles;
- **improving waste management** to deliver a more environmentally-sustainable economy. The landfill tax is encouraging efforts to minimise the amount of waste generated and to develop more sustainable waste management techniques, while the landfill tax credit scheme has supported a number of community and environment projects that have improved the quality of the environment at the local level; and
- **protecting Britain's countryside and natural resources** to ensure they are sustainable economically, socially and physically. The aggregates levy and sustainability fund are helping to tackle the environmental costs of quarrying, action has been taken to limit the environmental impact of pesticides use, and increased funding has been allocated to deliver productivity increases in the farming and food industries and to improve environmental performance.

Next steps I.32 Budget 2003 takes further steps to protect and improve the environment and to advance the Government's goals, including:

- **a package of reforms to improve waste management**, including:
 - **an increase in the standard rate of landfill tax** of £3 per tonne in 2005-06 and increases of at least £3 per tonne in future years, on the way to a medium- to long-term rate of £35 per tonne. The landfill tax rises to £14 in 2003-04, to £15 in 2004-05, and to £18 in 2005-06;
 - **further detailed consultation on options to ensure that landfill tax increases are revenue neutral to business as a whole;**
 - **a Waste Management Performance Fund** in England to help local authorities improve waste performance for all households; and
 - **a sustainable waste delivery programme** to reduce waste volumes and to promote recycling and new waste management technologies.
- **a freeze in the rates of the climate change levy;**
- **new enhanced capital allowances** to promote business investment in energy-saving new technologies and to encourage more sustainable water use and improvements in water quality;
- **detailed consultation on specific measures to promote household energy efficiency;**
- **deferred annual revalorisation of the main road fuel duties** until 1 October 2003, owing to the recent high and volatile level of oil prices, as a result of military conflict in Iraq;

- further steps to promote the use and development of cleaner road fuels, including new duty incentives for sulphur-free fuels and bioethanol and an increase in the duty on red diesel and fuel oil;
- a new lower rate of vehicle excise duty for the most environmentally-friendly cars with very low levels of carbon dioxide emissions; and
- a freeze in the rates of the aggregates levy.

Box 1.1: Promoting flexibility

Flexibility is the ability to respond to economic change efficiently and quickly in a way that maintains high employment, low inflation and unemployment, and growth in real incomes. In the modern global economy, flexible labour, product and capital markets are vital to ensure that the economy is responsive and that economic shocks do not have long-lasting effects, so that high and stable levels of output and employment can be maintained.

Were the UK to join EMU, the need for flexibility would be even greater, as the ability to adjust interest and exchange rates would no longer be available at the national level. In such circumstances, labour product and capital markets would need to respond dynamically to shocks, so as to avoid putting at risk high and stable levels of growth and employment.

A sufficient level of wage flexibility is vital to eliminate imbalances between supply and demand; relative price adjustment is a particularly important mechanism to allow changes in competitiveness between countries, and a flexible and integrated capital market can provide the financial instruments that help consumers and firms stabilise their consumption following a shock. These issues are addressed in detail in the preliminary and technical work supporting the five economic tests.

Building on the reforms already introduced, and summarised throughout this chapter, Budget 2003 announces new measures to improve:

- labour market flexibility, through measures to increase wage flexibility in the public sector; improve skills, particularly at the basic and intermediate level; enhance local discretion in the delivery of employment policies; and increase the supply of labour by helping people move from welfare to work and raising managed migration over the economic cycle;
- product market flexibility, with additional steps to enhance competition in specific markets; reform the planning system to make it work more quickly, predictably and efficiently; and ease the impact of regulation on small businesses; and
- capital market flexibility, through new proposals to improve access to finance for small enterprises with high growth potential, and consultation on further reform of the corporation tax system.

The Government supports policies to strengthen competition in the European Union and the Single Market. All European countries have embarked on an ambitious programme to reform labour, product and capital markets. However, more needs to be done across Europe, in particular to enhance employment flexibility, trade and the Single Market in financial services.

BUDGET MEASURES AND THEIR IMPACT ON HOUSEHOLDS

I.33 The measures introduced in this and previous Budgets support the Government's objectives of promoting work and tackling child and pensioner poverty, while laying the foundations for sustained investment in Britain's public services.

I.34 As a result of the freezing of the income tax personal allowance and the one per cent rise in national insurance contributions announced in Budget 2002, in 2003-04:

- a person on median earnings of £21,400 a year will pay an additional £3.66 a week;
- a person on 50 per cent of median earnings of £10,700 a year will pay an additional £1.61 a week; and
- a person on 150 per cent of median earnings – £32,100 a year – will pay an additional £5.72 a week.

