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MEETING THE PRODUCTIVITY CHALLENGE

Productivity growth underpins strong economic performance and sustained increases in living standards. The Government's long-term goal is that Britain will achieve a faster rate of productivity growth than its main competitors. In the modern global economy, faster productivity growth demands new flexibility in product, capital and labour markets, with government, firms and individuals able to respond quickly and adapt rapidly to change. Were the UK to join EMU, flexibility would be even more important to ensure that economic shocks could be managed and economic strength maintained. Building on reforms to the competition regime and the support for businesses already introduced, Budget 2003 sets out the further steps the Government is taking to strengthen the drivers of productivity growth, including:

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

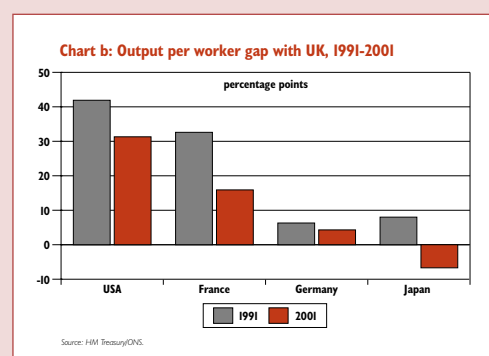
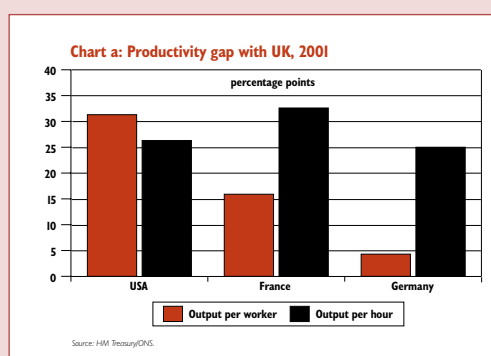
PRODUCTIVITY IN A FLEXIBLE ECONOMY

3.1 Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance and rising living standards. The UK has historically experienced low rates of productivity growth by international standards, as macroeconomic instability and market failures restricted competition, enterprise and innovation, and discouraged long-term investment in capital and skills. The Government's goal is to raise the sustainable rate of UK productivity growth through greater flexibility in product, capital and labour markets.

Box 3.1: The productivity challenge

Productivity is a measure of how effectively an economy uses resources to generate outputs. The Government's central measure of productivity is output per worker, a measure that is both relatively straightforward to quantify and is directly related to the Government's objective of raising the economy's trend rate of growth.

Latest estimates show that, on this measure, US productivity is 31 per cent higher than in the UK, and that productivity in France and Germany is 16 per cent and 4 per cent higher respectively. Measured in terms of output per hour, the gap with the US narrows to 26 per cent, while that with France and Germany widens to 33 per cent and 25 per cent respectively. The difference between the per worker and per hour measures of productivity partly reflects the fewer hours worked and longer holiday entitlements in France and Germany¹. However, lower participation rates also explain the gap between living standards in Europe and the US. While employment rates in the UK are similar to those in the US (71 per cent and 73 per cent respectively in 2001), they are substantially lower in both France (62 per cent) and Germany (66 per cent)².



Raising productivity growth is a long-term challenge, and so it is important to consider international trends over time. Chart (b) illustrates how the UK has performed over the last decade in comparison with other major economies. The gap relative to France, Germany and the US has narrowed, but Japan now has a productivity gap of 7 per cent with the UK.

International comparisons of productivity are very sensitive to statistical revision. Following Census 2001, the Treasury has estimated (as shown in the charts above) the impact of the latest ONS population estimates on the output per worker figures. Recent revisions to GDP figures and to Purchasing Power Parities have also led to a reduction in the estimated productivity gap with the G7. These indicate that the UK's productivity gap with the US is 7 per cent lower than estimated in the Pre-Budget Report, while the gap with Germany is 5 per cent lower and that with France 1 per cent higher.

¹ OECD figures show that average annual hours worked by people in employment in 2001 were 1,821 in the US, 1,711 in the UK, 1,532 in France and 1,467 in Germany.

² Figures are taken from the 2002 OECD Employment Outlook.

3.2 The Government is pursuing a wide-ranging strategy to tackle the barriers to productivity growth. This strategy involves maintaining macroeconomic stability to help businesses, individuals and the Government plan effectively for the long term, and implementing microeconomic reforms to remove the barriers that prevent markets from functioning efficiently.

Productivity and flexibility 3.3 In the modern global economy, faster productivity growth demands new flexibility in product, capital and labour markets. With global markets for business, investment and skills, it is important that governments, individuals and firms are able to respond quickly and adapt rapidly to change. Failure to do so risks an unproductive use of resources, with long-term costs to growth, employment and prosperity.

3.4 Flexible product markets help firms respond effectively to economic shocks and take advantage of competitive opportunities, ensuring high levels of output and maintaining employment. The Government is committed to sharpening the UK's competitive business environment and improving opportunities for entrepreneurship. Flexible capital markets play an important role in ensuring an efficient allocation of capital for investment, supplying capital for new business opportunities and helping to stabilise the economy in response to shocks – roles that would be increasingly important were the UK to join the single currency. The Government is further strengthening the flexibility of capital markets through its actions to modernise financial regulation and to improve financing options for investment and new business.

3.5 Were the UK to join EMU, these flexibilities would be even more essential, as the ability to adjust interest rates and exchange rates would no longer be available at a national level. In such circumstances, the labour, product and capital markets would need to respond dynamically so as to enhance the economy's resilience to shocks without putting at risk high and stable levels of growth and employment. A sufficient level of wage flexibility is vital to eliminate imbalances between supply and demand; relative price adjustments are a particularly important adjustment mechanism to allow changes in competitiveness between countries; and a flexible and integrated capital market can provide the financial instruments that help consumers and firms stabilise their consumption following a shock. The importance of flexibility in the UK and in the EU is considered further in the preliminary and technical work that underpins the assessment of the five economic tests.

3.6 The Government's programme of microeconomic reform seeks to address this challenge, improving the flexibility of markets and equipping people to master change. It focuses on historic weaknesses in five key drivers of productivity performance:

- enhancing **competition** to improve flexibility in product and capital markets and promote greater business efficiency and consumer choice;
- promoting **enterprise** by removing the market barriers that deter entrepreneurship and prevent new firms from developing and growing;
- supporting **science and innovation** to harness the potential of new technologies and to promote more efficient ways of working;
- improving **skills** among young people and the adult workforce to generate a flexible and dynamic labour market; and
- encouraging **investment** and better investment decision-making through stronger local and national capital markets.

3.7 In addition to the range of measures set out in Chapter 4 to promote a flexible and more dynamic labour market, this chapter describes the Government's work to strengthen product and capital markets and to improve levels of skills throughout the workforce.

Working with the CBI and TUC 3.8 While government has a key role to play in supporting productivity growth, it must work together with employers, employees and trades unions to close the productivity gap. The CBI and TUC have continued to work closely with the Government in identifying practical steps on a range of issues, and the Government has taken significant steps to

implement their recommendations, including through support to address basic and intermediate skills shortages and to improve the UK's innovation performance. Following further joint working in recent months, Budget 2003 includes further measures to increase access to finance and training for small and medium-sized enterprises (SMEs), improve the operation of research and development (R&D) tax credits, and extend the current round of Employer Training Pilots.

3.9 Looking forward, the Government will continue to work with the CBI and TUC to promote productivity growth through policies designed to:

- improve the environment for business investment and promote venture capital investment throughout the UK;
- support small and growing business and an entrepreneurial culture, especially in areas of high unemployment;
- stimulate innovation and R&D across the economy;
- increase flexibility in the economy, by tackling regulation and helping the labour market to respond more quickly;
- develop a longer-term view of government procurement; and
- raise skills levels, through further evaluation of Employer Training Pilots and enhanced Modern Apprenticeships.

Productivity and flexibility in the regions

3.10 To ensure that the benefits of improved productivity are spread throughout the country, measures to raise productivity growth and promote flexible markets should also be focused at the regional or sub-regional level. The Regional Development Agencies (RDAs) are the strategic leaders of economic development and regeneration in the regions, and have an important role to play in implementing the Government's productivity strategy. To benefit from their regional perspective, the Treasury asked the Agencies to provide advice on policy relating to enterprise, innovation, regulatory reform and skills, in preparation for this Budget. Among issues raised by the RDAs were proposals to promote entrepreneurship in schools, improve opportunities for SMEs in public sector procurement, work with the Government to consider how the regulatory burden on small firms can be minimised, and create flexibility at a regional level to meet employers' skills needs. Budget 2003 announces further measures which respond to the issues raised. The Treasury will discuss with the RDAs how to further enhance their input into future Budgets.

3.11 As announced in the 2002 Spending Review, pilots in selected regions are currently providing the RDAs with a wider leadership and management role in driving forward economic development and increasing flexibility in regional markets. The pilots, which will last for two years, involve two RDAs in the management and coordination of business support services at the regional level and three RDAs in the management of regional funding for post-19 training. The North West Development Agency is conducting a joint pilot of both activities.

European economic reform

3.12 Faster productivity growth in the UK depends on economic reform in Europe, as well as at home. A more flexible, dynamic and open Europe will increase employment, fairness and growth, and will promote and facilitate the UK's efforts to boost its own productivity and economic performance. While the EU has made progress in delivering reform¹, there is much more to do. EU enlargement, monetary union, global economic uncertainty, and an ageing and contracting workforce all demand renewed effort to deliver stronger and more flexible EU markets. The Government's priorities on the European reform agenda include:

¹ Set out in *Meeting Europe's potential: economic reform in Europe*, HM Treasury, February 2002, and *Meeting the challenge: economic reform in Europe*, HM Treasury, February 2003.

- the development of modern social policies that promote skills, employment and labour market flexibility;
- better implementation and enforcement of improved regulation;
- a stronger and more effective competition policy that proactively seeks to raise competition rather than just react to cases;
- a modernised state aids regime and regional policy; and
- work to deliver a single market for services, including progress on the Financial Services Action Plan.

3.13 Achieving the goal of higher productivity and employment requires each EU country and region to realise its full potential. In most cases, decision-making and delivery should be devolved and decentralised as far as possible, while maintaining clear accountability and coordination. The EU must support this, for example, by ensuring that the state aids rules and their implementation support economic growth at the national and regional level.

