

Budget 2004

Prudence for a purpose: A Britain of stability and strength

Economic and Fiscal Strategy Report and Financial Statement and Budget Report

March 2004

Return to an Order of the House of Commons dated 17 March 2004

*Copy of Economic and Fiscal Strategy Report and Financial Statement and Budget Report – March 2004
as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget.*

Ruth Kelly
Her Majesty's Treasury
17 March 2004

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The Economic and Fiscal Strategy Report and the Financial Statement and Budget Report contain the Government's assessment of the medium-term economic and budgetary position. They set out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval for the purposes of Section 5 of the European Communities (Amendment) Act 1993, these reports will form the basis of submissions to the European Commission under Article 99 (ex Article 103) and Article 104 (ex Article 104c) of the Treaty establishing the European Community.

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OVERVIEW

The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. With the global economy strengthening, Budget 2004 describes the steps the Government is taking to ensure long-term stability, growth and prosperity.

Budget 2004, *Prudence for a purpose: A Britain of stability and strength*, presents updated assessments and forecasts of the economy and public finances, reports on how the Government's policies are helping to deliver its long-term goals and describes the further steps the Government is now taking. The Budget:

- shows that the economy continues to grow steadily and that the Government is on track to meet its strict fiscal rules for the public finances;
- sets out plans for public service efficiency savings of up to 2.5 per cent a year by 2007-08, and the envelope for the 2004 Spending Review;
- announces that education spending in England will grow by an annual average of 4.4 per cent in real terms across the 2004 Spending Review period, and by 2007-08 education spending will be £7.4 billion higher in England than in 2005-06 and £8.5 billion higher for the UK on top of the uplift for 2005-06 already in spending plans. By 2007-08, education spending in the UK will be 5.6 per cent of GDP, up from 5.4 per cent in 2004-05;
- introduces plans to boost long-term productivity and growth, through a New Deal for skills, and a ten-year framework for investing in the UK's science and innovation base;
- announces a £100 payment to pensioner households with someone aged 70 or over, to help with their council tax bills;
- takes further steps to extend employment opportunity for all, through measures which focus help and support on those who face particular barriers to work;
- promotes fairness in the tax system by ensuring that everyone contributes to the extra investment in public services; and
- introduces a range of measures to improve the environment, including proposals to tackle climate change, improve air quality and reduce waste.

INTRODUCTION

I.1 The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all.

I.2 The long-term decisions the Government has taken – giving independence to the Bank of England, new fiscal rules, and a reduction in debt – have created a strong platform of economic stability. The UK economy grew continuously throughout the global downturn that began in 2001, while many of the world's major economies experienced recession. The UK is now experiencing the longest period of sustained low inflation for over thirty years and unemployment is the lowest of the G7 major industrialised economies.

I.3 Economic stability provides the platform for building prosperity, achieving social justice with security and opportunity for all, and maintaining investment in public services. With the world economy now strengthening, the challenge is to lock in the UK's stability and strength, and equip the UK to continue to succeed over the long term in a more competitive global economy.

I.4 In an increasingly knowledge-driven global economy, success lies in a flexible economy with a strong science and innovation base, and a highly skilled and educated workforce. The Budget sets out a programme of long-term investment in schools, colleges and universities, to give every young person the chance to make the most of their talents. It also sets out plans for new investments in science and innovation, and in a highly skilled workforce through apprenticeships and a New Deal for skills.

I.5 The Government is determined that continued progress towards a flexible and highly productive economy is matched with reforms which promote fairness. This Budget continues the action the Government is taking to create a fairer, more inclusive society with opportunity and security for all.

I.6 The Budget describes the next steps the Government is taking to advance its long-term goals of:

- maintaining macroeconomic stability, ensuring the fiscal rules are met and that inflation remains low;
- raising the sustainable rate of productivity growth, through reforms that promote enterprise across the whole economy, enhance flexibility and promote, science, innovation and skills;
- providing employment opportunity for all, by promoting a flexible labour market which sustains a higher proportion of people in employment than ever before;
- combining flexibility with fairness, by tackling child and pensioner poverty, providing opportunity for all children, effective choices for parents and delivering security for all in retirement;
- establishing world-class public services, with extra investment tied to reform and results, including plans for long-term investment in education; and
- addressing the challenges of climate change, poor air quality and environmental degradation in urban and rural areas.

