

The Government is committed to building a fairer and more inclusive society in which everyone can contribute to, and share in, rising national prosperity. Reform of the welfare state, including the introduction of the new Child Tax Credit and the Pension Credit from next year, is at the heart of the Government's strategy for supporting families with children and helping to provide security for all in old age. A fair and efficient tax system, which encourages work and saving and ensures that everyone pays their fair share of tax, underpins this programme of reform. By leading international efforts to achieve the Millennium Development Goals, the Government is determined to ensure that fairness at home is matched by genuine progress in reducing global poverty. The Pre-Budget Report describes the steps the Government is now taking to ensure that economic strength goes hand in hand with social progress and a modern tax system by:

- **publishing shortly next steps in the Government's strategy to help parents balance their work and family lives;**
- **consulting key stakeholders on the detailed implementation of the Child Trust Fund** to strengthen the saving habit and spread the benefits of asset ownership;
- **taking forward the recommendations of the Sandler review** to improve competition and efficiency in the market for long-term savings;
- **publishing on 17 December a Green Paper on pensions** setting out proposals to help those of working age plan more effectively for their retirement;
- **consulting, alongside the pensions Green Paper, on radical proposals to simplify the taxation of pensions** to increase choice and flexibility for all;
- **investing in the Social Fund** to enhance its ability to help those on low incomes manage their finances;
- **working to deliver a global new deal to tackle international poverty**, by promoting a new \$50 billion International Financing Facility and improvements in aid effectiveness;
- **taking further steps to encourage charitable giving**, which include extending the Government supplement on payroll donations until 2004;
- **abolishing Royalty payments made by North Sea oil companies** to encourage long-term investment by the industry;
- **launching a new strategy to protect VAT revenues and taking further steps to tackle tax avoidance** to ensure that everyone pays their fair share of tax; and
- **consulting further on the shape of a modernised stamp duty regime** for land and buildings to be introduced late next year.

INTRODUCTION

5.1 Previous chapters have described the Government's strategy for delivering a strong and stable economy, based on high and stable levels of growth and employment and faster productivity growth. This chapter sets out how the Government is working to underpin that economic strength with fairness and social inclusion, so that every individual has the chance to fulfil their potential, regardless of their circumstances.

A modern welfare state

5.2 Since 1997, the Government has placed reform of the welfare state at the heart of its strategy for promoting fairness and inclusion. A modern welfare state should deliver an equal chance for everyone to share in rising national prosperity.

5.3 Although the world has changed greatly since Beveridge published his plans in 1942, the principles which underpin the welfare state remain those of:

- opportunity, for people to improve their circumstances and those of their families;
- security, to protect people from undue hardship that can arise from life events; and
- responsibility, of everyone to make the most of opportunities, for example through employment.

5.4 The old welfare system was failing on many counts. It was passive and reactive, delivering poor quality, fragmented services. Welfare benefits were seen as being mainly for the poor, and were stigmatising as a result. High marginal rates of withdrawal of benefits meant that people did not always see much gain from moving into work or increasing their hours. Vulnerable groups, notably children, were left behind as others benefited from rising living standards.

5.5 The new welfare system puts into practice the principles of progressive universalism, with support for all, and most support for those who need it most. Advice and support will be delivered through modern, high quality, integrated services, such as Jobcentre Plus and the Pension Service, tailored to people's circumstances. Where appropriate, financial support will be delivered through the tax system, reducing stigma. Fewer families suffer from very high marginal deduction rates when they move into work or increase their hours, and there is a renewed focus on children and pensioners.

5.6 This chapter describes how the Government is applying these principles to tackle child and pensioner poverty, promote saving throughout life, and support people with disabilities. It also describes the broader action the Government is taking to establish a modern and fair tax system and promote international efforts to achieve the Millennium Development Goals for global poverty.

SUPPORT FOR FAMILIES AND CHILDREN

Tackling child poverty

5.7 The Government's aim is for every child to have the best possible start in life. Childhood experience lays the foundation for later life. Children who grow up in poverty can experience disadvantage that affects not only their own childhood, but their experience as adults and the opportunities available to their children. Poverty places strains on family life and excludes children from the everyday activities of their peers. Many children experiencing poverty have limited opportunities to play safely, live in overcrowded and inadequate housing, and eat less nutritious food, resulting in more accidents and ill health. Children growing up in low-income households also have fewer opportunities to learn and as adults are more likely to be unemployed or earn low wages.

5.8 By the mid-1990s the UK had the highest rate of relative poverty in the EU¹. Over the previous two decades the proportion of children living in low-income households had more than doubled, while the proportion of children living in workless households saw a similar steep rise. The Government's long-term goal is to halve child poverty by 2010 and to eradicate it within a generation.

¹ Measured as the proportion of children living in households below 60 per cent of median income.

5.9 The Government's strategy for tackling child poverty was set out alongside the November 2001 Pre-Budget Report². This strategy is designed to:

- ensure decent family incomes, with work for those who can and support for those who cannot;
- support parents, so that they in turn can provide better support for their children;
- deliver high quality public services in all neighbourhoods, with targeted interventions for those with additional needs; and
- harness the power and expertise of the voluntary and community sectors, promoting innovation and good practice.

Financial support for families and children

5.10 The Government is reforming the tax and benefit system to tackle child poverty and ensure decent family incomes. The reforms ensure that support is available to all families with children, in recognition of the costs and responsibilities which come with parenthood. Those who need the greatest support, including families on lower incomes, those with children under one, and parents of disabled children, receive the most help.

5.11 Since 1997, financial support for families with children has been increased significantly. Reforms so far include:

- record increases in Child Benefit to £15.75 a week for the first child and £10.55 for subsequent children. As announced in Budget 2002, **from April 2003, the rates of Child Benefit will rise in line with indexation to £16.05 and £10.75 respectively;**
- the introduction of the Children's Tax Credit in April 2001, now worth up to £529 extra a year for around 4.6 million families and, since April 2002, up to £1,049 a year for families in the year of a child's birth;
- the introduction of the Working Families' Tax Credit (WFTC) which benefits over 1.3 million families – around 500,000 more than previously received Family Credit. On average, these families are now receiving over £40 a week more under the WFTC than under Family Credit; and
- increases in the children's allowances in Income Support and other income-related benefits, including a doubling in real terms of the rates for children under 11.

The Child Tax Credit **5.12** As part of the next steps in tax and benefit reform, Budget 2002 introduced a new system of support to help families, tackle child poverty and make work pay. **From April 2003, the Child and Working Tax Credits will separate support for adults from support for the children in a family, while providing a common framework for assessing entitlement.** The Working Tax Credit is described in detail in Chapter 4.

² *Tackling child poverty: giving every child the best possible start in life*, HM Treasury, December 2001.

5.13 Income-related support for families is currently provided through several different instruments and is administered by different parts of government. Levels of financial assistance for children depend on whether their parents are in or out of work.

5.14 The Child Tax Credit will provide a single, seamless system of income-related support for families with children, bringing together the assistance for children currently provided through the child elements of the WFTC, the Disabled Person's Tax Credit (DPTC), and Income Support or Jobseeker's Allowance, as well as that provided by the current Children's Tax Credit. Building on the foundation of universal Child Benefit, the Child Tax Credit will deliver:

- a secure stream of income for families with children which does not depend on the employment status of the parents, creating a stable income bridge when families move into work;
- a system in which all support for children is paid direct to the main carer in the family – usually the mother – in line with Child Benefit;
- a common framework for assessment, so that all families are part of the same system and poorer families do not feel any stigma associated with current forms of support;
- a less intrusive, annual system, under which families whose circumstances remain the same will only need to contact the Inland Revenue once a year about tax credits;
- a modern income test, which does not penalise saving, instead taking into account the income from capital rather than the capital itself; and
- a more responsive system, in which a family's tax credit award can be adjusted to reflect changes in their income and circumstances. The new tax credits only respond to rises in income in the current year of more than £2,500, so that recipients will not see their tax credits reduced as soon as their income rises.