3.14 The momentum of reform must be increased to generate a more efficient allocation of resources across Member States and regions, and to ensure that increased prosperity is delivered across an enlarged EU. On regional policy, the Government believes these goals could best be achieved through its proposed EU Framework for Devolved Regional Policy², and is currently consulting on whether this should form the basis for a UK position in the debate on the future of Structural and Cohesion Funds.

3.15 Efforts to improve the flexibility of product and capital markets should not stop at the EU's borders. A more flexible and dynamic Europe will be better placed to contribute to the strength and resilience of the global economy, and could play a greater role in breaking down barriers to trade and investment in the rest of the world. The EU must make every effort to ensure that trade negotiations, in the context of the World Trade Organisation Doha Development Agenda, are completed to schedule by 2005. Further work is also needed to deepen the world's largest bilateral trade and investment relationship – that between the EU and US. Strengthening the transatlantic alliance, by further liberalising trade in goods and services, would do much to benefit consumers in both Europe and the US.

Public services productivity **3.16** As well as creating the right environment for improved productivity in the private sector, the Government is also striving for greater efficiency in the public sector. The performance of the public sector is a major determinant of the productivity of the economy as a whole. Strong health and education systems and an integrated transport network lay the foundations for an enterprising and high productivity economy, by producing a healthier, better skilled and more mobile labour force. The Government's approach to public service reform is described in Chapter 6, and in *Public Services: meeting the productivity challenge*, published alongside the Budget.

COMPETITION

3.17 Competition is central to the creation of flexible product and capital markets, and is an important driver of productivity performance. Competitive markets provide incentives for firms to respond quickly to changes in technology and costs, to adopt more efficient ways of working, and to develop new products and services that meet the demands of consumers. This is essential if businesses are to take full advantage of the opportunities offered by the European Single Market and by free and open trade.

²A modern regional policy for the United Kingdom, HM Treasury, Department of Trade and Industry and Office of the Deputy Prime Minister, March 2003.

The competition regime

3.18 The Government has taken significant steps to ensure that the UK competition regime ranks among the best in the world. Over the next six months, implementation of the Enterprise Act will further strengthen the competition regime by giving full independence to the UK competition authorities, creating a new proactive role for the Office of Fair Trading (OFT), and allowing criminal sanctions to be imposed on those engaging in hard core cartels. The OFT has now appointed its Board and is currently consulting on how best to run its mergers investigation regime.

Consumers 3.19 Following radical improvements to the UK competition regime, the challenge now is to develop an equally effective consumer regime that empowers and protects consumers, boosting competition and enhancing productivity. Consumer protection enforcement has been strengthened by the introduction of Stop Now Orders in 2001 and, from June 2003, their extension in the Enterprise Act. From summer 2004, the rollout of *Consumer Direct*, a new nationwide telephone and internet advice service, will further empower consumers.

3.20 A major international study to benchmark the domestic consumer regime in relation to the UK's main competitors is now reaching its completion, and the Department of Trade and Industry (DTI) intends to publish its findings in the summer. Following this study, **the DTI will review, jointly with stakeholders, the objectives of the consumer regime, and how these are delivered through the existing statutory framework, consumer education and information, redress mechanisms and enforcement.** The Government's goal is to ensure that the UK has one of the best consumer and competition regimes in the world by 2006.

Promoting competition in specific markets

3.21 The OFT is successfully promoting competition in specific markets. Four market studies – on pharmacies, private dentistry, consumer IT services and extended warranties for electrical goods – have already been completed. Further studies on taxi services, estate agents and doorstep selling are ongoing. The studies on private dentistry and doorstep selling were both launched in response to super-complaints by consumer organisations.

Pharmacies 3.22 The OFT report on pharmacy entry licensing was published in January 2003. The report recommended that regulations currently controlling entry to the pharmacy market should be lifted to increase competition. The Government welcomes the OFT's analysis and agrees that the present regime governing the pharmacy market should be updated. As the OFT noted in their report, a more competitive environment might necessitate additional targeted measures to ensure that patients in all areas are able to access essential pharmacy services. In formulating its response to the OFT's report, the Government will therefore aim to develop a balanced package of measures to promote competition, new entry into the market and increased choice for consumers, alongside support for wider social and health policy objectives. **Proposals for reform of the pharmacy market will be developed before the summer recess, and a report on progress will be published at the end of June.** All subsequent changes will be subject to full consultation.

The professions 3.23 Following the OFT's report on competition in the professions, the Government remains determined to remove all restrictions, where these do not clearly benefit the consumer or the public, on providing legal services, and to improve the regulatory framework. The Government will announce shortly its conclusions on opening up the probate and conveyancing markets and on allowing new business structures such as multi-disciplinary partnerships. **The Government will announce shortly details of the review of what currently appears to be an outmoded, over-complex and in some ways ineffective regulatory framework. In addition, the Lord Chancellor has announced that he intends to consult no later than the end of July on whether the status of QC should continue to exist and if so the method of appointment.**

- Private dentistry 3.24** The Government welcomes the OFT's report on private dentistry. The report highlights the lack of information provided to consumers, including insufficient price transparency. It also found a lack of compliance with professional guidance and inadequate complaints procedures, and identified a need for better and more effective self-regulation and regulatory restrictions on the supply of dental services.
- Payment systems 3.25** The Government looks forward to seeing the findings of the OFT's ongoing study of recent payment system developments, and will **introduce legislation to give the OFT new powers to promote effective competition in payment systems** as soon as parliamentary time allows.
- Energy 3.26** The Energy White Paper, published in February 2003, set out a long-term strategic vision to deliver environmental, social, economic and reliability of supply goals. Liberalised, competitive energy markets are key to the implementation of the Government's strategy. Liberalisation has already delivered lower gas and electricity prices, and increased competition has reduced the need for regulation, with price controls removed from domestic gas and electricity supply in April 2002. The Government is now extending the New Electricity Trading Arrangements to the Scottish market, to create a wholesale electricity market across Britain. British Electricity Trading and Transmission Arrangements, which will be implemented by April 2005, will ensure that Scottish customers receive the benefits of a competitive market aligned with that elsewhere in Britain, while helping independent generators to get their power to market.

Box 3.2: Strengthening EU product markets

Deepening the Single Market promotes product market flexibility by removing barriers to trade, increasing competition and expanding the variety of goods and services on offer. However, further action is needed to strengthen EU product and service markets so as to deliver greater flexibility and dynamism to businesses and consumers. In a single currency, flexible product markets are vital to ensure that the economy is responsive and that shocks do not have lasting effects. The Government's priorities include:

- a more proactive European competition regime, with investigation of markets which may not be working properly and in which the full benefits of competition may not be felt by consumers;
- steps towards more rigorous assessment of EU regulation and a lighter touch approach to new legislation, especially as it affects small firms. The Government will press for an assessment by the European Commission of the impact of regulation on competition and small businesses;
- modernisation and simplification of the state aids regime to ensure that procedures are streamlined, market failures constraining productivity and employment are tackled effectively, and that the Commission and Member States focus their attention on the most significant state aids;
- measures to provide framework conditions more conducive to business investment in R&D, including high levels of competition and an effective intellectual property regime. The Government will also press for implementation as soon as possible, in a business-friendly manner, of the recently agreed Community Patent; and
- the development of a regional policy which generates a more efficient distribution of resources across Member States and regions. The Government believes that this can best be achieved through its proposed EU Framework for Devolved Regional Policy, and is consulting on whether this should form the basis of a UK position in the debate on the future of Structural and Cohesion Funds.

Water 3.27 Legislation to extend competition for non-household consumers using large quantities of water was introduced in February 2003. The Government expects further opportunities for competition to increase choice, promote efficiency and improve services.

Regulatory reform

3.28 Effective and well-focused regulation can play a vital role in correcting market failure, promoting fairness and ensuring public safety. However, unnecessary or poorly implemented regulation can be an obstacle to flexibility, restricting competitiveness and employment growth, stifling innovation and deterring investment.

Reducing regulatory burdens 3.29 The Government is taking forward a set of reforms to reduce the overall burden of regulation on business and the public sector:

- more than 500 specific deregulatory measures have been identified since February 2002, of which over a quarter have already been implemented. In future, **departments will be held accountable for their performance on deregulation through annual reporting, and their performance will be taken into account in the next spending round;**
- more business secondees will be brought into the Government's Regulatory Impact Unit to **examine regulatory burdens on the construction, transport and environmental service sectors**, and to propose measures to reduce them; and
- **the Construction Industry Scheme will be reformed in April 2005** to reduce the regulatory burden on construction.

Small business regulation 3.30 Over 99 per cent of all UK businesses are SMEs, generating more than 12 million jobs. While such firms are often hit harder by regulation than larger firms, well-targeted exemptions can ease their regulatory burden and, alongside specific tax measures, help to break down the barriers to business success.

3.31 The Small Business Service (SBS) recently published a comprehensive new guide³ to help entrepreneurs understand the regulations which apply to them and the range of government services available to help them. Budget 2003 builds on this support with **a package of deregulatory reforms to ease burdens on SMEs, including raising the company law definitions of small- and medium-sized companies to the maximum possible under EU regulations**. Legislation to establish the new definitions will be introduced as soon as the new EU maxima come into force⁴. As a result of this:

- all firms falling under the revised small company threshold will become subject to the existing less onerous accounting and reporting regime. The Government has also already announced its intention to introduce a simpler accounting regime for small companies in the *Modernising Company Law* White Paper;
- firms falling under the revised medium-sized company threshold will be eligible for the 40 per cent plant and machinery allowance; and
- firms also falling under the revised small company threshold will be eligible for the 100 per cent information and communication technology (ICT) allowance until it expires on 31 March 2004.

³ *The no-nonsense guide to Government rules and regulations for setting up your business*, Small Business Service, March 2003.

⁴ The current EU maximum threshold for small businesses is £4.8 million turnover and £2.4 million balance sheet total. This compares with current UK company law thresholds of £2.8 million and £1.4 million respectively. For medium-sized companies, the equivalent EU maximum figures are £19.6 million and £9.8 million, and under current UK company law are £11.2 million and £5.6 million.

3.32 The Government is currently reviewing the impact of the last increase in the statutory audit threshold, from £350,000 to £1 million, that benefited a further 150,000 companies, and **will be consulting in summer 2003 on the potential for further increases in the audit threshold, with a decision in time for the 2003 Pre-Budget Report. In addition, the National Statistician is taking further steps to minimise the survey compliance burden on businesses**, in particular through rationalisation of surveys, wider use of administrative data and greater use of new technology in data collection. To strengthen firms' input into this process and to ensure the most efficient use of data collected, the Office for National Statistics (ONS) will establish a Small Business Forum. **The Information Commissioner will also produce revised and simplified guidance on the Data Protection Act** – including material specifically tailored for small businesses – by the end of May.

