

Productivity growth underpins strong economic performance and sustained increases in living standards. The Government's long-term goal is for the UK to achieve a faster rate of productivity growth than its major competitors. Budget 2005 sets out the next steps that the Government is taking to strengthen the drivers of productivity growth, including:

- **a package of radical reforms to tackle the burden of regulation on business**, while maintaining standards of protection for the public, consumers and employees, through:
  - building on the success of the Panel for Regulatory Accountability (PRA) by ensuring that regulation is only used where necessary, that it is not 'goldplated' if it originates from EU law, and that all Whitehall departments strengthen their focus on removing outdated and unnecessary regulations as recommended by the Better Regulation Task Force (BRTF) report;
  - adopting a risk-based approach to inspection and enforcement, streamlining regulatory structures and increasing accountability in order to reduce the costs to business of administering regulation, as recommended by the Hampton Review, and setting new targets to reduce the administrative burden over time;
  - applying the principles of better regulation in Europe through the six presidencies initiative;
- consistent with the Hampton principles, a strategy to meet stretching new targets **to reduce the administrative burden of the tax system for small businesses**, including in the short-term cutting the tax return for 500,000 of the smallest businesses and rolling out new options for paying and managing VAT online;
- **taking forward the ten-year Science and Innovation Investment Framework**, including a UK Stem Cell Initiative, chaired by Sir John Pattison, to formulate a ten-year vision for stem cell research, creating a platform for co-ordinated public and private research funding; a mandatory requirement that at least 2.5 per cent of public sector extra-mural R&D spending will be with Small and Medium Enterprises (SMEs) and engaging with business to ensure that the R&D tax credit better supports UK businesses with high potential to become major innovative firms of the future;
- **to support the Government's major new investment in education and skills**, plans to enhance workforce skills including continued support of £65 million for the Employer Training Pilots and funding to support a new Union Academy;
- **further support for enterprise**, through a new Local Enterprise Growth Initiative worth £150 million per year by 2008-9, to boost enterprise in the most deprived areas of England, following the end of the time-limited commercial stamp duty land tax disadvantaged areas relief in this Budget; and Regional Development Agencies' (RDAs) plans for the development of business coaching focused on businesses with high growth prospects;
- **a package of measures to increase the contribution of creativity to productivity growth**, including a review: led by George Cox, on how best to use the UK's world class creative industries and universities to support and develop the creativity of SMEs; and action by the RDAs to support the integration of design into corporate strategy, product and market development, including through the Design Council's Design Immersion Programme; and £12 million to the Arts Council England to promote better management and leadership within the cultural sector; and
- as a further step in reforming the investment chain, **taking forward the Morris Review recommendations** to promote greater competition in actuarial services and in advice to pension funds on investment issues, including asset allocation and fund manager selection, and to strengthen the regulation of the actuarial profession.

**3.104** The Government is committed to enhancing the economic environment within which businesses make their investment decisions. Central to this is providing a platform of macroeconomic stability to enable firms and households to plan for the long term. The Government is also implementing microeconomic reforms to remove the barriers that prevent capital markets from functioning efficiently and flexibly, so removing barriers to innovation and investment. A report on progress to promote product and capital market flexibility is provided in Box 3.11. The Government recognises that foreign direct investment brings a range of economic benefits. It is refocusing the resources of UK Trade and Investment towards strengthening inward investment services and promoting FDI, building on the UK's excellent record in attracting FDI. As described in Chapter 6, the Government has also taken action to address historic under-investment in the public sector, which plays a key role in driving productivity.

**Investment in transport** **3.105** There is a clear consensus on the importance of appropriate investment in transport for productivity and economic growth. The Government's White Paper *The Future of Transport: a Network for 2030*, published in 2004, set out a strategy for long-term increased investment by both public and private sectors, combined with smarter choices on travel. This also set out, as a result of the 2004 Spending Review, increased transport funding over the ten-year period through to 2015 with the introduction of a new Transport Innovation Fund to support the development of innovative transport measures that can benefit national productivity. Total public sector investment over this period will be over £79 billion in today's prices. Recognising the need to take a sustainable longer term view, and building on the 30-year strategy, it is necessary to bring together the right investment plans and the right framework for prioritising and delivering new infrastructure. **The Secretary of State for Transport and the Chancellor have asked Rod Eddington, outgoing Chief Executive of British Airways PLC, to work with the Department for Transport and HM Treasury to advise on the long-term impact of transport decisions on the UK's productivity, stability and growth.**

## The investment chain

**3.106** UK institutional investors manage almost half of UK equities, investing a large part of the wealth of UK savers and exerting indirect control and influence over much of UK industry. This ownership is intermediated through an 'investment chain' of relationships connecting ultimate owners with their investment in companies. Ensuring this chain works efficiently is of vital economic importance for productivity and long term growth, because the chain is a critical mechanism for ensuring that investment is efficiently allocated. The Government has taken action to improve the functioning of the investment chain, identifying under-performing links in this chain and implementing solutions, including:

- addressing the problem of distorted investment decision-making by institutions through the original Myners Review.<sup>28</sup> The Government endorsed Paul Myners' recommendation that trustees of occupational pension funds voluntarily adopt, on a 'comply or explain' basis, a set of principles codifying best practice for investment decision-making. Building on this, Sir Derek Morris' Review, described below, makes recommendations for increasing competition in the market for actuarial services and strengthening the regulatory framework for the actuarial profession;

<sup>28</sup> *Institutional investment in the UK: a review*, Paul Myners, March 2001.