5.15 Paid on top of Child Benefit, the Child Tax Credit will provide:

- a family element of £545 a year, or £1,090 for families with one or more children under the age of one, for all families with incomes of less than £50,000, gradually withdrawn for those with incomes above this amount; and
- a child element of £1,445 a year for each child or young person in families with incomes of up to around £13,000 a year, gradually withdrawn for families with higher incomes. Families caring for disabled or severely disabled children will receive increased child elements to reflect their greater needs. **From April 2004, the child element will be uprated at least in line with earnings rather than prices for the rest of the Parliament.**

Box 5.1: The new tax credits: “money with your name on it”

Around 5³/₄ million families with children are expected to benefit from the Child Tax Credit. To ensure that families understand the changes and what they might be entitled to, the Government has launched a nationwide awareness campaign, involving:

- a national television advertising campaign, supported by radio, press and on-line publicity, and including advertising focused on ethnic minority communities. Over £9 million has been allocated to advertising;
- a series of 11 tax credit road-shows held throughout the country, attended by around 2,000 people and supplemented by seminars aimed at specific groups such as employers and those who work with students or people with disabilities; and
- harnessing the potential of intermediaries to reach audiences that have traditionally been more difficult to get to. For example, pilot projects are involving local voluntary groups in work to promote tax credit take up in their communities.

The Government's awareness campaign was launched by the Chancellor on 16 September. As of 22 November:

- over 2 million enquiries had been received. People can call the tax credits freephone response line (0800 500 222) or log on to the tax credits website¹, which provides comprehensive information and enables families to calculate their entitlement and make a claim on-line; and
- 4 million forms had been sent out and so far around 1.4 million claims returned to the Inland Revenue, ahead of expectations.

Those receiving Income Support or Jobseeker's Allowance will be moved onto the new Child Tax Credit automatically from April 2004 and do not need to claim now. Families receiving one of the existing tax credits need to make a fresh claim before 31 January 2003 to guarantee that they will begin receiving the tax credits they are due in April 2003.

¹ www.inlandrevenue.gov.uk/taxcredits.

5.16 Table 5.1 shows the weekly levels of support that the Child Tax Credit and Child Benefit will provide for families from April 2003. The precise amount a family will receive will depend on their income and circumstances, with support gradually tapered away as income rises.

Table 5.1: Levels of support for families from April 2003¹

Family income (£ a year) Per cent of families	less than £13,000 25	less than £50,000 85	all families 100
1 child	£54.25	£26.50	£16.05
2 children	£92.75	£37.25	£26.80
3 children	£131.25	£48.00	£37.55

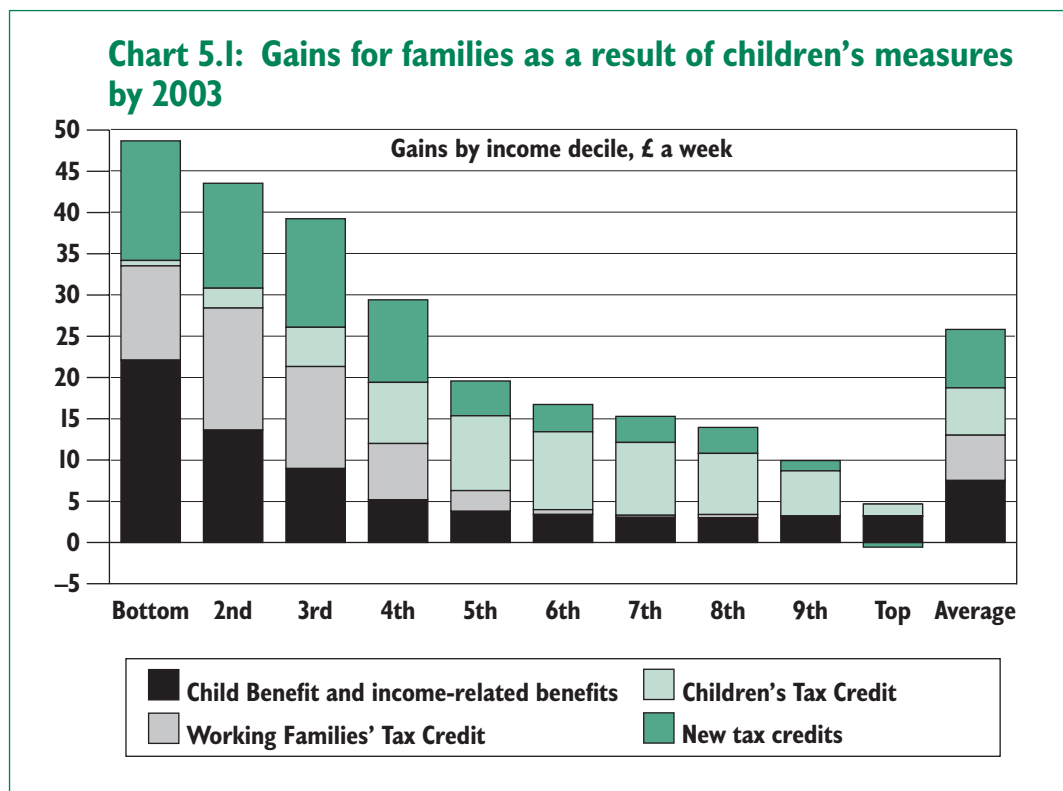
¹ Amounts of tax credits set in legislation are annual figures. Weekly equivalent figures are used to aid comparison with the current system.

Effects of measures to support families with children

5.17 As a result of the Government's personal tax and benefit reforms since 1997, including the changes to national insurance contributions (NICs) and the income tax personal allowance announced in Budget 2002, by April 2003:

- families with children will be, on average, £1,200 a year better off, while those in the poorest fifth of the population will be, on average, over £2,400 a year better off in real terms;
- a single-earner family on half average earnings of £14,200 with two young children will be £3,460 a year better off in real terms; and
- a single-earner family on average earnings of £28,400 and with two children will be about £300 a year better off in real terms.

5.18 Chart 5.1 shows the impact of the Government's reforms since 1997, including the introduction of the new tax credits, by decile, on families with children.



Social Fund 5.19 In addition to support provided by weekly benefit payments and tax credits, the Social Fund provides people on low incomes with grants and loans to help them manage a wide range of unexpected or occasional costs, such as those involved in replacing large household items, setting up home after leaving institutional care, or paying for a funeral.

5.20 The Government has introduced a number of important changes to the Social Fund since 1997, including a simpler and more transparent claims process. **From April 2003, the maximum payment for the fixed element of the funeral grant will rise from £600 to £700, and £90 million will be added to the Discretionary Social Fund over the three years to 2005-06.** Combined with additional administrative improvements, this investment will enhance the Fund's ability to help those on low incomes manage their finances.

Education Maintenance Allowances **5.21** Education is a crucial influence on a child's life chances. A decent education builds employment opportunity and enhances the wellbeing of people throughout their lives. Young people from low-income families who stay on to take A levels or equivalent qualifications are much more likely to move out of low income in adult life compared with those who leave school at the age of 16³. In the past, too few people have aspired to continue in learning after the statutory school-leaving age, often because of a lack of financial support. In recognition of the financial barriers which prevent some young people continuing in education, **Education Maintenance Allowances (EMAs) will be rolled out across England from September 2004.** EMAs will enable more young people from poorer families to pursue education beyond the age of 16 by providing up to £1,500 a year, depending on household income.