Improving enforcement **3.33** The Government is currently consulting⁵ on how to improve and monitor the performance of local enforcement bodies. The Regulatory Reform Act provides the Government with a reserve power to set out statutory codes of practice in enforcement, and the Government stands ready to exercise this power should some continue to use over-zealous means of enforcement in contravention of the Enforcement Concordat.

Improving regulatory procedures **3.34** The Government has also taken steps to improve the quality and flow of regulation within the UK and the EU. New guidance requires policy makers in the UK to consider the regulatory impact of new initiatives, particularly on small businesses, and to give consideration to alternatives. The competition authorities have also been given new powers to challenge anti-competitive regulations and to increase their scrutiny of new and existing regulation, and the OFT has already provided competition advice to the Government on more than 100 proposed regulations. As described in Chapter 4, the Government has also adopted a set of twelve principles for intervention in the labour market.

3.35 Around 40 per cent of new legislation with a non-negligible impact on UK business originates in the EU. The Government believes that rigorous assessment of European regulation is essential and welcomes new EU assessment procedures currently being phased in, with 42 proposals to be subject to review this year. The Government will push for further improvements, including that assessments at European level should include review of the impact on small businesses and competition, and will press the Commission to adopt a lighter touch approach to legislation which affects small firms.

Public sector procurement **3.36** In the 2002 Pre-Budget Report, the Government welcomed the Competition Commission's recommendations⁷ to improve competition in procurement, and announced that the Office of Government Commerce (OGC) would consider steps to increase competition, and thereby value for money; and to encourage better long-term capacity planning, in markets where the Government possesses significant purchasing power. The OGC will be supported by a working group comprising the DTI, the SBS and the Treasury, and will report to ministers in the summer.

3.37 The OGC is also taking further steps to enable SMEs to compete for government contracts and deliver value for money. It has launched an internet portal⁶ to advise SMEs on access to government procurement, and has simplified the financial appraisal of suppliers to make it easier for SMEs to bid. In addition, the Better Regulation Task Force's report on reducing the barriers to SMEs in doing business with the public sector, will be published during May, and will propose further important steps including:

⁵ *Enforcement Concordat: Good practice guide for England and Wales*, Department of Trade and Industry, March 2002.

⁶ www.supplyinggovernment.gov.uk

⁷ *Group 4 Falck A/S and the Wackenhut Corporation: A report on the merger situation*, Competition Commission, October 2002.

- improving advice for SMEs to enable them to access public sector markets;
- working towards standard pre-qualification procurement documentation for lower value contracts across central and local government; and
- research by the OFT into markets where SMEs can have an important impact on competition, innovation and value for money in public procurement.

3.38 Where appropriate, the Government will ask the OGC, the SBS and the Local Government Procurement Forum to act on these recommendations.

ENTERPRISE

3.39 *Enterprise Britain*⁸, published alongside the 2002 Pre-Budget Report, described the role of enterprise in delivering growth and flexibility in a modern economy. Ambitious, enterprising businesses drive competition, support flexible and adaptable markets, and help to support sustainable regeneration and neighbourhood renewal in disadvantaged communities. However, rates of entrepreneurial activity in Europe are typically only half the levels in the US, and variations in start-up rates between regions are even greater.

Creating an enterprise society

Enterprise and education

3.40 There is strong evidence to suggest that cultural and social constraints inhibit enterprise activity in the UK. The Government shares the conclusion of Sir Howard Davies' review of enterprise and education, that efforts to build a deeper and wider entrepreneurial culture must begin in schools, and is now introducing a series of measures, including:

- **£16 million over two years to fund Enterprise Advisers** to work alongside headteachers in around 1,000 secondary schools in deprived areas to encourage enterprise practice among teachers and pupils. These advisers will be funded from existing Learning and Skills Council resources and accessed through the network of Education Business Links Consortia;
- **pilots to investigate how best to provide pupils with five days of enterprise experience in their school career.** The pilots will begin in 2003 and cover around 250 secondary schools, including a number of schools in Enterprise Areas. Rigorous evaluation of these pilots will inform a national roll-out from 2005-06; and
- **the establishment of a new £1 million Enterprise Promotion Fund,** to support private and voluntary sector creativity in promoting enterprise awareness across schools, business and the wider non-business community. The Fund will offer resources to projects meeting specific enterprise objectives and demonstrating significant private sector support.

3.41 More people between the age of 16 and 25 years consider starting up in business than in any other age group. To meet the aspirations of young people, the Government will consider establishing a National Council for Graduate Entrepreneurship to act as a central information source for students and graduates considering starting up in business. The aim of the Council would be to engage career advisors, academics, institutions and organisations to promote and facilitate self-employment as a viable career option, including through promotional shows, networking events and mentoring opportunities.

⁸ *Enterprise Britain: a modern approach to meeting the enterprise challenge*, HM Treasury and the Small Business Service, November 2002.

Supporting business and entrepreneurship

3.42 The Government has introduced a series of reforms to create a fertile business environment and enhance the UK's position as an internationally competitive location for business. Budget 2003 describes further steps to ensure businesses in the UK are able to develop, grow and compete effectively in global markets.

Supporting small business training

3.43 Research shows that businesses that obtain training and advice are more likely to succeed than others. Given their important role in communicating support to small businesses, **the Government will work in partnership with high street banks to develop a new package of training and support for SMEs.** The package will use the banks' existing communication networks to stimulate demand for advice and training, and make entrepreneurs more aware of their benefits. It will also include a one-stop web-based training directory to raise awareness of public and private sector training opportunities and provide access to on-line counselling and mentoring services. A steering group, chaired by Sue Brownson, chief executive of Blue Bell BMW and a member of the Small Firms Council, will oversee the management and development of the support package. The group will include banks, the SBS, Ufi/learnirect, small business organisations, and a range of entrepreneurs, will oversee the management and development of the support package. Further details of how the Government intends to involve intermediaries in supporting SME development will be set out in the Skills Strategy, due to be published in June 2003.

Improving access to finance

3.44 While the majority of established businesses experience little difficulty in accessing the finance they need to fulfil their potential, the same is not true for new businesses in need of start-up funding or those seeking modest amounts of risk capital to finance rapid growth. Problems also tend to be more acute for businesses operating in disadvantaged communities. Flexible capital markets that work for small businesses in all localities are vital to support enterprise, job creation and growth.

3.45 The Government has taken a number of steps to help new and growing businesses access appropriate finance. Regional Venture Capital Funds will invest up to £270 million in growing SMEs across the country, and eight of the nine funds are now up and running. For businesses requiring debt finance, **eligibility for the Small Firms Loan Guarantee (SFLG) has been extended, from April 2003, to previously excluded sectors including retail and catering.**

3.46 To complement existing measures, and to support an increased flow of new fund managers into the early-stage venture capital market, **the Government will now consult on the scope for introducing Small Business Investment Companies (SBICs) in the UK.** SBICs are recognised to be one of the most important drivers behind the growth of venture capital in the US in the late 1990s. A new consultation paper, *Bridging the finance gap: a consultation on improving access to growth capital for small businesses*, is published alongside this Budget.

3.47 The paper also explores options for targeting support on those businesses most affected by the equity gap through the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) tax incentives. The EIS and VCT schemes have played a significant and growing role in the supply of private equity funds in recent years. Views are also invited on how to ensure that the SFLG reaches its full potential, particularly in disadvantaged communities, and the paper considers the scope for increasing flexibility in the rules governing how past SFLG-backed borrowing affects entitlement to future SFLG-backed loans.

Demand for risk capital

3.48 Steps to increase the level of demand for risk capital are as important as those to improve its supply. Unlike the costs incurred in raising loan finance, which are tax deductible for companies, there is currently no tax deduction for the incidental costs of raising equity finance. The consultation paper therefore invites views on whether the current tax treatment presents a further obstacle to SMEs seeking to raise equity finance and, if so, how tax relief might be implemented in practice.

Box 3.3: The equity gap

While the UK has a well developed private equity market, smaller-scale investments in growth-oriented businesses suffer from a number of constraints. There are significant transaction costs involved in identifying suitable investment opportunities, and in undertaking the necessary investment appraisal. Furthermore, while venture capital investors often devote significant resources to monitoring the ongoing performance of their investments and to providing mentoring or other management support, these costs generally do not vary in proportion to investment size, and may therefore be prohibitive for smaller transactions. Evidence also suggests that some smaller businesses and their advisers lack a clear understanding of equity finance, and investors sometimes cite poor presentation or business plans as a constraint¹.

Chart a: Change in number of investments by deal size, 1997-2001

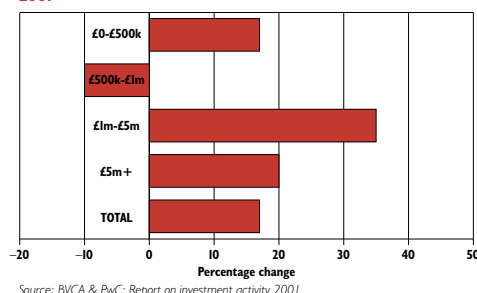
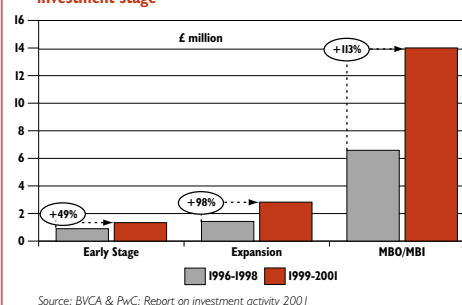


Chart b: Change in average venture capital investment size by investment stage



These constraints help to explain the existence of an equity gap, which appears to be particularly acute for investments of less than £1 million. Chart (a) shows that while the overall number of private equity investments has grown significantly in recent years, the number of investments of between £500,000 and £1 million has actually fallen. Only 8 per cent of private equity funds were directed towards start-up and other early-stage businesses in 2001² and, for any given stage of business development, the venture capital sector appears to have gravitated towards larger individual investments, as chart (b) shows. As a percentage of GDP, total early-stage investment in the US is more than twice as high as in the UK, and that in Canada is almost four times as high³.

¹ Designing an "investment ready" programme: some considerations, report to the Small Business Service, Mason, C. & Harrison, R, 2001.

² Report on Investment Activity, British Venture Capital Association, 2001.