MAINTAINING MACROECONOMIC STABILITY

I.7 The Government's long-term economic goal is to maintain macroeconomic stability, ensuring 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 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

I.8 The Government's macroeconomic framework is based on the principles of transparency, responsibility and accountability, and is designed to ensure lasting stability so that businesses, individuals and the Government can plan effectively for the long term. The Bank of England has operational independence to meet the Government's symmetrical inflation target. In the 2003 Pre-Budget Report, the Chancellor announced that the operational target for monetary policy would switch with immediate effect to a target based on the Consumer Prices Index (CPI). Budget 2004 reaffirms the target of 2 per cent for the 12-month increase in the CPI. Fiscal policy is underpinned by clear objectives and two strict rules which ensure sound public finances over the medium term. The fiscal rules underpin the Government's public spending framework which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

Economic prospects **I.9** The domestic stability delivered by the Government's macroeconomic framework has enabled the UK economy to cope well with the significant challenges in the world economy over recent years. The UK economy grew continuously throughout the global downturn that began in 2001, while many of the world's major economies experienced recession.

I.10 As geo-political and other international uncertainties have receded, global demand has strengthened and most major international financial markets have seen valuations rise back to around the levels of spring or summer 2002. In the UK, business and consumer confidence has risen further since the time of the 2003 Pre-Budget Report, and improved sentiment has underpinned a significant pick-up in domestic demand growth since early 2003. Moreover, tentative signs have also emerged of improved international prospects feeding through to higher external demand. Following growth of 0.8 per cent in the third quarter, UK GDP rose by 0.9 per cent in the final quarter of 2003, above trend rates and the fastest rate of quarter-on-quarter growth for over three and a half years.

I.11 As in the 2003 Pre-Budget Report, the recent pick-up in activity seen over the latter half of 2003 is expected to be consolidated through 2004 and into 2005. The Budget 2004 forecast is that:

- UK **GDP** is expected to grow by 3 to 3½ per cent in both 2004 and 2005, unchanged from both the Budget 2003 and the 2003 Pre-Budget Report forecasts. By 2006, with slack in the economy absorbed, and the output gap closed, growth is expected to return to its trend rate of 2½ to 3 per cent; and
- CPI **inflation** is expected to rise through the course of this year to reach its 2 per cent target by mid-2005, as the lagged effects of sterling's depreciation against the euro since 2002, combined with the effects of the strengthening recovery in the world economy, feed through to higher import prices. The credibility of the Government's monetary policy framework is also expected to contribute to returning inflation to target through anchoring inflation expectations.

The public finances **I.12** Budget 2004 presents the Government's annual fiscal forecast. The 2003 Pre-Budget Report interim projections showed weaker receipts as a result of lower than expected growth in certain GDP components and higher than expected spending, including that arising from the UK's international commitments. The Budget 2004 public finance projections show little change compared with the Pre-Budget Report, as receipts and spending have turned out largely as expected.

I.13 The estimated 2003-04 outturn for the public sector current budget shows a deficit of £21.3 billion compared with projected deficits of £19.3 billion and £8.4 billion in the 2003 Pre-Budget Report and Budget 2003 respectively. For public sector net borrowing, the estimated 2003-04 outturn is £37.5 billion, compared with £37.4 billion projected in the 2003 Pre-Budget Report and £27.3 billion projected in Budget 2003.

Budget policy decisions **I.14** Against this backdrop, and building on steps already taken, Budget 2004 announces further decisions to lock in stability and invest in Britain's future, including:

- a package of measures to encourage enterprise, and boost science and skills;
- further steps to boost employment opportunity for all, including extending the support offered to lone parents and sick and disabled people who want to return to work;

- action to protect tax revenues for the benefit of all taxpayers, tackling tax fraud and avoidance;

I.15 Budget 2004 sets firm overall spending limits for the 2004 Spending Review period, allowing:

- current spending to increase by an average of 2.5 per cent in real terms in 2006-07 and 2007-08, in line with the cautious assumption for trend economic growth and consistent with the nominal growth rates set out in Budget 2003 and the 2003 Pre-Budget Report. Final plans for Departmental Expenditure Limits and Annually Managed Expenditure will be set in the Spending Review; and
- public sector net investment to rise from 2 per cent of GDP to 2¹/₄ per cent of GDP by 2007-08 to continue to address historic under-investment in Britain's infrastructure while remaining consistent with the sustainable investment rule.