Adoption and foster carers **5.22** The Government recognises the important contribution of parents who foster or adopt children and has decided that payments to adoptive families under the new Children and Adoption Act should continue to be free of tax. These arrangements benefit all adoptive families who receive financial support to help them meet the extra costs they face when they adopt a child. **The Government is also considering ways in which the tax system may facilitate the recruitment and retention of foster carers.**

Supporting parents: balancing work and family life

5.23 The Government is committed to helping parents balance their work and family lives. From next April, a series of reforms, including the introduction of the new Child and Working Tax Credits, will help to deliver a step change in choice and support for parents, benefiting employers, employees and children alike. Details of the Government's strategy, including next steps, will be set out in the forthcoming document, *Balancing work and family life: enhancing choice and support for parents*.

Support in the early years of a child's life **5.24** In recognition of the considerable financial pressures associated with the birth of a child, the Government is providing additional support to help parents through the early months of their child's life. New maternity, paternity and adoption leave rights will improve the help available to parents seeking to balance work and caring responsibilities. In April 2002, the standard rate of Statutory Maternity Pay (SMP) was increased to £75 a week. **From April 2003, the standard rate of SMP will rise to £100 a week and the duration of paid leave will be extended from 18 to 26 weeks. Two weeks paternity leave and 26 weeks adoption leave will also be introduced, paid at the same standard rate as SMP.**

5.25 To complement these reforms, from April 2003 parents of young children and disabled children will also have a new right to request a flexible working pattern, and employers will face a new duty to consider such applications seriously.

Childcare **5.26** Support for working parents who require childcare is also being enhanced. Access to affordable and good quality childcare is a key concern for working parents. As described in Chapter 4, the 2002 Spending Review allocated significant new resources to create new childcare places and fund the operation of children's centres which will bring together good quality childcare, early years education, family support and health services. From April 2003, the Working Tax Credit will also provide an improved system of financial assistance to help families meet the costs of childcare. In particular, eligibility for the childcare element of the Working Tax Credit will be extended to include those who use approved childcare in their own home, benefiting, among others, parents of disabled children and those who work outside conventional hours.

³ *Intergenerational mobility among the rich and poor: results from the National Child Development Survey*, G. Johnson and H. Reed, Oxford Review of Economic Policy, Volume 12, No 1. 1996.

Working with business **5.27** Employers have an important role in helping their employees to balance their work and family lives. Such support benefits employers themselves, including by improving recruitment and retention prospects, reducing absenteeism and staff turnover, and improving productivity and business performance. The Government is therefore committed to working alongside employers to encourage them to adopt best practice and to offer flexible working opportunities throughout the workforce, including through the Work-Life Balance campaign.

Public services to tackle child poverty

5.28 Strong and dependable public services are essential to tackle the underlying causes of poverty and deprivation and their effects. The 2002 Spending Review provided substantial new investment in child-focused services, including:

- an extra £14.7 billion for education by 2005-06 – an increase of 6 per cent a year in real terms. A new Leadership Incentive Grant of £125,000 per school will enable governing bodies in schools in challenging areas to put in place good senior and middle management, and substantial increases to the School Standards Grant will help to deliver schools reforms;
- £570 million for the Children's Fund over the three years to 2005-06. Children's Fund partnerships provide targeted and coordinated local services for children at risk of social exclusion and their families. Some 85 Children's Fund partnerships are already operating and the final wave of partnerships will begin in April 2003; and
- resources to support a range of initiatives to tackle health inequalities, including better preventative health care services and targeted services for disadvantaged communities.

Children at risk **5.29** As part of the 2002 Spending Review, the Government conducted a cross-cutting review into the delivery of programmes and services to help children at risk of poor outcomes in areas such as health, education and employment. The review identified the factors that increase that risk, including growing up in poverty, poor relationships with parents, poor educational experience, low aspirations and lack of role models. Many of these factors manifest themselves early in life, but too many children only receive extra support after the onset of acute problems. The prevalence of these risk factors has also increased over time and they have become more concentrated in particular individuals and areas.

5.30 To enhance preventative services for children, the review recommended strengthening existing local partnerships and piloting new models for joint working; improving the focus of mainstream services for children and young people to ensure they respond better to those most in need; and identifying need at an earlier stage, to ensure that preventative services are available before children, young people and families reach crisis. In the light of the review, the Government is emphasising the importance of developing strategies at a local level to deliver preventative services to children. The Government also intends to **pilot new models for multi-agency working on services for children – Children's Trusts – by the end of 2003.**

5.31 As recently announced by the Prime Minister, **the Government intends to produce a Green Paper on services for children and young people at risk**, building on the analysis set out in the Children at Risk Review, carried out as part of the 2002 Spending Review. The Green Paper will bring forward proposals to improve the life chances of children at risk of a range of adverse outcomes, including truancy, educational under-achievement, offending, victimisation, teenage pregnancy, and poor mental health. The paper will examine the roles of social services and youth justice, as well as those of schools, families and communities.

Eradicating child poverty

5.32 The Government's annual anti-poverty report, *Opportunity for all*⁴, sets out progress against a series of indicators measuring the different aspects of poverty. In particular, the report describes performance against the Government's Public Service Agreement target for 2004 to reduce the number of children living in relative low-income households by one quarter compared with 1998-99. By 2000-01 the number of children in low-income households had fallen by 300,000 after housing costs and by 400,000 before housing costs from a base of 4.2 million and 3.1 million respectively. The Government is therefore one third of the way towards achieving its 2004 poverty reduction target in one third of the time.

5.33 This reduction does not reflect the full impact of the Government's policies to reduce the number of children living in low-income households. By 2003-04, there will be 1.5 million fewer children living in relative low-income households⁵ than there would otherwise have been, had the Government done no more than index 1997 policies to prices. This comprises both:

- the number of children living in households now lifted above the relative income level; and
- the number of children who would otherwise have fallen into relative poverty, as median real income and earnings rise.

5.34 Looking further ahead, the Government is committed to finding a measure of child poverty that will both underpin effective policy-making and enable the public to gauge progress towards the long-term goal of halving child poverty by 2010 and eradicating it within a generation. The Government has consulted⁶ on four options for building on its existing poverty indicators. These are:

- headline indicators, for the five key areas of low income, worklessness, educational attainment, health inequalities and housing standards;
- a child poverty index, distilling the five headline indicators into a single measure;
- a headline measure of 'consistent poverty', combining relative low income and material deprivation; and
- a core set of indicators of low income and 'consistent poverty', incorporating an absolute low income indicator, a measure combining material deprivation with relative income, and a separate relative income measure.

5.35 The Department for Work and Pensions will publish conclusions drawn from the consultation by spring 2003. This work will inform future decisions about the role of public services and tax and benefit reform in helping to deliver the Government's long-term goal.

⁴ *Opportunity for all*, Department for Work and Pensions, September 2002.

⁵ Defined as having income below 60 per cent of the contemporary median.

⁶ *Measuring child poverty*, Department for Work and Pensions, April 2002.

FAIRNESS FOR PEOPLE WITH DISABILITIES

5.36 People with disabilities should have the opportunity to lead independent and fulfilling lives. The New Deal for disabled people (NDDP) is helping those disabled people who can and wish to work make a successful return to employment, and the recent Green Paper, *Pathways to work: helping people into employment*, describes how the Government intends to intensify the support available to help those on Incapacity Benefit return to employment. In addition, **from April 2003, the Working Tax Credit will include support for people with disabilities**, bringing them into the mainstream system of support, while recognising the additional costs they may face when in work. All of these measures are discussed in more detail in Chapter 4.