³ OECD Venture Capital database, 1998-2001 data.

3.49 The SBS is currently running six 'investment readiness' demonstration projects which are providing intensive education to SMEs, to raise their awareness and understanding of the different financing options available and how best to access them. The Government will consider the results of these products carefully in determining how best to move forward in this area. One approach is to make more effective use of existing intermediaries. Accountants for example, provide advice to around two-thirds of SMEs. Recognising this, a joint Government/accountants working group is being set up under the chairmanship of Michael Snyder, chair of the Finance and Resources Committee at the Corporation of London, to explore how the quality of financial advice available to all growing SMEs could be enhanced further.

Modernising and simplifying VAT 3.50 The Government has already introduced a series of measures designed to help small and newly-registered businesses reduce their VAT compliance costs, improve their cash flow and manage their entry into the VAT system. Budget 2003 consolidates and enhances this support. From April 2003:

- **the VAT registration threshold will be increased in line with inflation from £55,000 to £56,000**, keeping the smallest businesses out of VAT and maintaining the UK threshold as the highest in the EU;
- **the optional VAT flat-rate scheme will be extended to businesses with turnover of up to £150,000**, as previously announced, meaning that more than 650,000 small firms can now benefit;
- **immediate entry into the annual accounting scheme will be extended to a further 15,000 businesses per year with turnover of up to £150,000**, allowing small businesses to make a single annual VAT return and to spread their VAT payments across the year; and
- **an incentive scheme will be launched to help small businesses trading above the registration threshold into the VAT system**. In return for maintaining high compliance standards, businesses will not face late-registration penalties and may be offered limited time to pay their outstanding VAT bills.

3.51 As well as reforming VAT for small and newly-registered businesses, the Government is also taking steps to modernise and simplify the VAT system for all businesses, including by:

- **allowing non-EU providers of electronically supplied services to register, account for and pay VAT electronically** to ease compliance burdens and maintain the UK as a world leader in e-commerce;
- **simplifying the VAT treatment of business gifts**, modernising the existing rules to reduce unnecessary compliance burdens; and
- **consulting on a package of measures to increase fairness in the recovery of input VAT**, including a simplified 'option to tax' on commercial buildings, and fairer rules on the recovery of VAT incurred on goods and services prior to registration.

3.52 Following a period of detailed consultation, Budget 2003 also **introduces from 1 December 2003 a simplified system for accounting for VAT at import**, allowing approved businesses to provide reduced or zero security against deferred VAT payments and offering up to £80 million in compliance savings. Budget 2003 also **introduces a system of civil penalties for minor breaches of customs law relating to the import and export of goods, and certain cases of evasion**, creating a level playing field for compliant businesses while retaining criminal punishments for serious offences.

Corporation tax 3.53 The Government has recently consulted⁹ on further reform of the corporation tax system to remove tax distortions to business decision-making, simplify and modernise the tax system, and ensure that the UK remains an attractive place for businesses to locate. The wide-ranging proposals explore the tax treatment of capital assets not covered by earlier reforms, rationalisation of the schedular system and the differences in the treatment of trading and investment companies. The Government has received a large number of

⁹ *Reform of corporation tax: a consultation document*, HM Treasury and Inland Revenue, August 2002.

responses from businesses and has held a series of discussions with specific sectors. **A further round of consultation will be launched in the summer, setting out the Government's strategy for taking forward the proposed corporation tax reforms.** The Government will consider the reform of corporation tax in its broader international and European context.

- Simplifying employee share schemes** **3.54** Employee share schemes provide employees with a real stake in the business they work for, promoting enterprise and productivity. The 2002 Pre-Budget Report announced simplified corporation tax rules for such schemes to encourage more companies to offer them to their employees. Budget 2003 builds on this reform with **new measures to simplify the Share Incentive Plan and modernise Save As You Earn and the Company Share Option Plan.**
- Capital gains tax** **3.55** To encourage entrepreneurial activity, the Government has introduced a generous capital gains tax (CGT) taper for business assets, reducing the effective rate of tax for a higher rate taxpayer to 20 per cent for assets held for one year and to 10 per cent after only two years, making the UK regime among the most favourable in the world. To improve access to property for unincorporated traders, the Government **will now extend business assets taper relief to property let to sole traders and a wider range of partnerships from 6 April 2004.** Building on the changes introduced last April, Budget 2003 also **further simplifies the CGT regime and reforms the CGT rules to ensure they operate more fairly in certain transactions in which the sale proceeds cannot be determined at the time of sale.**

Promoting enterprise in disadvantaged areas

- Enterprise Areas** **3.56** Entrepreneurial and business activity in disadvantaged areas is central to the sustainable regeneration of these communities. The 2002 Pre-Budget Report designated 2,000 Enterprise Areas on which measures to boost enterprise are being focused. These areas cover the most deprived communities across the UK, where social attitudes, the business environment and specific market failures can present significantly higher barriers to enterprise.
- Starting and growing a business** **3.57** To reduce the cost to business of locating and investing in disadvantaged areas, and to support the regeneration of brownfield sites, the Government has removed stamp duty from property transactions below £150,000 in the 2,000 Enterprise Areas. Following the receipt of EU state aids approval in January, **Budget 2003 announces that stamp duty will be removed from all non-residential property transactions in Enterprise Areas from 10 April.**
- Investing** **3.58** The Community Investment Tax Relief promotes private investment in enterprises in disadvantaged communities by offering tax relief to investors in Community Development Finance Institutions (CDFIs) which provide finance to businesses and social enterprises in deprived communities. Eleven CDFIs have now been accredited and enabled to raise around £35 million of new capital from private sector investors. Applications for accreditation from a further seven CDFIs are currently being considered.
- 3.59** The £40 million Bridges Community Development Venture Fund was launched in May 2002 and made its first investments at the end of last year. The Fund invests in businesses in disadvantaged areas that create local jobs, provide services to the local community or stimulate a local supply chain. **The Government is currently considering the scope for investing in a second community development venture capital fund.**
- 3.60** To encourage further business investment in Enterprise Areas, the Government is **considering how enhanced capital allowances for particular types of expenditure in these areas might be used to tackle specific market failures,** and the state aids aspects of any such measures.

Trading and employing **3.61** The comprehensive support for small businesses described earlier in this chapter, including the recently published *No-nonsense guide to Government rules and regulations*, will benefit thousands of new and growing businesses operating in deprived areas of Britain. The guide contains information on the extra support available in Enterprise Areas, to ensure that these firms are aware of it and can access it quickly. To build further on this support and tackle the higher barriers to enterprise in these areas, **HM Customs and Excise will improve its services to businesses in Enterprise Areas**, expanding the national programme of Business Advice Open Days to include a number of satellite events in Enterprise Areas. Two new types of enhanced business support provision will also be piloted in selected disadvantaged areas, complementing the assistance already available from Inland Revenue Business Support Teams and Employer Talk events. Around 1,000 employers have already attended these events.

Planning for deprived areas **3.62** The planning system must be transparent, accessible and affordable to businesses if they are to contribute to investment and development in deprived areas. The Government is working to identify a package of planning measures to help local authorities speed up and simplify the planning process in the most disadvantaged areas across the country. Legislation for Business Planning Zones, included in the current Planning Bill, will give local authorities the power to designate zones in which there is no requirement to apply for planning permission where predetermined criteria are met. Budget 2003 also announces that, in England, the Government will:

- **set aside resources from the Planning Delivery Grant to assist authorities delivering planning for Enterprise Areas, from 2004-05;**
- **encourage local authorities to use Local Development Orders in Enterprise Areas**, subject to forthcoming legislation, granting automatic planning permission for types of development specified in the Order; and
- **work with local authorities to ensure Enterprise Areas are effectively planned for in local plans.**

Enterprise at the local level

3.63 Productivity differentials are currently at least as great within regions as they are between them. A dynamic, high productivity economy requires greater flexibility in local markets and stronger local incentives to promote enterprise and encourage growth.

Local growth incentives **3.64** As described in Chapter 6, the Government is already offering greater freedoms and flexibilities to local authorities in return for commitments to deliver more stretching outcomes. To give a further boost to local growth and regeneration, as announced in the 2002 Pre-Budget Report, the Government also intends to **allow all local authorities in England to retain some or all of any additions to business rates revenues generated by increases in local business activity**. Amendments to the Local Government Bill have been introduced to provide the necessary primary legislation for the scheme. The precise details of the scheme are currently being considered and a series of options that balance simplicity, the distributional impact and the incentive effect are being developed. The Government will consult on these in the summer.

Urban regeneration **3.65** As announced in the 2002 Pre-Budget Report, to provide further support for regeneration and enterprise in many of Britain's urban areas, the Government has introduced a new tax incentive to encourage business donations toward the running costs of Urban Regeneration Companies (URCs), including those operating in Enterprise Areas. The tax incentive has been available since 1 April 2003 and allows businesses to deduct expenditure on contributions, whether in cash or in kind, towards the running costs of URCs when computing their taxable profits.

Enterprise in the EU

3.66 The European Commission published a consultative Green Paper on Entrepreneurship¹⁰ in January. While tax remains a matter for Member States, in keeping with the principle of subsidiarity, the Commission's initiative in other areas must now be translated into concrete reform. The Government is strongly supportive of action in a number of areas, including to ensure that the role of enterprise in delivering sustainable regeneration is reflected in the priorities of instruments such as the European Investment Fund Start-Up Facility.

SCIENCE AND INNOVATION

3.67 Innovation is an increasingly important source of productivity growth. New ideas generate products and markets, improve efficiency, and deliver benefits to firms, consumers and society. The UK has an excellent scientific research base, second only to the US in terms of the volume and influence of publications, but has historically been less effective than other advanced industrial economies at turning research outputs into innovations with commercial potential. The UK also has a relatively low overall level of industry-funded business R&D compared with industrial competitors, despite having high R&D intensity in particular sectors.