I.16 The growth rate of both overall spending and departmental spending will be lower in the 2004 Spending Review than in the 2002 Spending Review. However, building on the progress made in correcting historic under-investment, and with administration costs frozen in nominal terms and planned efficiency gains, the Government expects to match the pace of growth in front line public services achieved in the last Spending Review.

The fiscal rules I.17 Table 1.2 lists the key Budget policy decisions and their impact on the public finances. Further details are set out in Chapter A of the FSR.

I.18 The Government remains on track to meet its strict fiscal rules over the economic cycle. As shown in Table 1.1, the current budget since the start of the current economic cycle in 1999-2000 shows an average annual surplus up to 2005-06 of 0.1 per cent of GDP and the Government is therefore on track to meet the golden rule on the basis of cautious assumptions. There is a margin against the golden rule of £11 billion in this cycle, including the AME margin. With the economy assumed to be on trend from 2005-06 onwards, the projections show, based on cautious assumptions, that the average surplus over the period 2005-06 to 2008-09 is 0.1 per cent of GDP. At this early stage, the Government is therefore on track to continue to meet the golden rule after the end of this economic cycle. Public sector net debt is projected to remain low and stable over the next five years, stabilising at just under 36¹/₂ per cent of GDP – £53 billion below the 40 per cent ceiling set in the sustainable investment rule.

Table 1.1: Meeting the fiscal rules

	Per cent of GDP						
	Outturn 2002-03	Estimate 2003-04	2004-05	2005-06	Projections 2006-07 2007-08 2008-09		
Golden rule							
Surplus on current budget	-1.2	-1.9	-0.9	-0.4	0.0	0.3	0.7
Average surplus since 1999-2000	1.0	0.4	0.2	0.1	0.1	0.1	0.2
Cyclically-adjusted surplus on current budget	-0.6	-1.0	-0.2	-0.2	0.0	0.3	0.7
Sustainable investment rule							
Public sector net debt	30.8	33.2	34.4	35.3	35.9	36.3	36.4

I.19 Budget 2004 decisions are consistent with the long-term sustainability of public finances. Consistent with the requirements of the *Code for fiscal stability*, an analysis of long-term fiscal sustainability is presented in Annex A of the *Economic and Fiscal Strategy Report*. This shows that given the projected profile for tax revenue and transfers, current consumption can grow at around assumed GDP growth after the medium term while meeting the golden rule. Public sector investment can also grow broadly in line with the economy without jeopardising the sustainable investment rule. The UK is also in a strong position to face future challenges relative to many other developed countries.

MEETING THE PRODUCTIVITY CHALLENGE

I.20 Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance and rising living standards. As a result of macroeconomic instability and market failures, the UK has historically experienced low rates of productivity growth compared to other major economies. In recent years, UK performance has improved in relation to its main competitors. Recent data indicate that, on an output per worker basis, the UK now has higher productivity than Germany and is closing the gap with France. The Government's long-term goal is for the UK to continue to close the productivity gap by achieving a faster rate of growth than its main competitors. To do this it aims to promote productivity across all regions and countries of the UK. In the increasingly knowledge-driven global economy, a strong science and innovation sector is an important driver of productivity growth, backed up by a highly-skilled workforce and a competitive and enterprising economy.

Action so far I.21 Chapter 3 sets out the reforms the Government is taking to promote productivity, focusing on five key drivers of productivity performance:

- improving **competition** which promotes flexible markets and increases business efficiency and consumer choice. The Government has worked to ensure the UK competition regime ranks among the best in the world;
- promoting **enterprise** through measures aimed at increasing flexibility by removing barriers to entrepreneurship and developing an enterprise culture. Reforms to the business tax regime and measures designed to increase access to finance have helped small and growing businesses;
- supporting **science and innovation** through increases in funding for science and for promoting stronger collaboration between business and universities. Improvements to R&D tax credits have enabled more businesses to claim a wider range of relief;
- raising UK **skills** levels to create a more flexible and productive workforce. Increased resources have been made available to improve standards in schools and the further education sector. The Government has launched Employer Training Pilots and packages of training support for small businesses; and
- encouraging **investment** to increase the stock of physical capital supported by stronger, more efficient capital markets. The Government has taken steps to increase flexibility in the housing market and to improve the planning regime. It has also taken action to promote greater flexibility in capital markets.

