4 SUSTAINABLE GROWTH AND PROSPERITY

Over the last decade there have been significant increases in both employment and productivity, but the growing movement of people, investment and goods is increasing the pace of change in the global economy. Rapid technological change and the emergence of newly industrialised economies are also driving shifts in the competitive environment. The Government is committed to equipping the UK to respond to these changes and focusing reform on the drivers of productivity through:

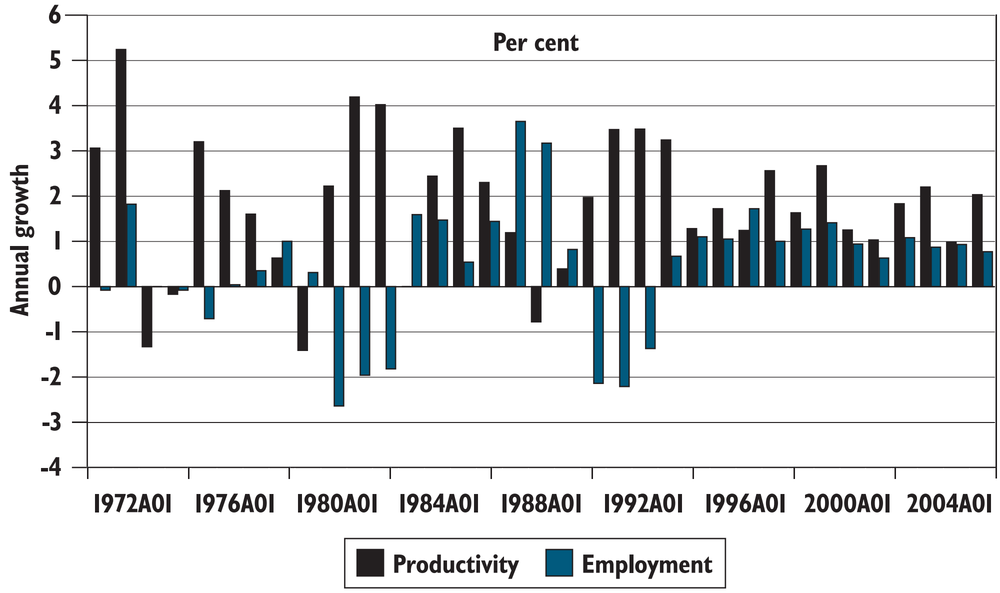
- **increasing spending by the Department for Innovation, Universities and Skills on higher education and skills from £14.2 billion in 2007-08 to £16.4 billion by 2010-11** to implement the recommendations of the Leitch Review, developing a strong partnership with employers and individuals to deliver higher skills;
- **increasing public investment in the science base from £5.4 billion in 2007-08 to £6.3 billion by 2010-11** to implement the recommendations of the Sainsbury Review. **Total public support for business innovation through the Technology Strategy amounting to over £1 billion** will ensure the UK's continued success in generating new ideas and using them in wealth creation;
- **confirming a 2¼ per cent annual real increase in the Department for Transport's programme budget**, consistent with the Long Term Funding Guideline which is **extended to 2018-19.** This will continue renewal of the UK's transport infrastructure including the **funding package for Crossrail**;
- **simplifying the tax system** to make it fairer and more efficient with the announcement of new principles, three reviews and a package of measures;
- **simplifying business support** to reduce confusion and the time businesses spend understanding what support is available and accessing it, and to improve the quality, effectiveness and efficiency of schemes;
- **supporting the private equity industry's moves to increase transparency and a number of measures to ensure that tax arrangements are sustainable and appropriate**; and
- **allowing local authorities to invest in economic development through levying a local business rate supplement and focusing the strategic role for the Regional Development Agencies on economic growth** as announced in the *Review of sub-national economic development and regeneration*.