5.37 People with disabilities who are unable to work should have financial security and support. The Disability Income Guarantee ensures that severely disabled people under 60 years of age and on income-related benefits receive a guaranteed minimum income of at least £144.45 a week for single people, and £189.95 a week for couples. From April 2002, young people disabled before the age of 20 have also been able to claim Incapacity Benefit without first having to satisfy contribution conditions, providing up to £28.10 a week in additional benefit payments.

Support for families with disabled children **5.38** In recognition of the fact that families with disabled children often need extra help, **the disabled child premium or disability element will rise in April 2003 to more than £40 a week on top of basic Income Support or tax credits**, benefiting around 80,000 children. In addition, the mobility component of Disability Living Allowance was extended to three and four year olds in April 2002, providing an extra £39.30 a week to these families.

Support for people with high care needs **5.39** Severely disabled people with high care needs who wish to work are now entitled to access the Independent Living Fund, regardless of their or their partner's earnings. This improvement in entitlement, worth an average of £130 a week to those families, recognises the additional costs attached to being severely disabled and in work. The capital limits have also been raised, extending help to people with savings of up to £18,500.

Tackling discrimination **5.40** Fairness and opportunity for disabled people requires an end to discrimination in the workplace and beyond. Following the establishment of the Disability Rights Commission in April 2000, the Government is now consulting on how best to advance disability rights within the structure of future equality machinery⁷, including the proposal for a single equality commission. Following consultation last year on the recommendations of the Disability Rights Task Force and the provisions of the Employment Directive, the Government is also consulting on proposals to amend the Disability Discrimination Act in 2004 to reflect the requirements of the Directive⁸.

FAIRNESS FOR PENSIONERS

5.41 A fair society guarantees security in old age. The Government has therefore introduced comprehensive reforms to tackle pensioner poverty and ensure that all pensioners are able to share in rising national prosperity. This programme of reform is underpinned by four important principles:

- security for all pensioners, through guaranteed minimum increases in the annual basic state pension and help with the costs of winter fuel;

⁷ *Equality and diversity – making it happen*, Department of Trade and Industry, October 2002.

⁸ *Equality and diversity – the way ahead*, Department of Trade and Industry, October 2002.

- extra financial support for the poorest pensioners, through a minimum income guarantee;
- reward for today's low and modest-income pensioners who have saved for their retirement, through the new Pension Credit; and
- a sustainable system of support which enables today's workforce to plan ahead and make decent provision for their retirement, protecting themselves against poverty in the future.

Tackling pensioner poverty

5.42 The Government's first priority has been to help those in greatest need by reforming Income Support for pensioners and introducing a more generous Minimum Income Guarantee (MIG). To ensure that more pensioners are able to share in rising national prosperity, **the level of the MIG will be raised in line with earnings throughout this Parliament.** Over two million pensioners now benefit from this support. The launch of the Pension Service in April 2002, and the Pension Credit from October 2003, will encourage more people to claim the support to which they are entitled.

Security for all pensioners

5.43 To ensure that all pensioners have security in retirement, not just the poorest, the Government has also:

- increased the basic state pension by more than inflation in each of the last two years. From April 2003, **the full basic state pension will rise further to £77.45 a week for single pensioners and to £123.80 a week for pensioner couples** – an annual increase of more than £100 for single pensioners and more than £160 for couples;
- **guaranteed that the basic state pension will rise in future years by 2.5 per cent or the increase in the September Retail Prices Index, whichever is higher;**
- introduced winter fuel payments, worth £200 per household each year for the remainder of this Parliament. Around 11 million people aged 60 or over benefit from this support each winter; and
- introduced free TV licences for households with someone aged 75 or over and free eye tests for all those over 60.

The Pension Credit: rewarding low and modest-income pensioners

5.44 In order to do more to tackle pensioner poverty and to reward saving, while providing a modern and integrated service for pensioners on low and modest incomes, **the Government is introducing the Pension Credit from October 2003.**

5.45 The Pension Credit will bring pensioners' incomes up to a guaranteed minimum entitlement and ensure that millions of pensioners who have saved modest amounts will gain from having done so. The current MIG capital regime will be revised and the MIG's intrusive weekly means-test abolished for the vast majority of pensioners. People on Housing Benefit and Council Tax Benefit will be protected to ensure that they receive the full benefit of the Pension Credit. The Pension Service will make it easier for pensioners to claim their entitlements.

5.46 On its introduction, the Pension Credit will reward pensioners whose savings, second pensions or earnings give them incomes of up to £139 a week for single pensioners and nearly £204 a week for couples. No single pensioner need therefore live on less than £102.10 a week and no pensioner couple on less than £155.80 a week.

5.47 The guaranteed minimum entitlement in the Pension Credit will be linked to the growth in average earnings throughout this Parliament so that all those receiving the Pension Credit will gain. The poorest third of pensioners will be about £250 a year better off on average than had the equivalent amount been spent on raising the basic state pension. Around half of all pensioner households will be entitled to £400 extra a year on average from the Pension Credit, with some gaining up to £1,000 a year.

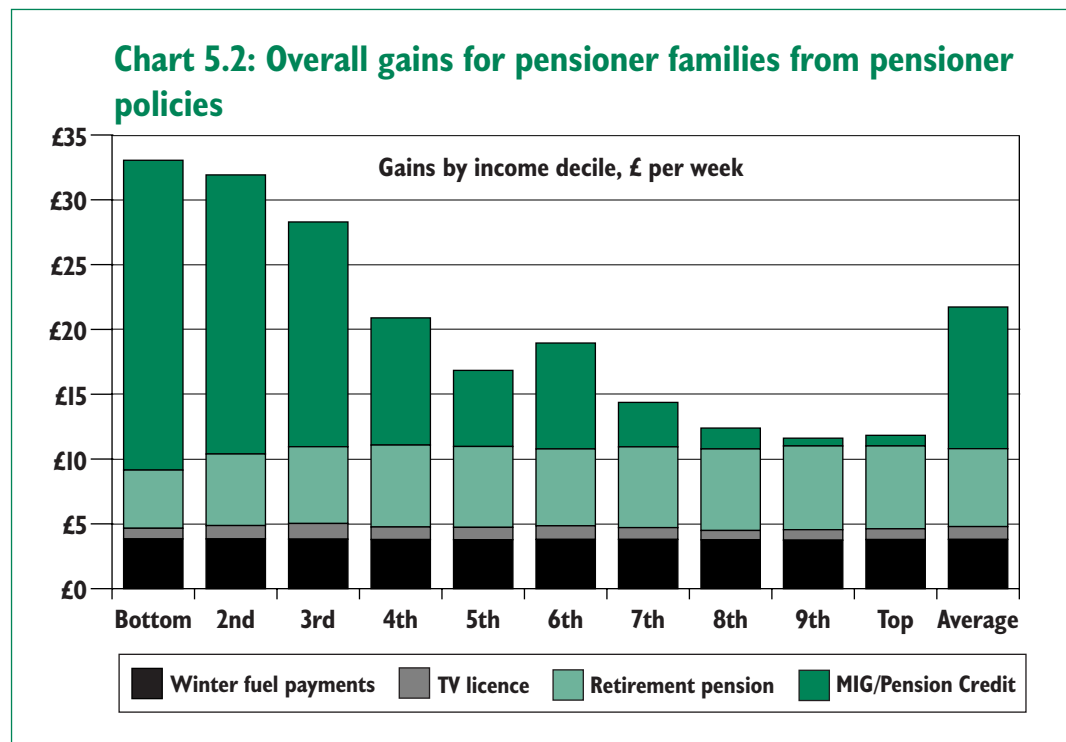
Effects of measures to support pensioners

5.48 In 2002–03 the Government is spending around £6 billion extra in real terms on pensioners as a result of policies introduced since 1997. This will ensure that the poorest third of pensioners receive an additional £2.5 billion – three times more than an earnings link in the basic state pension would have provided.