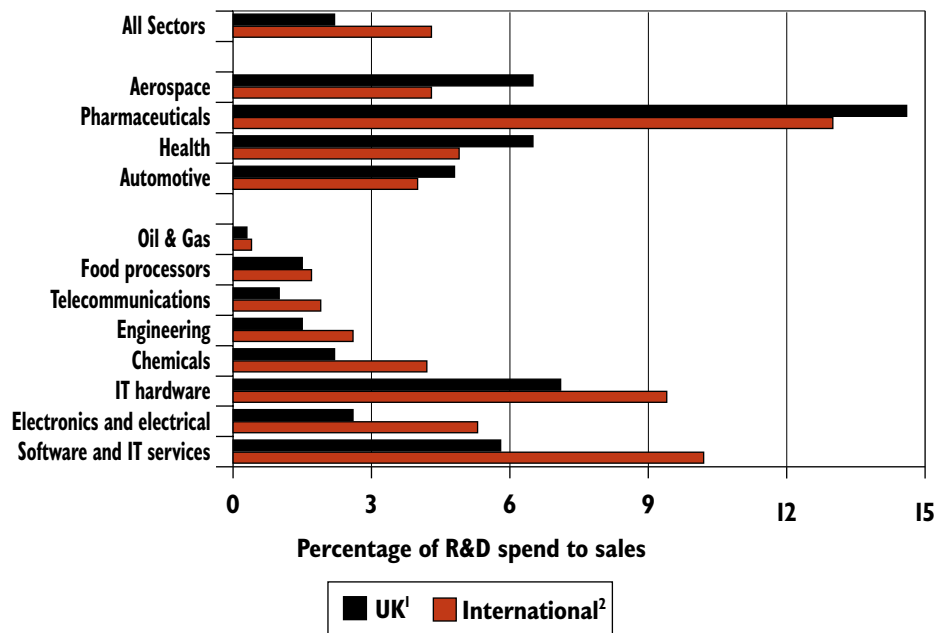
Science strategy **3.68** The Government's science strategy, *Investing in innovation*¹¹, was published in July 2002 and is now being implemented. Supported by the largest sustained increase in the Science Budget for more than a decade, the strategy sets out a comprehensive new approach to ensure that the UK remains competitive through investment in the UK's science base, improvements to the financial sustainability of university research and to the supply of science and engineering skills, and further steps to promote the translation of research into business innovation.

Research and development tax credits **3.69** To promote commercial R&D in the UK, the Government has introduced tax credits for SMEs and large companies. Introduction of the tax credits has been supported by a series of national roadshows designed to promote take-up and to provide a forum for exchange of views on the operation of the credits. The roadshows were attended by R&D businesses from across the country, and interest and take-up continues to increase. Around 3,000 claims for the SME tax credit for R&D activity carried out during 2001-02 are expected, leading to more than £150 million of support for innovative UK companies.

¹⁰ *Green Paper Entrepreneurship in Europe*, European Commission, January 2003.

¹¹ *Investing in innovation: A strategy for science, engineering and technology*, Department of Trade and Industry, HM Treasury, and Department for Education and Skills, July 2002.

**Chart 3.1: Research and development intensity by sector
Percentage of R&D spend to sales**



Source: DTI R&D scoreboard 2002

¹ UK covers the top 600 UK-based companies by R&D investment.

² International covers the top 600 international companies by R&D investment, of which 36 are UK companies.

3.70 The Government welcomes the useful feedback it received during the roadshows. Building on this feedback, **Budget 2003 introduces a series of reforms to improve the operation of the SME and large company R&D tax credits:**

- reducing the minimum expenditure threshold from £25,000 to £10,000;
- extending coverage of the credits to include the costs of agency workers and, subject to consultation on the definition, of advanced software;
- simplifying the rules for apportioning staff costs so that relief is still awarded for staff performing relatively small amounts of R&D; and
- additional steps to ensure that SMEs that are currently excluded from the credits are able to claim in future.

3.71 A new definition of R&D for tax purposes was introduced in 2000 under guidelines published by the Secretary of State for Trade and Industry. Since then, business interest in this issue has grown substantially, and **the Government will therefore consult on improving the definition of R&D to ensure that it remains consistent with technological developments and competitive internationally.** Any broadening of the definition would be subject to affordability, and the Government will consider the extent to which any changes might initially be limited to the SME scheme.

Scientific Research Organisations 3.72 As announced in the 2002 Pre-Budget Report, the Government is also reviewing the tax exemption for Scientific Research Organisations (SROs), to ascertain whether existing tax rules could be improved to allow SROs to undertake a wider range of R&D activities while still maintaining their current tax exempt status.

- Capital allowances for ICT** **3.73** Budget 2000 introduced temporary 100 per cent first year capital allowances for small businesses investing in ICT. The allowances provide a favourable and stable environment for businesses seeking to invest in technology that promotes greater efficiency and enables them to deal faster and more effectively with Government and other businesses. **Budget 2003 extends the allowances for one further year.** In future years, small employers will have financial incentives to organise their payroll via the Internet. The amendment to the company law definition of small businesses will increase the number of businesses eligible for the allowance.
- Knowledge transfer** **3.74** The Government is taking a number of steps to promote the translation of research into business innovation, including through the £187 million Higher Education Innovation Fund (HEIF). In the next round of the HEIF, for investment between 2004 and 2006, universities will be invited to present new strategies for building links with businesses, in particular SMEs, and RDAs will play an enhanced role in directing resources so that they contribute most effectively to regional economic growth. RDAs are also engaged in their own knowledge transfer initiatives to promote regional innovation. In support of this work, **the Secretary of State for Trade and Industry has asked Sir Tom McKillop, as chair of the first Regional Science and Industry Council, to work with the RDAs to ensure that best practice in promoting innovation and knowledge transfer is shared and spread rapidly between the regions.** The Government also continues to support the commercialisation of science and technology from Public Sector Research Establishments and NHS Trusts. Funding of £15 million will be allocated this year to help catalyse this activity, building on previous policy reforms and funding.
- DTI innovation review** **3.75** Building on the Government's science strategy and the growing level of resources for DTI innovation programmes, the Secretary of State for Trade and Industry has launched a wide-ranging review of business innovation and its contribution to UK productivity growth. The review will set out a clear strategy for improving the UK's comparative innovation performance across products, processes, services and business practices. It will report in summer 2003 on how to improve the effectiveness of innovation policies at both national and regional level.
- Review of business-university collaboration** **3.76** In the 2002 Pre-Budget Report, the Government commissioned Richard Lambert to conduct an independent review into how the long-term links between business and British universities can be strengthened to improve the UK's innovation and productivity performance. The review will focus on how business can best exploit the technologies and skills under development in the university sector, to the mutual advantage of both sectors. The review team are currently consulting widely with business, universities and national and regional administrations in the UK and overseas. The review will complement and feed into the DTI's innovation review, and will report to ministers in late summer 2003.
- Innovation and R&D in the EU** **3.77** Building on the call for the creation of a European Research and Innovation Area by EU leaders, in March 2002 the Barcelona European Council concluded that spending on R&D and innovation in the EU should increase to approach 3 per cent of GDP by 2010, with two-thirds of new investment coming from business. Achieving this target will require framework conditions conducive to business investment in research and innovation, including high levels of competition, accessible capital markets, appropriately skilled labour, and an effective intellectual property regime. The Government will press for these ideas to be taken forward in the Commission's forthcoming Action Plan on R&D and will also press for implementation as soon as possible, in a business-friendly manner, of the recently agreed Community Patent.

SKILLS

3.78 The quantity and quality of skilled labour in an economy are important determinants of economic performance and productivity growth, and the adaptability of the UK labour market is central to the flexibility of the economy as a whole. Skilled workers often adapt faster and more effectively to change, allowing firms to update products and working practices at the rate demanded by rapidly changing markets. International evidence suggests that the UK suffers from significant skills shortages, especially at the lower-intermediate level. To raise UK skills levels and increase productivity, the Government is therefore acting to improve the skills of young people entering the workforce and to increase the opportunities available to those already in the workforce to acquire new skills.

Skills Strategy 3.79 The Government is planning to publish a Skills Strategy in June 2003, setting a framework for action by government, individuals and employers to tackle deficiencies in the UK's skills base. The Strategy will propose measures to support employers facing barriers in raising skills levels, improve vocational opportunities for young people, engage more low-skilled adults in training, and make further education funding and qualification structures more responsive to the needs of the economy. The Strategy will also include the findings of a review of funding of adult learning, including proposals to ensure that the funding of further education provides incentives for individuals and employers to engage in training and to make training provision more responsive to the needs of the economy.

Developing the skills of young people

Primary and secondary education 3.80 The Government is determined to raise pupil attainment across the education system. Between 1997 and 2002, the proportion of 11 year-olds reaching expected levels in reading and maths rose by 12 per cent and 11 per cent respectively. The proportion of 16 year-olds achieving five A*-C grades at GCSE also rose, from 45 per cent in 1997 to 51 per cent in 2002.

3.81 Local and national policy is focused on the achievement of a range of targets to ensure that the education system meets the needs of all. Minimum attainment targets provide a framework within which local authorities and schools can exercise increased autonomy and freedoms in the provision of local education services. Reforms to the funding of Local Education Authorities will help to support increased local reforms, and the new Leadership Incentive Grant will help secondary schools in challenging areas to develop excellent leadership. The newly acquired ability for every school to benchmark its expenditures and outcomes against schools with a similar pupil intake is also strengthening local accountability and transparency, enhancing local decision-taking and serving to support existing inspection arrangements.

Modern Apprenticeships 3.82 Modern Apprenticeships (MAs) provide a nationally recognised programme of work-based training, understood by young people, their parents and employers. Since 1997, the number of young people participating in MAs has increased dramatically, from 76,000 to 220,000. The Government is now expanding the programme to meet the target that, by 2004, 28 per cent of 22 year-olds will have entered an apprenticeship, with plans that, by 2006, an estimated 320,000 young people will be participating in an MA.

3.83 A new employer-led National Modern Apprenticeship Taskforce was launched in February 2003. Chaired by Sir Roy Gardner, CEO of Centrica, the taskforce will seek to increase further the number of apprenticeship opportunities available for young people, and to ensure that the design of MAs meets the needs of young people and employers. In its first year, it will encourage more employers to provide MAs and increase the diversity of those who do, with a focus on smaller employers. The taskforce will also provide a number of sector reports, with an initial focus on the construction and retail industries.

Post-16 participation 3.84 As the UK moves towards a high-skilled economy, young people who leave formal learning at 16 are much less likely to gain long-term employment. Prior attainment is a key driver of post-16 participation in learning. Despite a marked increase in attainment at GCSE, more must be done to increase levels of participation towards those seen in comparable countries.

3.85 To increase the number of young people entering higher education or skilled employment, the Government intends to make the learning choices available to young people more appealing. **A working group, led by Mike Tomlinson, will report to Department for Education and Skills ministers in summer 2004 on work to strengthen the structure and content of full-time vocational programmes** and offer greater coherence in learning programmes for all young people throughout their 14 to 19 education. The review will make recommendations about a unified framework of qualifications that recognise different levels of achievement. The national roll-out of the Connexions Service and Education Maintenance Allowances (EMAs) will increase the support and guidance available to young people making the transition into post-16 education and learning. EMAs and the wider system of financial support for 16 to 19 year olds are discussed in Chapter 5.