4.1 A decade ago, the Government set itself the objectives of achieving high and stable levels of growth and employment and narrowing the productivity gap with the UK's major competitors. Economies with periods of strong employment growth often see relatively low productivity growth particularly because new workers can be less productive as they gain new skills. By contrast, as shown in Chart 4.1, in the UK since 1997 there have been significant increases in both employment and productivity:

- employment has risen by more than 2.6 million since 1997. The Government has made good progress on increasing employment among disadvantaged groups – the employment rate for lone parents has risen by over 12 percentage points; by 6.4 percentage points for working-age people aged over 50; and by 9.8 percentage points for people with a health condition or disability; and

- the Government has made significant progress in raising the long-run rate of productivity growth, narrowing the productivity gap with its main industrialised competitors over this same period on both the productivity per worker and productivity per hour worked measures.

Chart 4.1: Employment and productivity growth, 1972-2006



Source: Labour Force Survey, ONS

4.2 Over the next decade, the pace of change in the global economy will intensify, with growing movement of people, investment and goods. Rapid technological change and newly industrialised economies will increase competition in the global economy, with knowledge and other intangible assets growing in importance in maintaining competitiveness. A recent HM Treasury Economic Working Paper,[1] described in Box A3, investigates the consequences for the measurement of productivity of treating spending on intangible assets as investment. It finds that traditional measurement techniques may underestimate the importance of investment in intangibles in driving productivity growth in recent years, highlighting the importance to the UK economy of science, innovation and knowledge-based industries.

4.3 Pressures on the climate and natural resources are also a key challenge facing the UK and the world. Environmental pressures have economic and social consequences, but tackling them also presents opportunities for business. *The Stern Review on the Economics of Climate Change* (October 2006) showed how the cost of tackling climate change with well-designed policies would be lower than the cost of dealing with the consequences of unchecked greenhouse gas emissions. Chapter 7 sets out the steps the Government is taking to ensure the economy is environmentally sustainable.

[1] *Intangible investment and Britain's productivity*, Treasury Economic Working Paper No.1, available at: www.hm-treasury.gov.uk

4.4 The Government is committed to equipping the UK to respond to these changes. Macroeconomic stability has provided the platform for investment and the UK has led the world in understanding and responding to the economic impact of climate change. World-class innovation and an attractive and competitive business environment are helping businesses take advantage of wider trade and rising living standards, while individuals are developing higher skills to take advantage of new opportunities.

Productivity

4.5 The Government has contributed to raising UK productivity by pursuing microeconomic reforms to remove barriers preventing markets from working efficiently. These have been focused on the drivers of productivity. As part of the 2007 Comprehensive Spending Review **the Government announces a new Public Service Agreement (PSA) to raise the productivity of the UK economy** by:

- enhancing the skills of the UK workforce;
- investing in the UK science base and promoting innovation;
- modernising the UK's critical infrastructure;
- improving the business environment in the UK; and
- narrowing the productivity gap between the regions.

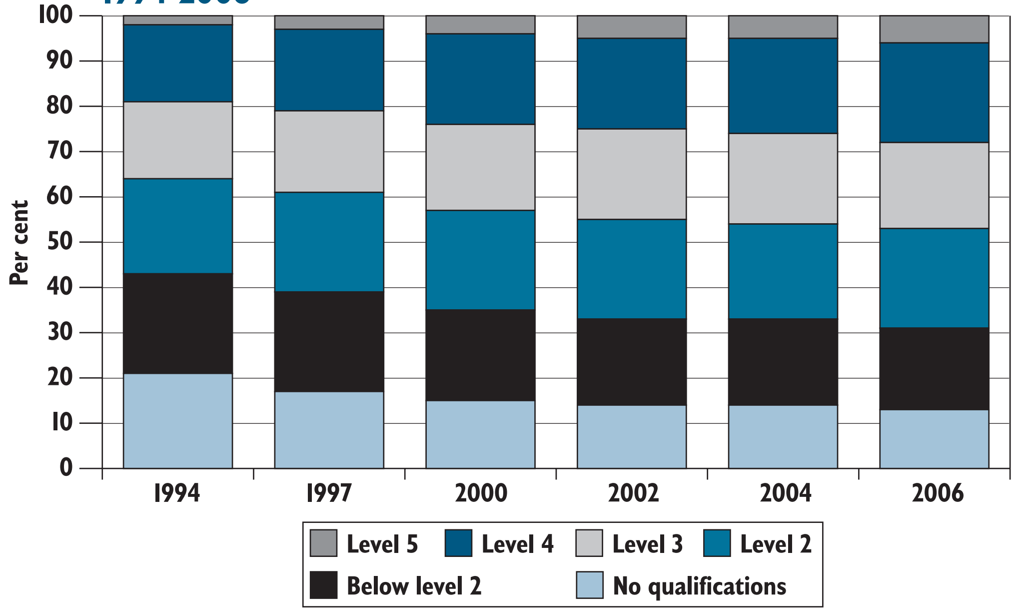
4.6 In June 2007 the Department for Innovation, Universities and Skills (DIUS) and the Department for Business, Enterprise and Regulatory Reform (BERR) were set up in recognition of the challenges and opportunities created by the changing global economy. DIUS brings together science, innovation, Higher Education and skills policies in recognition of the vital role that higher skills and university research play in driving innovation. BERR has responsibility for further improving the business environment and driving productivity through better regulation and competition. Details of their 2007 Comprehensive Spending Review settlements are set out later in this chapter and in Annex D.