5.49 Compared with the 1997 system, as a result of the Government's measures including the Pension Credit, on average:

- pensioner households will be over £1,150 a year better off in real terms – around £22.50 extra a week; and
- the poorest third of pensioner households will have gained over £1,500 a year in real terms.

5.50 Chart 5.2 shows the distributional impact, in current prices, of the Government's pensioner policies up to Budget 2002, including the Pension Credit.



Support for pensioners who pay tax

5.51 While most pensioners have no income tax to pay, for those who do **the age-related personal allowances will rise in 2003-04 for those aged 65 to 74 to £6,610 and for those aged 75 or over to £6,720**. This represents an increase of £400 and £240 a year respectively over the amount that would result from statutory indexation, and will ensure that no pensioner aged 65 or over will pay tax on income of less than £127 a week. Subsequently, the age-related allowances will be raised at least in line with earnings rather than prices for the remainder of this Parliament.

PROMOTING SAVING THROUGHOUT LIFE

5.52 Saving and assets provide people with security in times of adversity, long-term independence and opportunity and comfort in retirement. The Government's strategy for promoting saving and asset ownership is focused on:

- improving the environment for saving, by maintaining macroeconomic stability and establishing an efficient market in financial services, regulated by the Financial Services Authority (FSA);
- creating the right incentives for saving, by ensuring that the tax and benefit system does not unfairly penalise savers and by assisting those on lower incomes; and
- empowering individuals by providing greater financial information, improved access to honest and straightforward advice, and simpler, easier to understand savings products.

5.53 To help deliver this strategy, the Government is developing a series of savings products suitable for each stage in a person's life cycle. The design of these products will ensure that, as the scale of saving increases, proceeds from one product may be rolled into the next, so helping people to progress up the savings ladder.

Saving Gateway 5.54 The Saving Gateway helps those who would otherwise have difficulty starting on the savings ladder. The Saving Gateway is an account targeted at individuals from low-income groups, typically those at the start of their working lives. It aims to increase incentives to save through a Government-funded match of all money saved, up to a limit. Consumer research suggests that matched contribution schemes⁹ may be more effective than tax relief in encouraging saving by low and moderate earners, who tend to be less financially literate. Tailored financial information and education are provided alongside Saving Gateway accounts to help individuals make informed saving choices. For many younger or low-income individuals, the account provides an effective bridge to other forms of saving, such as Individual Savings Accounts (ISAs).

⁹ The Irish Special Saving Incentive Scheme and Individual Development Accounts in the USA are both structured and marketed as matched savings accounts.

Box 5.2: The Saving Gateway: piloting a new approach

As announced in Budget 2002, the Government launched a number of Saving Gateway pilot projects in August 2002. The pilots are being run in conjunction with the Community Finance and Learning Initiative, led by the Department for Education and Skills. The Halifax plc is providing branch, staff and account management services in the pilot areas¹.

Operating in Gorton, Tower Hamlets, Cumbria, Cambridgeshire and Hull, the pilots will involve up to 1500 participants in total. The Saving Gateway account will last for 18 months and each pound saved by participants will be matched with a pound from the Government. Participants will be able to save a maximum £25 per month up to an overall account limit of £375 of savings, £750 with matching funds. As of 20 November 2002, 250 pilot Saving Gateway accounts had been opened with total contributions of nearly £6,000.

The pilots have been designed to provide a regular stream of information and data and will be evaluated to assess their effect on saving behaviour. Further development of the Saving Gateway, including the appropriate level of the match rate and the criteria to be used to determine eligibility, will follow in light of evaluation evidence.

¹ A single financial services provider was selected for the pilots for evaluation purposes. For a national rollout it is envisaged that a consortium of providers would offer the Saving Gateway.

The Child Trust Fund **5.55** Attitudes to saving and assets are often shaped early on in life. Financial education delivered through the National Curriculum and by the FSA and certain voluntary organisations is helping children and young people understand the advantages of saving. The Child Trust Fund (CTF) would build on these foundations, strengthening the saving habit and spreading the benefits of asset ownership to all.

5.56 The CTF would be a universal account, opened for all children at birth, with an endowment paid by the Government. Founded on the principle of progressive universalism, every child would receive an endowment, with those from the poorest families receiving the largest lump sums. The CTF would advance the Government's goal to promote saving opportunity by ensuring that all young adults, regardless of their families' circumstances, start their adult lives with immediate access to a stock of assets. Funds would be accessible at the age of 18 and could be rolled over into other saving products such as ISAs, reinforcing the lifetime saving habit.

5.57 The Government has consulted¹⁰ on two proposals for delivering the CTF:

- open market competition, under which providers would be able to enter the market on satisfaction of a set of entry conditions similar to the way the market for ISAs is managed; and
- a licensed provider approach, under which provision would be limited to a panel of licensed providers, with licenses issued through competitive tender for a fixed number of years.

5.58 Following the consultation process¹¹ the Government has decided, on balance, in favour of open market provision. Existing open market provision with product regulation has succeeded in delivering high quality and efficiently priced products, as evidenced by ISAs and stakeholder pensions. The open market approach would also maximise the scope for a variety of providers to enter the CTF market – from high-street banks and building societies through

¹⁰ *Delivering saving and assets*, HM Treasury, November 2001.

¹¹ Forty six formal responses were received during the consultation process. Of the 44 that addressed the choice of delivery model, 20 preferred an open market, 11 preferred licensed providers, 3 suggested alternative approaches, and 10 registered no distinct preference.

to friendly societies – thereby allowing families to build on their existing relationships with national and local providers. While an open market could generate more complex choices for consumers, it would still be compatible with providing a default option for parents who do not wish to choose between many competing providers. The specification of product rules and provision of information and education would further limit the risk that parents are forced into making inappropriate choices.

5.59 The Government will now consult with key stakeholders on the detailed implementation of the Child Trust Fund, including the structure and value of endowments, consumer protection, fund investment options, and methods of delivering financial information, education and advice. The Government will also consider the relationship between the CTF and the suite of ‘stakeholder’ investment products recommended by the Sandler review and described below.

Individual Savings Accounts

5.60 Individual Savings Accounts (ISAs) are the Government’s primary vehicle for tax-advantaged saving and have helped to make saving, and the benefits of saving, simple for ordinary investors to understand. The flexibility of ISAs ensures that funds can be accessed to take advantage of opportunities at key life stages – for example, to provide the deposit for a house. In time, ISAs could also provide a suitable product for savers seeking to move on from the Saving Gateway or the CTF.

5.61 ISAs continue to be extremely popular. Over 14 million people have an ISA – nearly 6 million more than had a TESSA or PEP in 1998-99, their last and most successful year. Subscriptions to cash ISAs rose by 18 per cent during 2001-02 – around £2.5 billion – to over £17 billion. This increase helped to offset a decline in subscriptions to equity ISAs probably resulting from the uncertain investment climate – overall ISA subscriptions fell by just four per cent over the year. Nearly £100 billion has now been subscribed to ISAs since their launch in 1999.

The Sandler review of retail savings

5.62 In June 2001, the Government appointed Ron Sandler, former CEO of Lloyd’s of London, to conduct a review of the long-term savings industry. The review, which reported in July 2002, examined the markets for medium and long-term retail savings in the UK, identifying the competitive forces and incentives that drive the industries concerned and analysing the potential policy responses.