Higher education 3.86 The January 2003 White Paper, *The future of higher education*, set out a range of proposals to widen participation in higher education and to ensure that universities are equipped to compete in the world economy, including:

- major improvements in the funding of research and knowledge transfer;
- measures to support participation by those from disadvantaged backgrounds; and
- a new Graduate Contribution scheme from 2006.

Improving workforce skills

3.87 While measures to increase the skills of young people will lay the foundations for long-term improvements in the UK's skills base, their effect will only be gradual. Two-thirds of today's workforce will still be in the labour market in 2020 and more than one-third have qualifications below level 2. An increase in the number of people participating in workplace training has been achieved through voluntary approaches. However, despite these efforts, they have not been sufficient given the scale of the problem. The Government is therefore seeking to develop policy that will help employers, individuals and government to better address this problem. It is the shared responsibility of government, employers and individuals to tackle this problem, recognising and addressing the barriers which prevent both individuals and businesses from taking up the training they need to develop and progress.

3.88 The case for helping individuals to acquire level 2 skills is particularly strong. Level 2 skills are both important in their own right and provide an essential platform for progression to higher skill levels. Evidence shows that market failures are particularly acute at level 2, and that adults who have reached this level are much more likely to undertake further training on their own initiative or to receive training from their employers and gain higher-intermediate level skills. The Government is therefore considering how best to focus resources on areas where the market failures are greatest, such as training for a first level 2 qualification.

Increasing the demand for training

3.89 Employer Training Pilots (ETPs), launched in September 2002 in six local Learning and Skills Council (LSC) areas, are exploring ways to counter the financial barriers, time constraints and information failures which currently exclude people and businesses from the training they need to develop and progress. Across the six pilots, firms offer low-skilled workers paid time off to train and the Government is testing the impact of subsidies to cover the costs involved, together with free training courses up to NVQ level 2, and information and guidance on training.

3.90 Initial results suggest that the pilots are successfully engaging firms and individuals with little prior involvement in training. Within the first six months of operation, 1,500 employers had joined the scheme and more than 5,600 employees had begun training towards a basic skills or level 2 qualification. The pilots are helping to tackle the particular barriers to training faced by small firms – over 70 per cent of participating businesses employ fewer than 50 people – and are reaching other groups, such as part-time workers, that have previously had little opportunity to improve their skills during working hours. Early indications are that completion rates by learners are high, and both businesses and individuals are positive about the benefits of their involvement.

3.91 As announced in the 2002 Pre-Budget Report, **the Government is providing £130 million in England to enable Employer Training Pilots to be extended for a second year and to around one quarter of local LSC areas. New pilots will operate from summer 2003 in Berkshire, East London, Kent, Leicester, Shropshire and South Yorkshire**, helping to strengthen evaluation of the scheme. The extension will allow the Government to test the impact of elements within the model, such as the level of compensation to employers, more thoroughly, and will ensure that pilot areas can explore further the means of increasing the capacity of local training providers and engaging employers in the scheme. The extension will provide important evidence to inform the development of national policy, complementing work in other areas.

Union Learning Fund 3.92 Since 1998, the Union Learning Fund (ULF) has supported over 350 projects ranging from tackling basic skills needs to continuing professional development. The ULF has also helped to establish and train a national network of over 4,500 Union Learning Representatives who promote learning in the workplace, particularly among those with basic skills needs. **The Government has decided to increase funding for the ULF from £11 million in 2003-04 to £14 million in 2004-05 and 2005-06.**

Professional and other bodies 3.93 Building on the measures already described, **the Government also intends to review the tax treatment of fees and subscriptions to professional and other approved bodies**, to see how it can further strengthen and support the provision of workforce education and skills.

Management 3.94 Effective management makes a significant contribution to productivity growth. To improve understanding of the relationship between management and economic performance, Professor Michael Porter was asked by the DTI and the Economic and Social Research Council (ESRC) to oversee a short research project as part of a broader study into UK competitiveness. Professor Porter concluded that the UK has a managerial skills deficit among lower and middle management levels, reflecting the overall skills gap in the UK labour force. The ESRC has a £17 million research budget to take forward research in this area, building on the analysis in the report.

Migration 3.95 Migration is a long-standing source of skills and labour in Britain, and over time has helped to raise productivity, boost economic growth and mitigate domestic skills shortages. The Government has taken a number of steps to maximise the contribution of migration to a skilled and flexible workforce and to help employers facing specific recruitment difficulties. The Highly Skilled Migrant Programme (HSMP), introduced in 2002, has proved successful in enabling highly-skilled individuals to enter the UK to seek and take up work. Around 1,300 people entered through this route in the first year of operation, demonstrating their eligibility through educational qualifications, work experience, achievements in their field and past income. Applications renewing HSMP status to date have been approved on the basis of very strong labour market performances.

3.96 The work permit system now provides a flexible and effective service for employers who are unable to fill positions through domestic recruitment. Over 95 per cent of permits are processed within 24 hours, and Work Permits UK expect to receive some 200,000 applications in the coming year. As confirmed in the 2002 Pre-Budget Report, a Small Business Unit has been established within Work Permits UK to ensure that all employers are able to use the work permit system effectively to meet their skills needs.

3.97 Building on the success of recent initiatives, the Government is taking further steps to facilitate migration as a source of skills and labour in the economy. **To maximise the economic contribution of high-skilled migration, the Government will strengthen the Highly Skilled Migrants Programme** by adjusting the threshold eligibility criteria, introducing a new category for younger applicants, and taking partners' achievements into account in assessing individual applications. The new criteria will take effect from August 2003.

3.98 Overseas students can help to relieve UK shortages in the supply of science, technology, engineering and mathematics skills, and the Government is committed to encouraging them to utilise their skills in these subject areas after they graduate. The Government will, therefore, **introduce a new entitlement for foreign students beginning or continuing courses in these subjects to work in the UK for 12 months following graduation from a UK institution.** This will apply to students completing courses from summer 2004.

3.99 The Work Permit system is proving effective in alleviating employers' recruitment difficulties at NVQ level 3 and above, across a wide range of sectors. **New schemes for lower skilled migration will also operate from May 2003 to alleviate labour shortages in the food processing and hospitality sectors.** Employers will be able to apply for 12 month permits from an initial annual quota of 10,000 migrants per sector, and will be expected to provide suitable accommodation and support for their employees. Evaluation of these schemes will provide valuable evidence on the potential benefits of low-skilled migration in meeting employer demand and tackling illegal working.

3.100 However, acute shortages of intermediate, NVQ level 2 vocational skills remain in certain sectors, such as the construction industry. **The Government will therefore consult in summer 2003 on how best to address intermediate vocational skills shortages in these sectors,** including consultation on lowering the minimum qualification for work permit occupation on a sector specific basis.

3.101 The Government is also introducing changes to the Working Holidaymakers Scheme, under which young Commonwealth citizens can work in the UK for up to two years, to make it more flexible and responsive to labour market needs. **Working Holidaymakers will in future be able to take up work in any sector, move freely between employers, and switch into work permit employment after one year in the UK.**

3.102 The Home Office is also taking steps to ensure that employers and individuals have access to appropriate information on UK migration routes, to improve the effectiveness of the system and aid the integration of recent migrants. **The Home Office will review its website provision and establish a dedicated site for legal economic migration to the UK by autumn 2003.**

Immigration into the EU

3.103 Migration is also key to the EU's ability to meet the challenges and opportunities posed by an ageing population and a contracting workforce. The Spring European Council in March 2003 concluded that migration should be considered in the context of skills shortages and demographic challenges across the EU as a whole. The Government welcomes the Commission's intention to produce a Communication on the relationship between immigration, integration of migrants in EU society and employment.

INVESTMENT

3.104 Alongside a skilled labour force, investment in physical capital is vital to support a flexible and productive economy. In the past, the capital stock of firms and the stock of public infrastructure in the UK has fallen well below the levels in other industrial countries, impairing the UK's labour productivity performance. The Government is taking important steps to reverse this trend, improving the environment for private investment and investment decision-making through macroeconomic stability and greater flexibility in capital markets, taking forward investment plans in transport infrastructure, and addressing failures in the property market.

Improving investment decision-making

3.105 Efficient and flexible capital markets have a vital role in allocating capital in the economy, promoting growth and productivity. Capital markets help businesses manage risk, while integrated international markets improve the flow of capital and reduce costs. The effective combination of high, robust standards of corporate governance and strong shareholders is the essential underpinning for efficient, flexible markets in a modern global economy.

3.106 The Government takes a broad approach to reform of capital markets, to ensure that the chain of savings, investment and governance works efficiently and effectively to create wealth and long-term value for savers, companies and the economy. This approach operates at a number of levels. At the level of the company, there is a need to promote the interests of shareholders and to ensure that they have access to timely and accurate financial reporting. This in turn requires a set of external stakeholders whose actions promote and reinforce good governance: institutional shareholders that are responsive to the needs and interests of their ultimate customers and accountable for the ownership rights they exercise; independent auditors; comprehensive and robust accounting standards; and fair and timely commentary from analysts and ratings agencies.

3.107 The Government has therefore commissioned a number of strategic reviews. The Cruickshank, Myners and Sandler reports investigated competition in banking, institutional investment and retail savings products. The Higgs review of the role and effectiveness of non-executive directors, the Coordinating Group on Audit and Accounting Issues, and the Smith group recommendations on guidance for audit committees together provided an overarching approach to reforming the governance and financial reporting of companies. These, in turn, require effective exercise by institutional shareholders of their ownership rights, an important theme of the Myners review.

The Myners review of institutional investment **3.108** The Myners review of institutional investment in the UK was published in March 2001. In October 2001, the Government confirmed that it would take forward all of the recommendations of the review, including revised Codes of Investment Principles to encourage diversity in investment approaches. Since then:

- the Institutional Shareholders' Committee (ISC) has published guidance for fund managers on Shareholder Activism, helping them to maximise the value of their clients' equity holdings and the productivity of the companies they own. In 2004, the Government will review the extent to which the ISC's statement of principles has been successful in delivering behavioural change;
- the December 2002 Pensions Green Paper restated the Government's commitment to legislate to require more expertise of Pension Scheme Trustees. This will improve the investment decisions taken for the huge blocks of capital controlled by the occupational pension scheme sector;
- the Government has launched a major review, to run until the end of 2003, of the effectiveness of the Myners principles in driving change in investment decision-making by occupational pension schemes. The review will inform future decisions on the need for further action to improve the operation of the institutional investment market; and
- the Financial Services Authority is now consulting on proposals on soft commission and the 'bundling' of transaction costs by brokers, following discussion of these issues in the Myners report.