WORKFORCE, SKILLS AND MIGRATION

4.7 The skills of the workforce are a key driver of the productivity of an economy. Improving the skills of individuals enables firms to improve products and processes, to adapt more quickly to changing competitive environments and to increase opportunities for innovation.

4.8 The UK's skills base has improved over recent years as reforms and investment have begun driving improvements. The skill level of young people joining the workforce is improving with 71.4 per cent of 19 year olds gaining at least a Level 2 qualification (achieving 5 GCSEs at grades A* to C) in 2006 compared with 66.3 per cent in 2004, and more young people than ever before participating in Higher Education. The number of young people participating in apprenticeships is at a record level with more than 250,000 now in learning – up from around 75,000 in 1997. Advances have also been made in the skill level of adults already in the workforce. Over 1.7 million adults have boosted their basic skills since 2001, and the proportion of people with no qualifications has fallen from 22 per cent in 1994 to 12.4 per cent in 2006.

Chart 4.2: Highest qualification held by people of working age, 1994-2006



Source: ONS

A new ambition for skills

4.9 However, the UK still has a relatively large number of people with low skills compared with comparator OECD countries. In response to this challenge, the Government commissioned the Leitch Review of Skills[2] to assess the UK's long-term skills needs. In July 2007 the Government published its plans for taking forward the recommendations of the Leitch Review in *World Class Skills: Implementing the Leitch Review of Skills in England* and today **the Government announces a new PSA to improve the skills of the population, on the way to ensuring a world-class skills base by 2020**. The PSA sets stretching national targets to support working age individuals to acquire the skills they need to succeed at all levels, from functional literacy and numeracy to qualifications at further and higher levels and apprenticeships.

4.10 Combined with the new PSA to maximise employment opportunity for all (see Chapter 5) this PSA will provide a clearer focus on integrating the two systems to deliver the objective of sustainable employment and progression. The indicators in the skills PSA are underpinned by a new commitment to measure the employment outcomes of training to ensure the skills system delivers qualifications that are valuable to individuals and employers.

DIUS spending settlement

4.11 To provide the resources needed to make progress towards these goals, **the budget for DIUS will grow by 2.2 per cent per year on average in real terms over the CSR07 period** increasing total spending on Higher Education and skills from £14.2 billion in 2007-08 to £16.4 billion by 2010-11, including Higher Education spending on science. The spending settlement for the Department for Children, Schools and Families, as outlined in Chapter 5, will also see a further improvement in the number of young people continuing in education and training beyond compulsory school age.

[2] *Prosperity for all in the global economy – world class skills, Final Report*, Leitch Review of Skills, December 2006.

Implementing the Leitch review

4.12 The Government is building a stronger partnership with employers and individuals to deliver the higher skills ambitions recommended by the Leitch Review. Employers are being encouraged and supported to develop the skills and qualifications of their workforce by making a Skills Pledge[3] – a promise to their workforce by the leadership of an organisation to support all its eligible employees to develop their basic skills and work towards relevant qualifications to at least a first full Level 2. The public sector has played a leading role in this and all central government departments have now signed up to the Skills Pledge. In total, over 300 public and private employers, covering over 2 million employees, have made a Pledge.