Next steps I.22 Budget 2004 introduces further measures to promote productivity growth, including:

- the publication of a **consultation document to inform the preparation of a ten-year investment framework for science and innovation**, as part of the 2004 Spending Review, committing to grow public investment in the science base faster than the trend rate of GDP growth over the next Spending Review period;
- a **commitment to increase NHS funding for R&D by £100 million by 2008**, to underpin the creation of a new UK Clinical Research Collaboration for the effective and efficient translation of scientific advances into patient care;
- a **New Deal for skills** to ensure that individuals are helped to develop the skills they need for employment and employers can develop the skilled workforce needed for the success of their business, and extending Employer Training Pilots to six new areas;
- **reforms to reduce the regulatory burden on businesses**, including consulting on the implementation of phasing out payment via employers for Working Tax Credit, strengthened Government scrutiny of regulatory proposals, and changing the structure of the UK's tax administration;
- **devolving delivery of regional and local Business Link services** from the Department of Trade and Industry to the Regional Development Agencies;
- **full details of the Local Authority Business Growth Incentives scheme**, which will boost the role of local authorities in promoting enterprise and economic growth;
- the Barker Review of housing supply, published today, concludes that house building must rise substantially to reduce house price inflation and increase the number of affordable homes. The Government agrees with the need for a significant increase in housing development over time. It intends to **implement a programme of reform to planning and delivery of development as recommended in the Review and consider a package of measures to increase housing supply**, including social housing investment, alongside a Planning-gain Supplement by the end of 2005;
- a **new entitlement for graduates of the world's top 50 business schools to come to the UK** to seek employment; and
- seeking views on how **property investment funds** (a UK version of the successful US Real Estate Investment Trusts) should be structured, to encourage more efficient investment in commercial and residential property.

INCREASING EMPLOYMENT OPPORTUNITY FOR ALL

I.23 The Government's long-term goal is employment opportunity for all – the modern definition of full employment. It aims to ensure a higher proportion of people in work than ever before by 2010. To achieve this, each individual who wants and is able to work should be provided with the support to enable them to find work and develop skills. The Government recognises that each person will face different barriers to work. Delivering full employment requires a personalised approach, with services tailored to the needs of the individual and local circumstances.

Action so far I.24 The Government's strategy for extending employment opportunity for all builds on the strong performance of the UK labour market over recent years. UK unemployment has fallen to 5.0 per cent, the lowest of the G7 economies, while the working age employment rate has reached 74.8 per cent. Chapter 4 describes the successful action the Government has already taken through:

- **extending employment opportunity** and equipping people to take advantage of employment opportunities. Labour market policies such as the New Deals provide effective support to help people into work. Further measures aim to promote diverse forms of employment, facilitate labour market mobility and raise skills;
- **making work pay**, through the National Minimum Wage and tax credits which create a system of support that provides greater rewards from work, improving incentives for individuals to participate in the labour market; and
- **ensuring responsive and flexible delivery**, so that providers are able to tailor policies to suit the specific needs of the community they serve.

Next steps I.25 Budget 2004 describes the further steps the Government is taking to strengthen the labour market, and to extend support to those who face particular barriers to work, including through:

- **the piloting of a mandatory work-focused interview regime for some existing claimants of incapacity-related benefits** in the Pathways to Work pilot areas;
- **the piloting of a job preparation premium of £20 per week** in the Pathways to Work pilot areas, for existing claimants of incapacity-related benefits who undertake relevant activity that supports a return to work;
- **the introduction of a worksearch premium of £20 per week**, available to those in a family in receipt of the Working Tax Credit who are not working, in six pilot areas with high levels of worklessness;
- **the introduction of a second set of Local Housing Allowance Pathfinders in the private rented sector from April 2005;**
- **a package of measures to simplify the rules around Housing Benefit;**
- **from October 2004, an increase in the adult and youth rates of the National Minimum Wage** to £4.85 and £4.10 respectively, and the **introduction of a National Minimum Wage for 16 and 17 year old workers** of £3.00 an hour; together with the Learning and Skills Council and employers, the Government will work to achieve minimum pay levels for apprentices in England of £70 to £80 per week;
- **an extension of measures for lone parents** in six cities with large lone parent populations, including access to NVQ level 3 training; and
- **'Fair Cities' initiatives**, to be established in three areas later this year, to improve employment outcomes for people from disadvantaged ethnic minority groups.