I.35 The introduction of the Child and Working Tax Credits from this month will provide greater support for families with children and reward work. As a result of all personal tax and benefit measures taking effect in April 2003:

- a single earner family on median earnings of £21,400 and with two children will be nearly £5.00 a week better off, largely because of the new Child Tax Credit;
- 50 per cent of families with children will be better off, even after the freezing of the income tax personal allowance and the one per cent rise in national insurance contributions announced in Budget 2002; and
- a single person, aged 25 or over, and working 35 hours a week at the National Minimum Wage will be £21.75 a week better off, largely because of the new Working Tax Credit.

I.36 As a result of personal tax and benefit measures introduced since 1997¹:

- families with children are, on average, £1,200 a year better off; and
- families with children in the poorest fifth of the population are, on average, £2,500 a year better off.

I.37 As a result of personal tax and benefit reforms since 1997, by October 2003:^{1,2,3}

- households will be, on average, £775 a year better off;
- pensioner households will be, on average, £1,250 a year better off; and
- the poorest third of pensioner households will be, on average, £1,600 a year better off.

I.38 Table 1.2 lists the key Budget policy decisions and their impact on government spending and revenue. Further details are provided in Chapter A of the FSBR.

¹ Compared with the 1997-98 system of taxes and benefits, indexed to 2003-04 prices.

² The Pension Credit is introduced from October 2003.

³ The National Minimum Wage will be £4.50 for adults from October 2003.

Table I.2: Budget 2003 policy decisions

	(+ve is an Exchequer yield)			£ million
	2003-04 indexed	2004-05 indexed	2005-06 indexed	2003-04 non-indexed
MEETING THE PRODUCTIVITY CHALLENGE				
1 100 per cent first year capital allowances for ICT	-5	-160	+70	-5
2 VAT flat-rate scheme upper limit of £150,000	-15	-15	-15	-15
3 Revalorise VAT registration and deregistration thresholds	0	0	0	-5
4 VAT: simplify the treatment of business gifts	*	-5	-5	-5
5 VAT: electronically supplied services	+20	+25	+30	+20
6 Simplified import VAT accounting	-5	-20	-20	-5
7 Improvements to research and development tax credit	-20	-40	-50	-20
8 Employment benefits: deregulatory measures	-5	-5	-5	-5
9 Reform of North Sea infrastructure taxation	0	-15	-20	0
10 Life companies: change to policyholder rate and apportionment of profits	-25	-40	-40	-25
INCREASING EMPLOYMENT OPPORTUNITY FOR ALL				
11 Income tax: indexation of starting and basic rate limits	0	0	0	-400
12 Housing Benefit disregard	0	-45	-45	0
BUILDING A FAIRER SOCIETY				
Supporting families and pensioners				
13 Child Trust Fund	-350	-230	-235	-350
14 Tax exemption for foster carers	0	-5	-5	0
15 Income tax exemption for reimbursed homeworking costs	-5	-5	-5	-5
16 Extend hospital downrating exemption to 52 weeks	-30	-15	-15	-30
17 Indexation of the pension schemes earnings cap	0	0	0	-5
18 £100 payment to older pensioners	-180	-180	-180	-180
Protecting tax revenues¹				
19 Tackling avoidance and creating a fairer system: equity remuneration	+110	+90	+95	+110
20 Chargeable gains: anti-avoidance involving second-hand life insurance policies	0	+30	+30	0
21 Capital gains tax: countering avoidance schemes through offshore trusts	0	+5	+5	0
22 Loan relationships: closing loopholes	+25	+50	+50	+25
23 Tackling avoidance through sale and repurchase agreements	+30	+50	+50	+30
24 Income tax: avoidance through relevant discounted securities	+20	+20	+20	+20
25 Service companies: closing loopholes used by domestic workers	+15	+15	+15	+15
26 VAT anti-fraud measures	+225	+230	+235	+225
27 VAT on continuous supplies	*	+15	+15	*