4.13 The Government and employers are also investing to develop the National Skills Academy network, giving employers direct influence over the content and delivery of training in their sector. Six Academies are already operational or are in the process of becoming operational in the areas of Fashion Retail, Manufacturing, Construction, Financial Services, Food and Drink Manufacture and Nuclear. Over their first five years of operation, we expect these six Academies to have offered learning opportunities to over 150,000 people in total. The Government will continue to develop the network and by 2008 aims to have 12 Academies operational.

Train to Gain and apprenticeships

4.14 To deliver the Government's skills ambitions it is essential that funding for training is increasingly driven by the specific needs of employers and individuals. Train to Gain is an employer demand-led training service that delivers training in the workplace. It provides free training for employees who lack basic skills or a first full Level 2 qualification, as well as subsidies for a proportion of Level 3 training, and it signposts employers to other training and business support services. Since its launch last year, 36,890 employers have supported over 96,000 employees to achieve a full Level 2 qualification. Over the CSR07 period, Train to Gain will be expanded significantly. At the same time, the Government will aim to expand the number of apprenticeships to around 300,000 by 2010-11, as a step towards realising the Leitch Review ambition of 500,000 apprenticeships in the UK by 2020.

4.15 Paragraph 4.46 sets out further details of the merger of support offered through the Train to Gain skills brokerage service with the range of services provided through Business Link to simplify support for businesses of all sizes.

Commission for Employment and Skills

4.16 The UK Commission for Employment and Skills, as recommended by Leitch, will be fully operational by April 2008. Sir Michael Rake, chair of BT Group, has been appointed as chair of the Commission and is now working with the Government and Devolved Administrations to complete the set up of the new body. The Commission strengthens the collective employer voice in the skills system. It will articulate employer views on skills better; assess progress towards the UK's 2020 skills ambitions; performance manage the Sector Skills Councils, including making recommendations to the Government on re-licensing; promote employer investment in training; and advise Ministers on the policies needed to increase employment rates and skill levels.

Migration

4.17 Migration will continue to make a vital contribution to economic growth and to meeting skills gaps in the labour market. Migrants raise UK economic output through increasing employment and bring skills which complement those in the existing workforce. For these benefits to be realised it is important that migration is carefully managed.

[3] www.traintogain.gov.uk/skillspledge

4.18 The Government announces a new PSA to ensure controlled, fair migration that protects the public and contributes to economic growth which will be delivered by strengthening UK borders, fast tracking asylum decisions, and enforcing compliance with immigration laws. The e-Borders system will be introduced to track 95 per cent of movements across the UK's borders, enabling the Government to count people in and out of the country. Biometric visas will be rolled out to all migrants requiring a visa to improve the security of the immigration processes. The new and simpler points-based system will deliver transparent decisions based on objective criteria to facilitate economic migration to the UK.

SCIENCE AND INNOVATION

4.19 In an increasingly knowledge-based global economy, the UK's future economic success depends crucially on the ability to generate innovative ideas and to translate new knowledge into high-value products and services.

4.20 Good progress has been made towards the Government's long-term ambitions for science and innovation. The UK remains second only to the US in global scientific excellence, and knowledge transfer from the research base continues to increase. There are also encouraging signs that attainment and take-up of science, technology, engineering, and mathematics skills is beginning to improve. However, further steps are needed to increase the level of business innovation and ensure that the UK is well placed to benefit from the opportunities of globalisation.

4.21 The Government announces a new PSA to promote world-class science and innovation in the UK which commits to world-class research in UK centres of excellence, investment to enable Higher Education Institutions and Public Sector Research Establishments to develop their capacity to engage with business, increased business investment in Research and Development (R&D), and a strong supply of future scientists, engineers and technologists through the take-up of A-levels and PhDs.

4.22 The 2007 Comprehensive Spending Review confirms that total public investment in the science base will rise from £5.4 billion in 2007-8 to reach £6.3 billion by 2010-11, meeting the Government's commitment to increase investment in the public science base in line with the trend rate of growth in the economy.