Accountancy and audit **3.109** Corporate crises in the US have highlighted the vital importance of strong frameworks for financial reporting and audit regulation, and corporate governance in underpinning efficient and flexible national and international capital markets. The final report of the Coordinating Group on Audit and Accounting Issues was published in January 2003. The Government endorses the recommendations set out in the report, including that enforcement of accounting standards should become more proactive and risk-based. The report also recommended that steps be taken to strengthen auditor independence, including through:

- strengthened requirements on the rotation of audit partners, and greater restriction on the provision of non-audit services;
- an enhanced role for audit committees in appointing and overseeing auditors. The group endorsed new guidance for audit committees proposed by Sir Robert Smith; and
- the transfer of responsibility for setting standards for auditor independence to a body independent of the professional accountancy bodies, as part of a wider restructuring of the regulation of the accountancy profession.

The Higgs review of non-executive directors **3.110** Effective non-executive directors have a central role to play in raising standards of corporate governance and performance. In April 2002, the Government appointed Derek Higgs to review the role and effectiveness of non-executive directors. The report was published in January 2003 and concluded that the existing framework of corporate governance, though sound in its essentials, should be progressively strengthened. The 'comply-or-explain' nature of the Combined Code has been successful in raising corporate governance standards, and the report recommends that the existing Combined Code be updated to include the following provisions:

- half of a listed company's board should be independent of management;
- the roles of chairman and chief executive should be separated;
- the chief executive should not go on to become chairman of the same company;
- disclosure of the role that non-executives perform, the time they commit, and their attendance at board meetings should be significantly increased;
- there should be closer relationships between non-executive directors, including the senior independent non-executive director, and shareholders, building on the conclusions of the Myners Review of institutional investment and developing shareholder activism as proposed by the ISC;
- there should be formal performance evaluation of the board as a whole, and of individual directors; and
- the role of chairman should be strengthened, recognising their pivotal role on the board.

3.III The Government welcomes the conclusions of the report. It is now for the Financial Reporting Council (FRC) to update the Combined Code in the light of its recommendations and those of Sir Robert Smith's group on audit committee best practice. The Government welcomes the FRC's intention to amend the Combined Code after a short consultation period so that the new Code is in place to report in future years, beginning 1 July 2003. When the new Code is in place, the test will be the extent to which the business and investment communities rise to the challenge that has been laid down. The Government therefore welcomes Derek Higgs' recommendation for a two-year review of progress against his conclusions. It also believes that effective implementation of the Higgs recommendations will both assist and depend on active shareholder engagement, consistent with the principles set out by the Institutional Shareholders' Committee.

Shareholder Executive **3.II2** Government-owned businesses also have an important role to play in raising UK productivity. As announced in the Pre-Budget Report, **the Government has decided to create a Shareholder Executive located in the Cabinet Office** to allow it to fulfil better its role as shareholder in those businesses. An early priority for the Chief Executive and their team will be to assess the current shareholder performance of government. Following this review, and within the first six months, the Shareholder Executive will define best practice standards and processes for all shareholding departments, develop action plans to enable the main shareholding departments to improve their shareholder performance, and help departments to implement those action plans. Departments will be held accountable for their shareholder capability and processes, and their effective use of the Shareholder Executive and implementation of its recommendations, in the next Spending Review.

Box 3.4: Strengthening EU capital markets

The creation of a genuine single market in financial services is a cornerstone of EU economic reform. A single financial services market will make it easier for European businesses to raise finance, and benefit consumers by giving them a wider choice of competitively priced products. The European Financial Services Action Plan is intended to create a single market by removing barriers to its development. However, further efforts are required to improve the flexibility of capital markets and to ensure that these do not stop at the EU's borders. Flexible capital markets are especially important in the context of Economic and Monetary Union. The Government's priorities include:

- increasing competition within EU capital markets. As described earlier in this chapter, the Government encourages the Commission to investigate whether there are barriers to competition in specific sectors;
- ensuring effective and efficient corporate governance. The Government strongly supports efforts to improve corporate governance across the EU, and calls on the Commission to ensure that the forthcoming Corporate Governance Action Plan focuses on agreeing high-level principles to underpin a framework of mutual recognition between Member States; and
- improving EU-US regulatory dialogue and mutual recognition. A more intensive EU-US regulatory dialogue should encourage cooperation and facilitate the mutual recognition of EU and US regulatory systems. As a first step, the Government calls for the commissioning of a report to assess the potential benefits of EU-US mutual recognition. The Government would like to see this initiative extended to other non-EU markets.

Encouraging North Sea Investment

3.II3 Budget 2002 introduced necessary changes to ensure that North Sea taxes raise a fair share of revenue and encourage investment, helping to create a stable fiscal regime for the longer term. Within that framework the Government wants to achieve maximum value from scarce oil and gas resources by encouraging optimum use of North Sea infrastructure and the development of all commercially viable reserves. **The Government therefore intends to abolish, from 1 January 2004, Petroleum Revenue Tax on all new third party tariffing business under contracts completed on, or after, Budget day relating to use of pipelines and other infrastructure in the UK and on its continental shelf.** This change is the result of constructive dialogue between the Government and industry, who have made it clear that the benefits of the change will be passed on to infrastructure users. The Government wishes to continue this dialogue through the establishment of a consultation group to examine the issue of current low levels of exploration, working in parallel with PILOT, the industry task force. Over the next six months, the group will consider whether there are cost-effective, targeted measures that could improve this situation and help maximise economic recovery of North Sea oil and gas.

Investing in transport

3.II4 A modern and reliable transport network fosters labour mobility and provides businesses with access to markets, a pool of available labour and new investment opportunities. The Government's Ten-Year Plan for Transport sets out plans for public and private investment in excess of £180 billion to create a modern transport network across the UK. The Department for Transport is currently conducting a review to assess how best to roll forward the Ten-Year Plan into the next decade, as part of which it will also review existing support for local bus services to ensure that these are effectively targeted on the Government's objectives. The Government is also engaged in a national consultation on UK airport capacity. Further detail is set out in Chapters 6 and 7.

Housing, property and planning

3.II5 On 5 February, the Deputy Prime Minister set out the Government's new approach to creating and maintaining sustainable communities in a growing and changing economy¹². The Government's strategy places key housing, planning and regeneration policies in the context of wider requirements for sustainable communities, including jobs, quality public services, transport, a safe and healthy local environment, and sound local government.

Housing 3.II6 A stable and flexible housing market is essential to a healthy economy and housing market imbalances are a potential brake on economic development (see Box 3.5). Strong cycles in the housing market have been a striking feature of the UK economy over the past three decades. This volatility has affected the wider economy through private consumption, as household spending is closely linked to changes in housing wealth. Reducing volatility in the housing market will therefore promote macroeconomic stability. The Government has recognised that reforms are needed to help increase the supply of housing, reduce volatility and promote stability in the wider economy. The effect the housing market has on macroeconomic stability will be much more significant should the UK join EMU. The housing market forms an important part of the monetary transmission mechanism – the means by which interest rates affect the wider economy. This is the subject of a supporting study to the assessment of the five economic tests.

3.II7 Poor quality and abandoned housing is strongly linked to social disadvantage and has a detrimental impact on investment. In areas of high demand, an inadequate supply of affordable housing also affects the supply of skilled workers, such as nurses, teachers and police officers, who deliver the UK's essential services. The Government recognises both the

¹² *Sustainable communities: building for the future*. Office of the Deputy Prime Minister, February 2003.

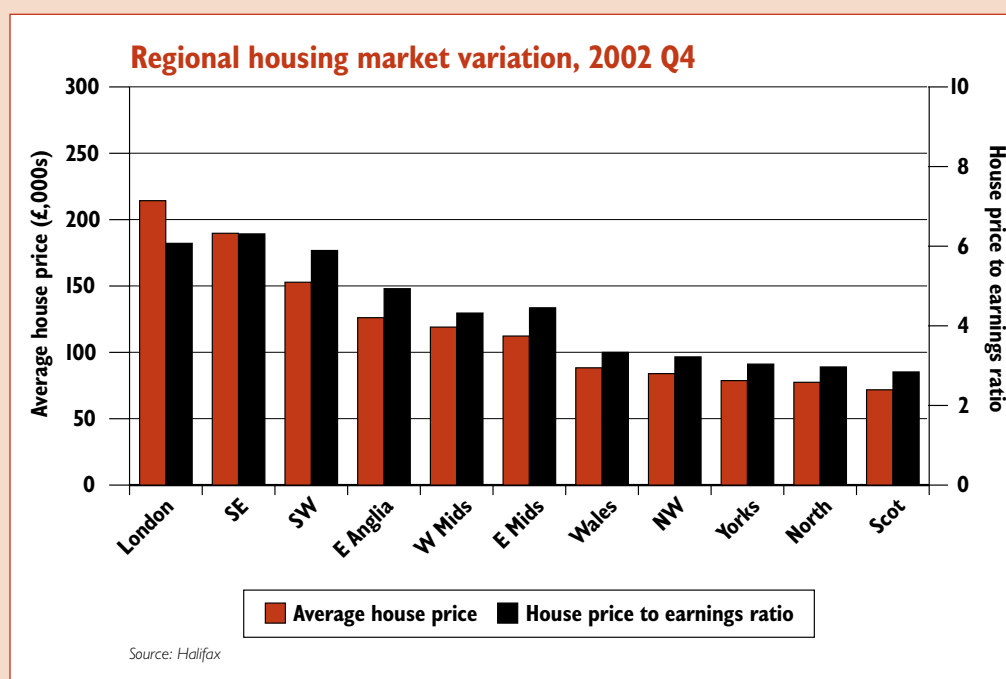
need to provide an adequate supply of new homes and jobs in areas of the country experiencing high growth and to combat the decline of other areas where there is a surplus of housing stock. The programme will establish a series of 'pathfinders', financed by £500 million of new resources, to deal with declining areas suffering severe abandonment of housing, and an ambitious three-pronged strategy will be launched for areas in the South East, East and East Midlands regions experiencing high demand:

- bringing the number of homes built up to planned levels in all local authority areas;
- focusing additional housing development in selected growth areas; and
- delivering a new corridor of growth in the Thames Gateway. The scale of the brownfield development opportunity will give it a major role in providing for sustainable growth in London and the South East.