BUILDING A FAIRER SOCIETY

I.26 The Government is committed to combining flexibility with fairness, by tackling child and pensioner poverty, providing opportunity for all children, effective choices for parents and delivering security for all in retirement. The tax and benefit system puts into practice the Government's principles of progressive universalism, with support for all, and more help for those who need it most, when they need it most. The Government is also committed to a modern and fair tax system, in which everyone pays their fair share. It is also at the forefront of global efforts to achieve the Millennium Development Goals for global poverty.

Action so far I.27 Chapter 5 describes the range of reforms the Government has undertaken to achieve its goals in these areas, including:

- **support for families and children** to lift children out of poverty and so ensure they have the opportunity to make the choices they need to fulfil their potential. The Government has increased financial support through the tax and benefit system, with significant rises in Child Benefit and the introduction of the Child Tax Credit (CTC). The 2003 Pre-Budget Report announced a significant rise in the CTC, which will enable the Government to meet or exceed its target of reducing by a quarter the number of children in low-income households by 2004-05 on a before housing costs basis;
- **support for pensioners** to tackle poverty and ensure security in retirement for all pensioners, with extra help for those who need it most. The Government has increased financial support for pensioners through the basic state pension and has introduced the Pension Credit which rewards saving by pensioners on low and modest incomes; and
- **steps to encourage saving**, including through the introduction of the Child Trust Fund, stakeholder pensions and Individual Savings Accounts. The Child Trust Fund will provide an endowment for every child, with more for children in the poorest third of families, and will strengthen the saving habit of future generations.

Next steps I.28 This Budget sets out the next steps the Government is taking to support these aims, including:

- **reforming financial support for 16 to 19 year olds**, to increase the proportion of young people who reach the age of 19 equipped with the skills they need to succeed in a modern global economy;
- **additional funding for Sure Start, early years and childcare of £669 million in 2007-08** compared with 2004-05, an average annual real growth rate of 17.3 per cent;
- **a Children's Centre in all of the 20 per cent most disadvantaged wards in England by 2008**, moving towards the goal of a Children's Centre for every community;
- **a £100 payment to pensioner households with someone aged 70 or over to help with their council tax bills**;
- **simplifying the taxation of pensions**, replacing the complexity of eight existing regimes with a single, simplified regime with a lifetime allowance for tax-privileged pension saving;

- **promoting financial inclusion**, focusing on helping households access affordable banking and credit;
- **taking action to protect tax revenues and modernise the tax system**, including measures to combat tax fraud and avoidance; and
- **implementing the O'Donnell review recommendations to establish a new customer-focused tax service**, integrating the Inland Revenue and HM Customs and Excise.

DELIVERING HIGH QUALITY PUBLIC SERVICES

I.29 The Government's goal is to establish world class public services, with extra investment tied to reform and results. This is central to achieving a stronger, more flexible economy and a fairer society. A healthy and educated workforce, modern and reliable transport network, and adequate supply of affordable housing promote productivity and flexibility and help to ensure opportunity and security for all. The Government's strategy is to deliver improvements in public services through sustained investment and reform to ensure that taxpayers receive value for money.

Action so far I.30 Chapter 6 sets out the steps the Government has taken to deliver lasting improvements in the delivery of public services, including:

- **a new framework for managing public spending** that strengthens incentives for departments to plan for the long term, ensures that resources are used as effectively and efficiently as possible and gives departments the flexibility they need to ensure improvements in public service delivery; and
- **significant extra resources for public services**, consistent with the fiscal rules. The 2002 Spending Review delivered substantial extra investment in key public service priorities, with more than 75 per cent of planned additional spending allocated to the key priorities of health, education, criminal justice, housing and transport.