Table 1.2: Budget 2003 policy decisions

	(+ve is an Exchequer yield)			£ million
	2003-04 indexed	2004-05 indexed	2005-06 indexed	2003-04 non-indexed
Duties and other tax changes				
28 Treatment of options for the purposes of tax on chargeable gains	0	+20	+40	0
29 Inheritance tax: indexation of threshold	0	0	0	-30
30 Electronic payment for large employers	0	+10	+10	0
31 Introduction of gross profits tax for bingo	-20	-25	-20	-20
32 Amusement machines licensing duty: freeze of rates	-5	-5	-5	0
33 General betting duty: minor amendments	+5	+5	+5	+5
34 Tobacco duties: revalorisation of rates	0	0	0	+170
35 Alcohol duties: revalorise beer and wine, freeze other rates	-35	-35	-30	+145
PROTECTING THE ENVIRONMENT				
36 Landfill tax: £3 increases from 2005-06	0	0	+140	0
37 Climate change levy: freeze rates	-20	-20	-20	0
38 Aggregates levy: freeze rates	-10	-10	-10	+10
39 Enhanced capital allowances for water-efficient technologies	-20	-30	-25	-20
40 Enhanced capital allowances for additional energy-saving technologies	-5	-5	-10	-5
Transport and the environment				
41 Company car tax: emissions level for minimum charge	0	0	+125	0
42 Fuel duties: revalorisation of rates from 1 October	-300	0	0	+300
43 Fuel duties: new duty rate for bioethanol from January 2005	0	-5	-30	0
44 Fuel duties: increase rebated oils by 1p above revalorisation	+95	+95	+100	+95
45 Air passenger duties: freeze of rates	-25	-25	-30	0
46 Changes to Vehicle Excise Duty	+30	+30	+35	-95
47 VAT: revalorisation of car fuel scale charges	0	0	0	+10
OTHER POLICY DECISIONS				
48 Recycled revenues from landfill tax increases	0	0	-140	
TOTAL BUDGET MEASURES	-505	-250	+110	-45
* Negligible				
ADDITIONAL BUDGET POLICY DECISIONS				
Resetting of the AME margin	+805	-980	-1,750	

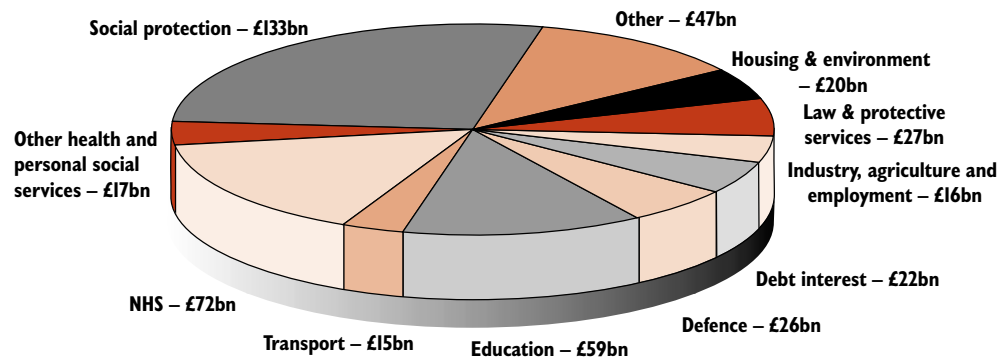
¹ In addition, further details of the package of measures to modernise stamp duty announced in Budget 2002 are set out in Table A2.1. The original yield set out in Budget 2002 (Tables 1.2 and A.1) has been updated, and a reduced yield (by £10 million in 2003-04, and £100 million in 2004-05) included in Budget 2003 fiscal projections.

GOVERNMENT SPENDING AND REVENUE

I.39 Chart 1.1 presents public expenditure by main function. Total public spending (Total Managed Expenditure – TME) is expected to be around £456 billion in the current financial year, 2003-04. TME is divided into Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). DEL spending is set out in Table C12 of the FSBR, though a number of DELs, particularly those of the devolved administrations, contribute to spending on more than one of the functions in Chart 1.1. AME components are shown in Table C11 of the FSBR and some of these, especially spending financed locally by local authorities, also cover spending on several different functions.

Chart 1.1: Government spending by function

Total managed expenditure: £456 billion

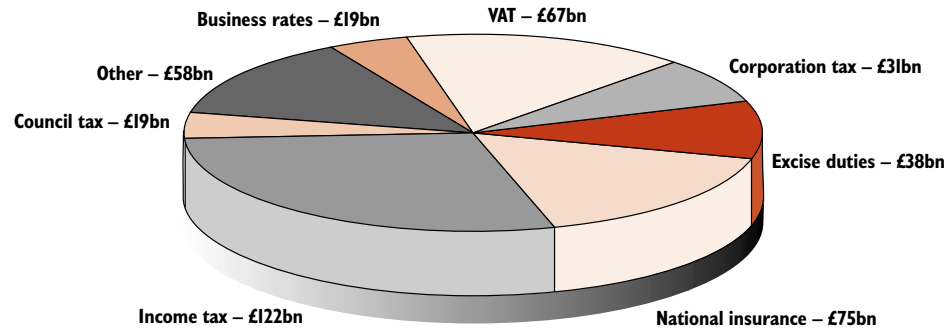


Source: HM Treasury, 2003-04 near-cash projections. Other expenditure includes spending on central administration; culture, media and sport; international cooperation and development; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted in AME, in line with OECD guidelines. Figures may not sum to total due to rounding.

I.39 Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £428 billion in 2003-04. Table C8 of the FSBR provides a more detailed breakdown of receipts consistent with this chart.

Chart I.2: Government receipts

Total receipts: £428 billion



Source: HM Treasury, 2003-04 projections. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts – for example, interest and dividends. Figures may not sum to total due to rounding.