5.63 The Government has welcomed the review’s compelling analysis of the lack of competitive intensity in the retail savings market. **The Sandler review made six major recommendations, addressed at the Government and the FSA, all of which are being taken forward in various ways:**

- a series of safer and easier to understand ‘stakeholder’ investment products with capped charges, prudential restrictions on investment profile and the ability to exit on reasonable terms. Regulation will be built into the products, opening the way to a streamlined system of sales regulation. The Treasury has established a working group of industry and consumer representatives to assist it in producing a specification for these products, and will issue a consultation document in the new year;
- reform of with-profits policies, including an ‘ideal model’ that would be transparent to support investor decisions, and clearly separate policyholders’ and shareholders’ interests while retaining the smoothing features so many investors have found valuable. The FSA will consult shortly on how to take forward the issues raised by the review, both for the proposed new ‘stakeholder’ funds and for existing funds;

- an increased and ring-fenced consumer education budget for the FSA and better coordination of the Government's work on financial education. The FSA has welcomed this suggestion and will be consulting more fully on its long-term strategy for consumer education next year. The Treasury has already begun work to coordinate the government effort devoted to financial education;
- reform of the market for the distribution of investment products, including specific recommendations about how independent financial advisers should be remunerated. The FSA has welcomed the review's recommendations and has taken them into account in its recently announced decision on reform of the 'polarisation' requirement and on intermediaries' remuneration;
- a set of investment principles for providers of retail investment products, building on the approach set out by the Myners review. The review proposes that this disclosure should, in most cases, be voluntary. The Treasury agrees that this disclosure should help produce a more transparent, better-informed and hence more competitive system. Unit trusts already disclose much of this information. The FSA will be considering how these principles should apply to with-profits funds as part of its ongoing work on with-profits. If the industry fails to disclose voluntarily, the Government will consider requiring it to do so, as recommended by the review; and
- removing distortions and reducing complexity in the savings industry caused by the taxation system, in order to increase consumer understanding, reduce the cost of savings advice and strengthen competitive forces. As well as consulting on the simplification of pensions tax and on the VAT treatment of fund management, the Government is considering the review's other tax proposals as part of the Budget process and will discuss their implications with the industry in the coming months.

5.64 The review also recommended the creation of a level playing field in the VAT treatment of fund management. HM Customs and Excise will now consult the industry on a range of options, and would be particularly interested to receive views on the example cited in the Sandler review that the VAT exemption for pension fund management fees be extended to those levied by non-life companies.

Saving for retirement

5.65 Saving for a pension should be a key consideration for most individuals throughout their working lives. While wealth accumulated for retirement will often include an ISA, a house or a business, pensions will for most people provide the principal source of income in retirement in the form of an annuity.

5.66 As more people look forward to longer and healthier lives, it is all the more important that they fulfil their potential at work and that they save, in order to maintain living standards in retirement. The Government provides a foundation of support in retirement through the basic state pension, the MIG and, from October 2003, the Pension Credit, which will guarantee minimum incomes in retirement and ensure that people see the benefits of having saved. Some 18 million people stand to gain following the introduction of the State Second Pension in April 2002. The Government also helps adults to make the most of their working lives, through support to help the unemployed and inactive find and succeed in work, and through a range of products to help people save throughout their lives, including stakeholder pensions.

Stakeholder pensions **5.67** Launched in 2001, stakeholder pensions have extended the opportunity to build pension savings to previously excluded groups. Stakeholder pensions provide a safe, flexible and low cost way for moderate earners to save for retirement and are now available through the workplace to the majority of those currently without a private pension. Many existing schemes exceed the minimum requirements set by the Government and low stakeholder charges have helped to exert downward pressure on pension charges generally. The Government's integrated approach to saving ensures that individuals can roll over money saved in ISAs into stakeholder pensions, subject to annual limits.

Pensions Green Paper **5.68** In addition to providing a foundation of support for pensioners, the Government also encourages and facilitates private pension provision. It does so by helping individuals to make informed choices about the level of income they want in retirement and to plan their saving and working patterns accordingly. The financial services industry can facilitate such choices by developing a simpler, more transparent market in which trusted and trustworthy providers sell simple, good-value products to informed consumers. Employers also have an important responsibility as providers of and contributors to occupational pension schemes and as sources of information about pensions options.

5.69 The Government believes that there is more to do to strengthen the framework of partnership between the Government, individuals, employers and the financial services industry that has long been a key strength of the pensions system in the UK. Building on measures introduced to date, **the Government will publish on 17 December a Green Paper on pensions** setting out proposals for renewing this partnership for the future to enable those of working age to plan more effectively for a secure retirement. The Green Paper will build on the conclusions and recommendations of three reviews into different aspects of pensions provision commissioned by the Government into the regulatory regime for private pensions¹², the taxation and administration of occupational pensions, and the operation of the market for medium and long-term retail savings, including personal pensions¹³.

Simplifying the taxation of pensions **5.70** There are currently eight different tax regimes for pensions and within these regimes there are different rules concerning the levels of contributions and the levels of benefits. This proliferation of regimes and rules creates complexity that makes pensions difficult to understand and explain, constrains people's choices about when and how to save, and imposes unnecessary administrative burdens on employers, individuals and pension providers.

5.71 In March 2001, the Government launched a review of the tax regimes governing occupational pensions, led by the Inland Revenue in partnership with the pensions industry, and drawing on a wide range of evidence, including that presented in the Sandler review of retail savings. The review studied the various tax regimes and their impact on employers, pension providers and individuals who save in pensions. In the light of the findings of the Inland Revenue review, **the Government now intends to consult the pensions industry and other interested parties on radical proposals to simplify the taxation of pensions.** Details of the Government's proposals will be published alongside the pensions Green Paper.

Annuities **5.72** Annuities provide a financially efficient and secure means of turning pension capital saved through defined contribution pension arrangements into income that lasts for the whole of an individual's retirement. The Government wants to deliver increased product choice and flexibility for consumers in the annuities market. **Further proposals to make the annuity market function more efficiently will be included in the forthcoming consultation on simplifying pensions tax.**

¹² *A simpler way to better pensions: an independent report by Alan Pickering*, July 2002.

¹³ *Medium and long-term retail savings in the UK: a review*, Ron Sandler, July 2002.

A MODERN AND FAIR TAX SYSTEM

5.73 A modern and fair tax system encourages work and saving, keeps pace with developments in business practice and the global economy and raises sufficient revenue to fund the Government's objective of establishing world-class public services. To ensure that the burden of tax does not fall unfairly on compliant taxpayers, loopholes giving scope for avoidance must be closed. Everyone – individuals and businesses – should pay their fair share.

Income tax and national insurance contributions

5.74 As announced in Budget 2002, to deliver the largest ever sustained increase in NHS spending, while meeting other priorities and ensuring sound public finances over the medium term, **the income tax personal allowance for those aged under 65 and the national insurance contributions (NICs) threshold will be frozen in 2003-04.** Other rates and thresholds will increase in line with inflation. **From April 2003 there will also be an additional one per cent NIC paid by employers, employees and the self-employed on all earnings above the NICs thresholds and lower profits limit.**

5.75 For the third year in a row, **Class 2 NICs will be frozen at £2.00 per week. Class 3 voluntary contributions will rise in line with inflation.**

Charitable donations

5.76 The Government recognises the important contribution that charities make to the life of the nation. Millions of people in the UK give to charities and other voluntary organisations, and the Government wants to develop this relationship by encouraging further donations of time, money and assets. To help to achieve its goals, the Government will therefore **extend the existing 10 per cent Government supplement on donations to charities through the payroll for one further year until 2004.** This will build on the success of the existing scheme, through which donations have now risen to more than £72 million. The Government will continue to work with the voluntary and corporate sectors to promote a culture of giving. As described in Chapter 6, the Government will publish shortly a discussion document setting out the next steps in its strategy to promote volunteering and giving.