Box 3.5: Flexibility and the housing market

A flexible and mobile workforce plays an important role in matching people to jobs and, in particular, matching those with specific skills to appropriate jobs. Current evidence suggests that while increased labour mobility can make a significant contribution to increasing employment, it can make an even greater impact on improving productivity. However, labour mobility in the UK is low in comparison with the US and lower than in most other northern European countries.

One barrier to labour mobility is variation in house prices and house price to earnings ratios, which can prevent people moving from low to high price areas. For instance, in the UK these differences can prevent people from migrating into high demand areas such as London and the South-East. The chart below shows the variation between house prices and house price to earnings ratios across the UK's regions. These variations can create labour shortages and put upward pressure on wages in both private and public sectors.



Owner-occupiers face higher costs of moving than private renters, an issue that is exacerbated in the UK due to its high level of owner-occupiers. In addition, the UK's large social housing sector has, historically, been immobile. The Government is now taking steps to address this through Housing Benefit reform and restructuring social rents. Transaction costs incurred in buying or selling property can also reduce labour mobility. In the UK overall transaction costs are very low compared to most other European countries.

3.118 To help address these issues, £22 billion will be invested over the next three years in housing, planning and regeneration, £5 billion of which will be made available for affordable housing, including at least £1 billion for housing for keyworkers. Some £446 million will be invested in the Thames Gateway, in addition to resources from other programmes, and a further £164 million will be invested in the other growth areas.

3.119 The Government will work closely with regional and local partners to deliver infrastructure, economic development and regeneration in growth areas, and will strengthen local delivery mechanisms in support of this goal. In the Thames Gateway, the Government intends to establish two new Urban Development Corporations – one in the London Gateway and the other in Thurrock – and will consult on the latter shortly. The Government will also bring forward proposals for special delivery vehicles in other areas, which it will discuss with delivery partners.

3.120 The Government is also committed to ensuring, through intervention if necessary, that local authorities in high demand areas deliver housing numbers set out in Regional Planning Guidance. Local authorities should not just be operating the planning system, but also ensuring that the necessary level of house building happens. There will be a new role for the Audit Commission to assess authorities' performance in this area, while the new Comprehensive Performance Assessment (CPA) system for local authorities, described in Chapter 6, will appraise the performance of authorities in delivering the right sort of housing in the right quantities and the right places. **Performance against this criterion will influence local authorities' CPA assessments as well as the allocation of resources recommended by Regional Housing Boards for new affordable housing.**

3.121 As described in Chapter 2, the Government has also commissioned a review of the factors affecting the elasticity of housing supply in the UK.

3.122 The land-use planning system has an important impact on many property investment decisions, including housing. The Government is committed to a faster, more transparent and more effective planning system to support macroeconomic stability and flexibility, particularly within the housing and retail sectors, and the delivery of infrastructure to support sustainable growth.

Planning 3.123 The Government's proposals for reform of the planning system were set out by the Deputy Prime Minister in July 2002¹³. The 2002 Spending Review allocated an additional £350 million over the next three years to help local planning authorities make improvements to their planning services. The reforms, which are designed to promote better infrastructure and investment decisions, include:

- the first Planning Bill for more than a decade;
- the creation of statutory Regional Spatial Strategies to guide the pattern of development at a regional level;
- the abolition of county structure plans to remove an entire tier of plan-making;
- the introduction of a more flexible local development plans system;
- statutory timetables for called-in applications;
- reviews of national Planning Policy Guidance (PPG); and
- the introduction of Business Planning Zones.

¹³ *Sustainable communities: delivering through planning*. Office of the Deputy Prime Minister, July 2002.

3.124 However, the Government wants to go further to improve the planning system. Building on the reforms already announced to deliver a step change in planning policy, further significant changes in the planning, supply and finance of housing will be required to address demand and supply in the housing market to tackle market failures, significantly increase the responsiveness of supply to demand, and reduce national and regional price volatility. It is vital that planning underpins a flexible housing market, responds better to the needs of deprived areas, and is better aligned with transport objectives. These objectives will not be delivered without a change in the culture of the planning system. Budget 2003 announces measures to respond to these challenges.

Supporting the delivery of new housing

3.125 The predictability and consistency of the planning system is key to the flexibility and stability of the housing market. The Government will vigorously pursue its target that 60 per cent of new housing should be built on brownfield land, and issued policies in 2000 on planning for housing (PPG3), designed to maximise the use of brownfield land and ensure that new housing is suitably located and built at higher densities than in the past. While the Government is committed to these policies, there is evidence that some planning authorities are implementing the guidance in ways which lead to a shortfall in overall housing supply compared with regional targets. To support better implementation by planning authorities the Government will:

- **state that its overriding policy objective is that local authorities should deliver agreed housing numbers;**
- **help ensure the delivery of housing numbers by preventing the arbitrary use of local authority phasing policies to delay otherwise suitable housing developments allocated in plans;**
- **ensure that local authority plans make provision for at least 10 years' potential supply of housing,** while continuing to prioritise 'brownfield' development and drive up density;
- **propose that local authorities should allow land allocated for industrial or commercial use in their development plans, and redundant commercial buildings,** to be used for housing or mixed use development unless a convincing case for retention can be made;
- **offer greater help to planning authorities in negotiating planning obligations** to ensure a more professional and consistent approach;
- **as part of the Planning Delivery Grant, continue to offer extra resources to local planning authorities in the growth areas;**
- **set out, before the summer, measures to improve the performance of planning authorities that are not delivering an adequate supply of new housing** – including incentives, support, and engagement – followed, where necessary, by intervention;
- **be prepared to call in proposed major housing developments for decision where local authorities are not delivering housing numbers** and where intervention will speed up delivery; and
- **review the application of PPG3** this year to ensure that it is having the desired effect.

3.126 To address problems in delivering new housing, the Government will also:

- **increase certainty for applicants by issuing new guidance requiring expectations for planning obligations** – including affordable housing agreements – to be set out in policies in their plans;
- **take forward the existing reviews of regional plans covering the high demand growth areas in the South East** as the means for realising the additional growth potential of 200,000 homes identified in *Sustainable communities – building for the future*;
- **require the Regional Planning Bodies to consider the case for additional growth in the longer term when preparing new Regional Spatial Strategies**, and to take account of volatility in the housing market and the need to promote macro-economic stability as part of delivering sustainable development. The Government will publish region-by-region analysis of these issues for consultation by the end of 2003;
- **explore whether, in the medium term, achieving the Government's objectives will require a system of binding local plans to increase certainty and ensure the stability of the housing market**;
- building on the development of a register of surplus public sector land being developed by English Partnerships, **consider how surplus central and local government landholdings can contribute to the delivery of corporate Government objectives**, including housing supply, and clarify the scope for public bodies to take account of these broader interests; and
- consider ways to encourage a greater range of private sector involvement in both the financing and provision of affordable housing.

Improving retail planning **3.127** Productivity in the UK retail sector lags that in competitor economies. The planning system may be one of the factors affecting productivity if it restricts competition, innovation and choice. **The Government is committed to ensuring the viability and vitality of town centres, and will review its guidance on planning for retail development to ensure that this is achieved alongside improvements in productivity.** Revised guidance will encourage proactive planning for town centres and multi-level retail development to reduce land take. The Government will also ask Regional Planning Bodies to consider the need for, and broad location of, major new retail and distribution facilities in Regional Spatial Strategies.

Delivering infrastructure and land 3.128 The delivery of sustainable communities will require major new development, supported by appropriate infrastructure and land assembly processes. Land use and transport strategies need to be woven together at the national, regional and local levels. The Government will therefore:

- **conduct, by the end of 2003, a wide-ranging review of the links between transport and land-use planning;**
- **radically simplify the compulsory purchase process** and make it easier to use, subject to legislation;
- **provide extra resources to planning authorities** to incentivise better performance, particularly in handling major planning applications, as part of the Planning Delivery Grant;
- **review whether the compensation offered for the indirect and nuisance effects of infrastructure development is appropriate**, building on the work of the Law Commission; and
- **explore whether the Government's proposals to conduct planning inquiries in concurrent sessions can be extended to other types of inquiry to save time.**

Changing the culture of planning 3.129 Too often the planning system is seen as reactive and regulatory rather than as a positive tool for change. The Government has already introduced in the Planning Bill a duty for regional and local plans to support sustainable development. To further promote culture change, the Government will work with stakeholders to develop a wide programme of action, including:

- **inviting Sir John Egan, President of the CBI, to develop a skills and training strategy for economic development, regeneration and planning to deliver sustainable communities**, building on the efforts of the Royal Town Planning Institute to examine its own structure and the educational requirements leading to a planning qualification;
- **piloting a new Planning Advisory Service**, which will seek to use business experience of process management to help local authorities improve the way they handle planning applications;
- **issuing a new draft version of its key planning policy guidance note (PPG1) for consultation** in the autumn, setting out the key principles guiding plans and development control decisions; and
- holding a conference in the autumn to promote a positive vision for planning, focused on delivering increased productivity and economic development in support of *Sustainable communities*.

Commercial property 3.130 Commercial property is an important factor of production, contributing directly to economic growth and regeneration in towns and cities. However, inflexible lease terms can restrain business growth and expose them to undue risk. The Government is working with all parts of the industry to promote a voluntary Code of Conduct on Commercial Leases to improve lease flexibility. The effectiveness of the Code is being independently evaluated. **Should the interim independent evaluation of the Code show that there has been little progress in the commercial lease market towards greater flexibility, the Government will consult later this year on possible legislative options to ameliorate the situation.**

3.131 Tax distortions can be a further source of structural problems in the commercial property market. Chapter 5 outlines a series of reforms to stamp duty to tackle avoidance and reduce distortions to commercial decision-making. Tax reforms may also have a role to play in enhancing the property investment market. **The Government will discuss with the industry the appropriate tax treatment of new property derivative products. Consultation on corporation tax reform also provides an opportunity to consider the tax treatment of commercial property. The Government also wishes to explore with the industry the evidence for further measures to improve the efficiency and flexibility of the commercial property market.**

3.132 Building on the reforms to the planning regime and to raise levels of skills in the workforce described in this chapter, the next chapter sets out in detail the Government's wider strategy to create a dynamic and flexible labour market.