<sup>29</sup> *Medium and long-term retail savings in the UK: a review*, Ron Sandler, July 2002.

- rectifying, following the Sandler Review<sup>29</sup>, the failure of the retail savings industry to serve medium to long term savers optimally, by working with the FSA to develop simplified and more transparent savings products and to enhance disclosure of the cost of advice;
- improving the UK corporate governance regime following Sir Derek Higgs' Review<sup>30</sup> into the role of non-executive directors. The Financial Reporting Council has issued a revised Combined Code on Corporate Governance. As a result of the Smith Review<sup>31</sup> and the work of the Co-ordinating Group on Audit and Accounting, measures have been implemented to improve the independence and transparency of audit and the quality of financial reporting; and
- to promote more active engagement by shareholders with companies, welcoming in October 2002 the Institutional Shareholder Committee (ISC) principles and the commitment to reflect these in fund management mandates. The ISC will shortly conclude its review of the impact of the principles on engagement and the government will take account of the ISC's conclusions when finalising its own review.

**Myners principles: review of progress** **3.107** Addressing the problem of distorted investment decision-making by institutions is central to improving the functioning of the investment chain. In December 2004, the Government published a review of progress against the Myners principles. This shows that, while behaviour is beginning to change, progress is lagging in key areas. The Government has therefore proposed changes to the principles designed to: strengthen trustee expertise; ensure more effective use is made of advisers; improve the quality of asset allocation activity and the resources devoted to it; and provide greater clarity on funds' investment time horizons. In addition, the Government will work with key stakeholders to improve the quality of the commentary trustees make on how they are implementing the principles. The Government is consulting on its proposals.

**Morris Review** **3.108** The Government asked Sir Derek Morris to conduct a wide-ranging independent review of the actuarial profession following Lord Penrose' Inquiry into the Equitable Life<sup>32</sup> and as part of the Government's wider programme of reform to improve the efficiency of the investment chain. The provision of high-quality actuarial advice is a key element of the investment chain – actuaries advise pension funds on strategic investment issues, including asset allocation and fund manager selection. Sir Derek Morris has today published his final report and has made a number of recommendations, described further in Box 3.10, to increase competition in the market for actuarial services; to strengthen the regulatory framework for the actuarial profession and on the future role and institutional status of the Government Actuary and his Department.

<sup>29</sup> *Review of the role and effectiveness of non-executive directors*, Derek Higgs, January 2003.

<sup>31</sup> *Audit committees: Combined Code guidance*, Financial Reporting Council appointed group chaired by Sir Robert Smith.

<sup>32</sup> *Report of the Equitable Life inquiry*, The Right Honourable Lord Penrose, March 2004.

**Box 3.10: Morris Review Recommendations**

The central recommendation of the Morris Review is that regulation of the actuarial profession should be subject to independent oversight by the Financial Reporting Council (FRC.) The FRC should:

- create an Actuarial Standards Board as a new operating body of the FRC to set actuarial professional standards and oversee the regulatory and other activities of the actuarial professional bodies – including their role in: setting ethical standards; administering education and CPD; monitoring of compliance with professional standards; and in administering disciplinary procedures.

In order to promote an open and competitive market for actuarial services the review recommends that it is best practice for pension scheme trustees to:

- invite tenders separately for actuarial advice, strategic investment advice and fund manager selection advice, as proposed by the Government in its recent revision to the Myners' principles.
- (i) informally evaluate their actuarial advisers on an annual basis, (ii) undertake a more formal evaluation every three years and (iii) undertake a formal market test of their actuarial advisers no less frequently than every six years.

In relation to the Government Actuary's Department the review recommends that:

- the Government should increase choice and competition for users of actuarial advice to public service pension schemes and should transfer a limited number of functions to other government departments in order to achieve more effective integration of the services provided; the Government Actuary should continue to report to Ministers and Parliament on the National Insurance Fund; and the Government should consider converting the Government Actuary's Department into a trading fund.

**3.109** The Government welcomes the report of the Morris review and, in principle, accepts its recommendations, and looks forward to working with the actuarial profession and other stakeholders on implementation. The Government believes that the report's recommendations provide a blueprint for practical and effective reform of the actuarial profession and clarify the ongoing role of the Government Actuary and the Government Actuary's Department. **The Government urges all stakeholders – the actuarial profession and its users, the Pensions Regulator, the Financial Reporting Council, and the Financial Services Authority – to support the report's recommendations and work with the Government to see how they can be implemented in practice.**

## Investment in housing and property

**3.110** A stable and flexible housing market is essential to a productive economy. Housing market imbalances between supply and demand are a potential brake on economic development, as the cost and availability of housing influences the geographical distribution and mobility of the labour force and may affect capacity levels in local labour markets.

### Implementing the Barker Review

**3.111** Kate Barker's independent review of housing supply,<sup>33</sup> published alongside Budget 2004, set out the long-term lack of supply and responsiveness of housing in the UK. It identified problems of affordability for new households, wealth redistribution from those outside the housing market to those inside the market, and significant regional price differentials and expectations, reducing labour mobility and constraining productivity. It recommended a step change in housing supply and a programme of wide-ranging reform to

<sup>33</sup> *Delivering Stability: Securing Our Future Housing Needs*, Kate Barker, March 2004