Modernising stamp duty

5.77 The existing stamp duty regime allows many large commercial land transactions to take place without incurring a charge, and **the Government therefore intends to introduce a new regime for stamp duty on UK land and buildings late next year.** The Government's proposals for a modernised stamp duty regime were published alongside Budget 2002¹⁴. Stamp duty should apply fairly to similar transactions and should be supported by a modern compliance regime balanced by proper appeal rights. The Government continues to consult interested parties on these proposals, and intends to introduce legislation for the new regime in Finance Bill 2003. Draft clauses covering the main charge will be published shortly, alongside a summary of responses to the consultation. The Government is continuing to develop proposals to reform lease duty and the charge on indirect transactions.

¹⁴ *Modernising stamp duty on land and buildings in the UK*, Inland Revenue, April 2002.

Taxation of foreign company branches

5.78 As announced in Budget 2002, **from 1 January 2003 capital will be attributed to a UK branch for tax purposes based on the amount of capital that would be needed if the branch were an independent company.** This measure brings the UK tax system closer into line with established, international practice and will mean that UK branches pay a fair share of corporation tax which reflects the profits they make from activities carried out in the UK.

5.79 The Government has consulted those affected and interested parties on the practical details of implementation and legislation. Building on these discussions, the Government is now publishing updated, draft legislation and draft guidance. There will be further discussions with interested parties on the practicalities of incorporating existing interpretation and practice into this legislation. This will help to ensure a smooth and timely implementation, delivering certainty and consistency going forward.

North Sea tax regime

5.80 Budget 2002 introduced important changes to the North Sea tax regime to ensure that it strikes the right balance between encouraging long-term investment and providing a fair share of revenue derived from a national resource. Companies now pay a 10 per cent supplementary charge on North Sea profits and receive a 100 per cent first year allowance for capital expenditure in the North Sea. Budget 2002 also announced the Government's intention, subject to consultation, to abolish Royalty payments. **The Government has now consulted interested parties and has decided that Royalty payments will be abolished with effect from 1 January 2003.** This decision recognises the important contribution that mature fields can make to the future of the North Sea and will deliver a significant boost to companies investing in these fields.

Residence and domicile

5.81 Budget 2002 announced a review of the residence and domicile rules as they affect the tax liabilities of individuals. The residence rules determine an individual's liability to UK tax. People who are UK resident and domiciled pay tax to the UK exchequer on their worldwide income. Similar rules govern liability to inheritance tax. Those residents who are not domiciled in the UK pay tax on their foreign income and gains only when these are remitted to the UK. The Government values a dynamic and open economy, and supports the international interchange of skills and expertise. However, the current rules determining residence and domicile have developed over the past 200 years, are complex and poorly understood, and do not reflect the reality of today's more integrated world.

5.82 In Budget 2002 the Government set out the principles that would underpin any modernisation: the rules should be fair, clear, easy to operate and support the competitiveness of the UK economy. The Government welcomes the comments received in response to the Budget announcement, and invites further contributions to inform the ongoing work in this area. Since the Budget, the Government has been considering implications for the current rules of increasing international labour mobility, particularly among those with high skills, and is now taking further steps – described in Chapter 3 – to ensure that the UK economy can benefit from the expertise available in the growing global market for skilled labour. The Government has also looked at the interaction between increasing labour and capital mobility and the Government's commitment to creating a tax system which ensures that individuals make a fair contribution to investment in public services. Building on this work, the Treasury and the Inland Revenue will assess how the current rules work in practice, and will publish a background paper to aid discussion of how the rules compare with the Government's principles.

Bingo

5.83 Following the success of its reforms to general betting duty and pools betting duty, when the Government replaced tax on players' stakes with a tax on betting companies' gross profits, Budget 2002 announced that the Government would consider the scope for extending the gross profits model to the taxation of bingo. A consultation exercise formally ended on 31 October, and the proposal has received widespread support from the bingo industry. The Government will now examine, in consultation with the industry and players, the detail of how a gross profits tax can work, with a view to announcing changes to the taxation of bingo in Budget 2003.

Tackling tax abuse

Tackling tobacco smuggling

5.84 Tobacco smuggling undermines the Government's health objectives and involves serious and widespread criminality. In March 2000, the Government launched a new strategy¹⁵ for tackling tobacco smuggling, designed first to slow the upward trend in smuggling and subsequently put it into decline within three years. The strategy included a target for 2001-02 to hold the share of the UK cigarette market taken up by smuggling to 22 per cent.

5.85 The initial success of the strategy has been maintained in its second full year. Almost 2.6 billion cigarettes destined for the UK market were seized in 2001-02, and more than five billion have been seized in the first two years of the strategy. HM Customs and Excise investigators have also broken up 60 major organised crime gangs involved in smuggling huge volumes of illicit cigarettes.

Tackling cross-Channel smuggling

5.86 Without any action, the share of the UK cigarette market taken up by smuggling was forecast to have reached 31 per cent by 2001-02. As a result of the Government's strategy, the smuggled market share has instead been held at 21 per cent. While the Government remains concerned about the level of tobacco smuggling, it welcomes the fact that the strategy has succeeded in stopping the growth in the share of the market taken up by smuggled cigarettes for the first time since records have been maintained.

Tackling VAT losses

5.87 The strategy has also succeeded in reducing the revenue evaded annually through smuggling of alcohol and tobacco by cross-Channel passengers from £1.5 billion to £290 million. To reinforce action against smugglers, protect the rights of honest shoppers, and make clear the distinction between the two, the Economic Secretary to the Treasury announced on 29 October the second stage of the Government's strategy, details of which are set out in *Protecting indirect tax revenues*, published alongside this Pre-Budget Report.

5.88 **The Government now intends to apply its approach to tackling tobacco and other excise duty fraud to tackling leakages of revenue in the VAT system.** VAT revenue losses have their origins in a wide range of non-compliance problems, from organised criminal fraud and abusive tax avoidance schemes to mistakes made by businesses when compiling and submitting tax returns. The Government's new strategy, set out in detail in *Protecting indirect tax revenues*, will:

- increase the pressure on 'missing trader' VAT fraud, by speeding up the identification and challenge of suspect traders;
- increase the number of challenges brought against abusive VAT avoidance schemes; and
- combine enhanced support, education and advice for compliant and newly-registered businesses with a range of specific measures to target businesses which choose not to comply or which fail to register when they should.

¹⁵ *Tackling tobacco smuggling*, HM Customs and Excise and HM Treasury, March 2000.

5.89 The strategy will seek to stop the long-term growth in the percentage of VAT that goes uncollected, and by 2005-06 reduce it to 12 per cent, the level seen ten years ago. The measures in the strategy are designed to produce more than £2 billion per year in additional revenues by 2005-06. This is the Government's aim, but in line with the audited, cautious approach underlying the public finances a lower figure of £1.4 billion a year by 2005-06 has been included in the public finances forecast. Further details are set out in Annex B.

Tackling unfair tax avoidance

5.90 As well as acting to prevent illegal smuggling and fraud, the Government is also committed to closing loopholes in the tax system which allow some people to avoid paying their fair share of tax, increasing the burden on other taxpayers and giving those who use avoidance schemes an unfair advantage. The Pre-Budget Report announces further steps, to be implemented immediately, including:

- **measures to counter the avoidance of tax and national insurance contributions through the abuse of Employee Benefit Trusts.** Chapter 3 gives details of a new statutory corporation tax deduction that will provide tax certainty for those companies using employee share schemes to encourage productivity;
- **legislation to prevent businesses claiming accelerated allowances** on investment in industrial buildings by entering into artificial transactions;
- **changes to the controlled foreign companies rules** to close a loophole that allows some companies selling extended warranties, credit protection policies and similar products to UK customers to escape UK taxation on the profits; and
- **action to prevent companies avoiding the payment of VAT on the sale of freehold buildings.**

INTERNATIONAL POVERTY REDUCTION

5.91 As well as tackling poverty at home, the Government is playing a leading role in international efforts to fight global poverty and achieve the Millennium Development Goals (MDGs). The MDGs are global targets for 2015. They include halving the proportion of people living in extreme poverty, reducing child and maternal mortality, the achievement of universal primary education, and the reversal of the spread of HIV/AIDS, malaria and other killer diseases.