Next steps I.31 The 2004 Spending Review will set spending plans for 2006-07 and 2007-08 and will confirm the plans set for 2005-06 in the 2002 Spending Review. In doing so it will consolidate and build on the step change in funding for key public services achieved in previous spending reviews. In Budget 2004, the Government announces:

- **education spending in England will grow by an annual average of 4.4 per cent in real terms across the 2004 Spending Review period**, and by 2007-08 education spending will be £7.4 billion higher in England than in 2005-06 and £8.5 billion higher for the UK on top of the uplift for 2005-06 already in spending plans. By 2007-08, education spending in the UK will be 5.6 per cent of GDP, up from 5.4 per cent in 2004-05;
- **reforms including resources for Children's Centres in all of the 20 per cent most disadvantaged wards, and a transformation of all secondary schools to twenty-first century standards in the next 10 to 15 years**; and
- that the growth rate of both overall public spending and departmental spending will be lower in the 2004 Spending Review than in the 2002 Spending Review. However, building on the progress made in correcting historic under-investment and with administration costs cut in real terms and planned efficiency gains equivalent to £20 billion a year by 2007-08, the Government's objective is to match the pace of growth in front line public services achieved in the last Spending Review.

PROTECTING THE ENVIRONMENT

I.32 Sustainable development is vital to ensure a better quality of life for everyone, today and for generations to come. Economic growth is key to rising national prosperity. However, growth must not come at the expense of the environment or social progress. The Government's goal is to deliver sustainable growth and a better environment, by addressing the challenges of climate change, poor air quality and environmental degradation in urban and rural areas.

Action so far I.33 Chapter 7 describes the steps the Government has taken to deliver its environmental objectives, including:

- **tackling climate change and improving air quality**, ensuring that the UK meets its international commitments under the Kyoto Protocol. The Government's aim is to put the UK on the path to a 60 per cent reduction in greenhouse gas emissions from current levels by 2050;
- **promoting a clean and efficient transport system**, including support for the take-up of the most efficient fuels and vehicles, and promotion of the development of greener forms of transport and fuels;
- **improving waste management**, so that resources are re-used or recycled to deliver economic value. The landfill tax and targeted strategic waste management programmes are central to these aims; and
- **protecting the UK's countryside and natural resources**, to ensure they are sustainable economically, socially and physically. The aggregates levy is helping to tackle the environmental costs of quarrying, and action has been taken to limit the environmentally damaging impact of agriculture.

Next steps I.34 Budget 2004 describes the next steps in the Government's environmental strategy, including:

- **new eligibility criteria for climate change agreements**, which will increase the number of businesses which can participate in the scheme, and **a freeze in the rates of the climate change levy**;
- **a package of measures to promote household energy efficiency** including a reduced rate of VAT for ground source heat pumps, and possibly for micro-combined heat and power units from 2005, and incentives for the private rented sector to invest in energy efficiency;
- **duty rates for sulphur-free fuels raised in line with inflation from 1 September 2004, the duty for ultra-low sulphur fuels set at 0.5 pence per litre above this level from the same date, an increase in rebated fuels rates, and three-year certainty for duty rates on biofuels and road fuel gases**;
- **reforms to the tax treatment of company vans and emergency vehicles**, taking 85 per cent of drivers of company vans out of the system altogether;
- **publication of the third progress report on the lorry road-user charging scheme**, which now moves the scheme into the procurement phase, and sets out decisions on key aspects of the scheme's design; and
- **reform of the aggregates levy relief scheme in Northern Ireland.**

BUDGET MEASURES AND THEIR IMPACT ON HOUSEHOLDS

I.35 The measures introduced in this and previous Budgets support the Government's objectives of promoting enterprise, skills and science, creating employment opportunity, and tackling child and pensioner poverty. Table 1.2 lists the key Budget policy decisions and their impact on the public finances. Further details are provided in Chapter A of the FSBR.

I.36 The increase in CTC announced in the 2003 Pre-Budget Report builds on the success of Working and Child Tax Credits, which were introduced in April 2003. As a result of the personal tax and benefit measures that come into effect in 2004-05, by October 2004, in real terms:¹

- families with children will be, on average, £175 a year better off, while those in the poorest fifth of the population will be, on average, £425 a year better off;
- a single earner couple with two children, with earnings up to the median for full time workers – £22,000 per year – will be at least £4.20 a week better off; and
- a lone parent with two children, working 16 hours per week at the National Minimum Wage, will be at least £16.00 per week better off.