5.92 The Government believes that fulfilment of the MDGs requires a new deal for the global economy, with all countries meeting their shared obligations:

- developing countries accepting their primary responsibility for their own development, through good governance and policies that favour growth and investment and meet the basic needs of their people; and
- developed countries recognising that international support through open markets, reforms to improve aid effectiveness and significant increases in aid flows for poverty reduction are needed alongside the best efforts of the developing world.

Trade 5.93 Under this new deal, all countries must recognise that international trade, properly managed, is essential to increase prosperity and reduce global poverty to meet the MDGs. Full global trade liberalisation could lift at least 300 million people out of poverty by 2015. The Government is committed to making trade work for developing countries, and to ensuring that any trade liberalisation is properly sequenced, with development concerns fully taken into account.

5.94 The Government continues to work for implementation of the commitments agreed at the World Trade Organisation's Doha Ministerial meeting in 2001. These include measures to build the capacity of developing countries to engage effectively in the world trading system and to improve market access for poor countries. The Government will also continue to press for significant reform of the European Union's Common Agricultural Policy in the present Mid-Term Review. This is especially important as developed country subsidies to agriculture amount to one billion dollars a day – seven times the level of overseas development assistance.

Improved aid 5.95 The Government is proposing a new international compact to improve the quality and poverty focus of aid. There are significant potential gains to be had from better use of the existing \$50 billion of annual aid flows. In particular, reform and better allocation of poor quality aid could make it 50 per cent more effective in reducing poverty. Reforms should include a refocusing of EU assistance on poorer countries, implementation of the European Commission's proposals on untying aid, and the development of stringent codes and standards that permit more rigorous scrutiny of the quality of bilateral aid programmes.

5.96 Such a compact would enable aid to be committed in a predictable way and over the longer term and so provide better value for money. It can be used much more effectively by developing countries – for example, to reduce poverty through long-term investment in health and education. Higher aid volumes are also needed to secure economies of scale and the additional gains from investing across several sectors simultaneously. This approach requires greater coordination between donors, and better harmonisation of the activities of international institutions and the Regional Development Banks in the poorest countries. Crucially, it provides the right incentives for developing countries themselves to fulfil their responsibility to improve governance and implement sound policies.

5.97 As part of this new compact the Government would be prepared to submit its own programme to an internationally agreed new scrutiny process. The Department for International Development (DfID) has already introduced long-term financing frameworks in several countries. By 2005-06, 90 per cent of the UK's bilateral aid resources will be spent in low-income countries where research shows it can be used best. Last year the Government untied 100 per cent of its aid, and now provides more aid through direct budget support. The UK is seeking to work more closely with bilateral and multilateral donors to reduce transaction costs in aid for developing countries.

5.98 The 2002 Spending Review increased the UK's aid commitments to developing countries from 0.32 per cent of national income in 2002-03 to 0.4 per cent by 2005-06. This represents the largest ever increase in UK aid, and a near doubling in real terms since 1997, underlining the Government's commitment to the UN target of 0.7 per cent. It fulfils the UK's obligation under the EU's commitment to reach an aid ratio of 0.39 per cent by 2006.

Box 5.3: International Financing Facility

The World Bank and the United Nations estimate that an additional \$50 billion in aid from the international community will be needed each year if the MDGs are to be achieved by 2015. The significant increases in aid pledged by the EU and US in March 2002 could total \$12 billion by 2006 and will make an important contribution to meeting the MDGs. However, they still fall far short of what is required.

To bridge the gap between what has been pledged and what is required, the Chancellor has proposed a new \$50 billion International Financing Facility (IFF) to leverage pooled resources to finance the investment needed. This facility would capitalise on long-term commitments from donors, and leverage additional financing through the issue of development bonds on international capital markets. Additional aid could then be disbursed in the form of grants and concessional loans to developing countries.

The commitment by donors to provide additional funding to 2015 and beyond, would allow a commensurate commitment in aid flows over the longer term to developing countries, and avoid the short-term volatility that is so damaging to investment planning and development spending. Crucially, developing countries would be able to budget for substantially higher aid flows over the medium term to tackle poverty. An IFF would also promote a balanced distribution of resources and coordination between donors.

The Government stands ready to provide the clear long-term commitment to developing countries that is needed. But full international cooperation is essential. To build global support and consensus, the Government will shortly be publishing a new prospectus for the IFF, setting out the key features of the Facility and outlining the steps that the international community must take to ensure that the MDGs are achieved.

Debt relief 5.99 The Government continues to be a leading advocate of debt relief through the Heavily Indebted Poor Countries (HIPC) initiative. Twenty-six countries will benefit from debt relief worth \$62 billion already committed under the initiative, reducing their debt payments by around \$1.3 billion each year. The UK stands ready to cancel £1.9 billion of debt in total and is already providing 100 per cent debt relief to those countries that have demonstrated a commitment to poverty reduction. The Government has also pledged \$375 million to multilateral institutions to support the HIPC initiative.

5.100 Debt relief must however lead to a sustainable exit from indebtedness. The Government believes that the provision of debt relief at Completion Point should be flexible and take account of exogenous shocks, such as reduced export earnings resulting from falls in commodity prices. At the Annual Meetings of the World Bank and IMF in September, the Government helped to secure agreement to the need for additional funds, of up to \$1 billion, to ensure that the HIPC initiative provides a robust exit from unsustainable debt. The Government is ready to contribute its full share of up to \$120 million.

Africa 5.101 This year the Government has made Africa a high priority. At the G8 Summit in June, the Government endorsed a New Partnership for Africa's Development, a common vision that the prime responsibility for Africa's future lies with Africa itself, and that a new outlook will require a strong commitment to reform and sustained political leadership. In turn, developed countries must share the benefits of globalisation, ensuring Africa can benefit from the opportunities it provides. The 2002 Spending Review established, for the first time, a £1 billion annual bilateral programme for Africa by 2005-06.

Universal primary education **5.102** The Government is working closely with other countries to ensure that every child has access to primary education. Today, 113 million children – 75 million of them in Commonwealth countries – have never been to school. Since 1997, DfID has committed over £700 million to help to deliver universal primary education in developing countries. The Government will expand this support by a further £1.3 billion over the next five years, with the objective of assisting developing country governments to place an extra 20 million children into school by 2006. To provide strategic support to the goal of universal primary education in the Commonwealth, the Government has also launched a new Commonwealth Education Fund. The Fund is chaired by the Governor of the Bank of England and managed by Action Aid, Oxfam and Save the Children Fund. The Government will match pound-for-pound, including tax relief, contributions from business and Comic Relief's Sports Relief in 2002.

Tackling the diseases of poverty **5.103** Every year almost 6 million people die from HIV/AIDS, malaria and tuberculosis. To step up the fight against these diseases, the Government has played an influential role in establishing a new international Global Health Fund. International commitments to the Fund now stand at \$2.1 billion, of which the Government has so far pledged \$200 million over five years. Since 1997, DfID has also agreed new bilateral commitments worth over £1 billion to help strengthen the capacity of health systems in poor countries.

5.104 To reinforce this work, Budget 2002 introduced a new tax measure to encourage research and development (R&D) into vaccines and medicines for the prevention and treatment of specific diseases threatening lives in poor countries. The credit extends existing R&D incentives, providing 50 per cent relief on qualifying expenditure. The Government is also seeking to encourage responsible donations of medical supplies and equipment to developing countries, by allowing companies to deduct from their taxable profits the cost of donations made for humanitarian purposes.