I.37 As a result of all personal tax and benefit measures introduced since 1997, by October 2004, in real terms:^{2,3}

- households will be, on average, £850 a year better off;
- families with children will be, on average, £1,350 a year better off; and
- families with children in the poorest third of the population will be, on average, £3,000 a year better off.

I.38 As a result of all personal tax and benefit reforms introduced to help pensioners, including the Pension Credit, in 2004-05:²

- pensioner households will be, on average, £1,350 a year better off; and
- the poorest third of pensioner households will be, on average, £1,750 a year better off.²

¹ Compared to the 2003-04 system of taxes and benefits, indexed to 2004-05 prices.

² Compared to the 1997-98 system of taxes and benefits, indexed to 2004-05 prices.

³ The National Minimum Wage will be £4.85 for adults from October 2004.

Table 1.2: Budget 2004 policy decisions

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
MEETING THE PRODUCTIVITY CHALLENGE				
1 Venture capital schemes: improvements	0	-55	-60	0
2 VAT: revalorise registration and deregistration thresholds	0	0	0	-10
3 Business Premises Renovation Allowance	0	-10	-35	0
4 Capital Allowances: one year increase for small enterprises	*	-55	+15	*
5 Local Authority Business Growth Incentives	0	-150	-300	0
INCREASING EMPLOYMENT OPPORTUNITY FOR ALL				
6 Housing Benefit: align rules with tax credits	-5	-35	-35	-5
7 Housing Benefit and Council Tax Benefit: backdating for up to 12 months	-10	-15	-10	-10
8 Housing Benefit: private sector second round Pathfinders	0	-15	-15	-15
BUILDING A FAIRER SOCIETY				
Supporting families and pensioners				
9 Income tax: index starting and basic rate limits	0	0	0	-610
10 Pensions tax simplification	0	0	-25	0
11 £100 payment to over 70s	-475	0	0	-475
12 Pension Credit backdating for up to 12 months	-5	-15	-15	-5
13 Pension schemes earnings cap: indexation	0	0	0	-5
14 Modernising Trusts	0	0	-5	0
15 Payroll Giving: grant scheme for SMEs	-5	-5	0	-5
Protecting tax revenues				
16 Finance leasing: closing loopholes	+75	+110	+110	+75
17 Life companies	+5	+10	+10	+5
18 Red diesel: supporting the UK oils fraud strategy	+80	+180	+190	+90
19 VAT: transfers of going concern	+155	+140	+125	+155
20 VAT: demonstrator cars	*	+5	+5	*
21 Distributed profits: minimum rate ¹	+10	+340	+490	+10
22 Customs: allocation for alcohol strategy	0	-15	-10	0
Duties and other tax changes				
23 Inheritance tax: index threshold	0	0	0	-55
24 Tobacco duties: revalorise rates	0	0	0	-15
25 Alcohol duties: freeze spirits duty until end of this Parliament	-35	-70	-70	0
26 Alcohol duties: revalorise beer and wine duties and freeze other rates	-5	-5	-5	+155
27 Small breweries' relief: extension	-5	-5	-5	-5

Table 1.2: Budget 2004 policy decisions

	(+ve is an Exchequer yield)			£ million
	2004-05 indexed	2005-06 indexed	2006-07 indexed	2004-05 non-indexed
PROTECTING THE ENVIRONMENT				
Environment				
28 Enhanced capital allowances for additional energy saving technologies	*	-5	-10	*
29 Landlords' energy saving allowance	*	-10	-10	*
30 Changes to Climate Change Agreement eligibility criteria	-5	-25	-25	-5
31 Climate change levy: freeze	-25	-25	-25	0
32 Aggregates levy: freeze	-10	-10	-10	0
33 Aggregates levy: extension of Northern Ireland credit scheme	-15	-20	-25	-15
34 Recycling of landfill tax revenues	0	0	-245	0
Transport				
35 Fuel duties: revalorise rates from 1 September 2004 and introduce differential between sulphur free and other main road fuels	-300	0	0	+345
36 Fuel duties: increase road fuel gases by 1p over next three years	+5	+10	+10	+5
37 Fuel duties: differentials for bioethanol and biodiesel at 20p until 2007	*	+5	+10	*
38 Company vans: reform	*	-30	-30	*
39 Air passenger duties: freeze rates	-25	-30	-30	0
40 VED: freeze rates	-130	-130	-135	0
TOTAL BUDGET MEASURES	-725	+65	-170	-395
* negligible				

MEMO ITEMSEnforcement and compliance²Direct taxes compliance package³

+155 +465 +925

Resetting of the AME margin

-1,000 -2,000

¹ Alongside the revenue raised by this measure, tax revenue has been reduced as a result of an increase in the number of self-employed individuals incorporating their business to reduce tax (see Chapter 5). Estimates of the impact of the measure, and of the estimated reduction in tax payments by small businesses incorporated for tax reasons since the last Budget are set out below:

	2003-04	2004-05	2005-06	2006-07
	-250	-420	-50	+80

² Forecast impact if operational measures to enhance compliance, or to enhance the powers available to the Revenue Departments.

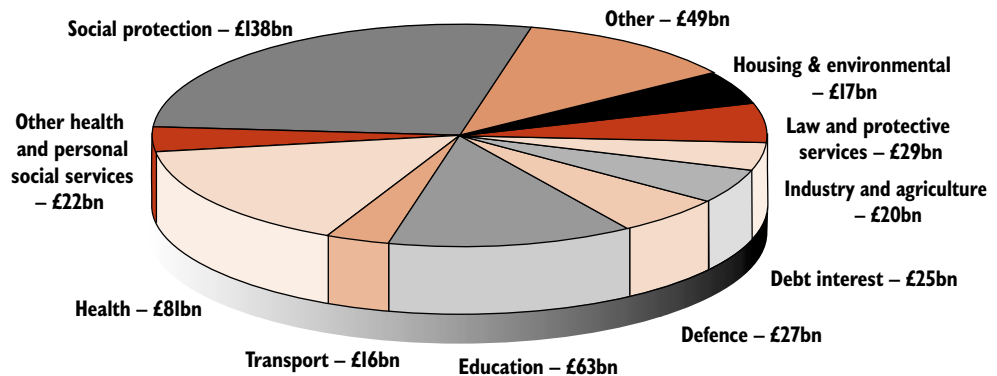
³ Net of additional resources allocated to the Inland Revenue.

GOVERNMENT SPENDING AND REVENUE

I.39 Chart 1.1 presents public spending by main function. Total Managed Expenditure (TME) is expected to be around £488 billion in 2004-05. TME is divided into Departmental Expenditure Limits (DEL), shown in Table C14 of the FSBR, and Annually Managed Expenditure (AME), shown in Table C12 of the FSBR.

Chart 1.1: Government spending by function

Total managed expenditure: £488 billion

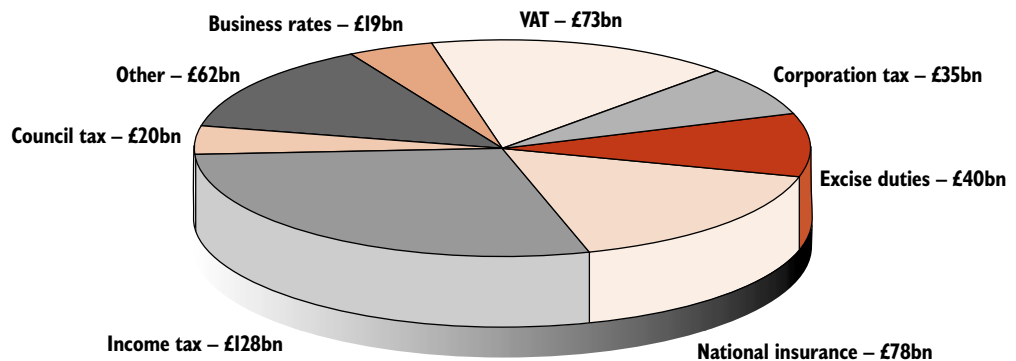


Source: HM Treasury, 2004-05 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services; recreation, culture and religion; international cooperation 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.40 Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £455 billion in 2003-04. Table C8 of the FSBR provides a more detailed breakdown of receipts consistent with this chart.

Chart 1.2: Government receipts

Total receipts: £455 billion



Source: HM Treasury, 2004-05 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.