Sainsbury Review

4.23 Building on the Government's existing science and innovation policies, the Chancellor asked Lord Sainsbury in November 2006 to examine what more needs to be done to ensure the UK's continued success in wealth-creation and scientific policy making. The Sainsbury Review published its conclusions on 5 October 2007.[4] The Review found that while the UK remains well-placed to make the most of the opportunities of globalisation, further action is needed to deliver a world-class innovation system and increase the economic impact of research. The main recommendations are summarised in Box 4.1. **The Government welcomes the Sainsbury Review and accepts the recommendations**. DIUS will lead on implementing the Review's recommendations and reporting on progress.

[4] *The Race to the Top: A Review of Government's Science and Innovation Policies*, Lord Sainsbury of Turville, October 2007.

Box 4.1 Sainsbury Review recommendations

The Sainsbury Review argues that the UK's long-term competitive advantage in the global economy lies in high-value goods, services and industries, and that continued success in this area depends on creating the right environment to foster world-class science, innovation and skills. To this end, the Sainsbury Review proposes further action to create an effective UK innovation system, building on the *Science and Innovation Investment Framework 2004-2014* and *Next Steps*.[5] The Review:

- **supports the establishment of the Technology Strategy Board (TSB) as an arms-length body from 1 July 2007, and recommends that it should be given a lead role in co-ordinating innovation support activities across the economy;**
- **recommends that performance management of the Research Councils focuses on knowledge transfer, including the amount of collaborative research they will conduct in partnership with the TSB;**
- **recommends that the next round of funding provided through the Higher Education Innovation Fund (HEIF) should be allocated wholly by formula, and that a greater share of funding should support knowledge transfer between universities working with regional and local firms, many of whom may not have worked with a university before;**
- **recommends a new package of measures to promote science, technology, engineering and mathematics (STEM) skills, including financial incentives to improve teacher qualifications and retention, and an overhaul of careers advice;**
- **recommends a new National Science Competition, building on existing schemes to engage young people in the exciting opportunities science provides; and**
- **recommends that the Small Business Research Initiative (SBRI) should be reformed to more closely resemble the successful scheme in the US, with a clear focus on supporting early-stage, high-technology companies.**

Technology Strategy Board

4.24 In line with the recommendations of the Sainsbury Review, the Technology Strategy Board (TSB) will take a lead role in coordinating public funding for business innovation. **Together with co-funding of at least £120 million committed by the Research Councils, and co-funding of £180 million committed by the Regional Development Agencies (RDAs), total public support for business innovation in support of the Technology Strategy will amount to over £1 billion over the CSR07 period.**

4.25 The TSB will publish its detailed strategy in early 2008, but plans include:

- three new Innovation Platforms to find technological solutions to major societal challenges: health care for ageing populations; low environmental impact buildings; and low carbon transport;
- extending the TSB's sector coverage by creating two new Knowledge Transfer Networks in digital communications and the creative industries; and
- doubling the number of Knowledge Transfer Partnerships to get highly qualified science and technology graduates working with businesses.

[5] *Science & innovation investment framework 2004 – 2014*, HM Treasury, Department for Trade & Industry and Department for Education & Skills, July 2004; *Science & innovation investment framework 2004 – 2014: next steps*, HM Treasury, Department for Trade & Industry, Department for Education & Skills and Department of Health, March 2006.

Medical research and development

4.26 Following the 2007 Comprehensive Spending Review settlements for science and health, total investment in medical research will reach £1.7 billion by 2010-11. The budgets of the National Institute for Health Research (NIHR) and the Medical Research Council (MRC) will together form the single health research budget to be managed by the new Office for the Strategic Coordination for Health Research (OSCHR), in line with the recommendations of the Cooksey Review of UK Health Research.[6] This will support a number of priorities highlighted in the Cooksey Review, including increased support for translational research and clinical trials, and helping to realise the research benefits of the National Programme for IT.

INFRASTRUCTURE

4.27 Public investment makes a crucial contribution to the productivity and flexibility of the wider economy. The 1998 Comprehensive Spending Review and subsequent spending reviews have substantially addressed the legacy of under-investment in the UK's public infrastructure, increasing public sector net investment from just 0.6 per cent of GDP in 1997-98 to 2.1 per cent in 2007-08. This investment will rise to 2 $^{1}/_{4}$ per cent of GDP over the CSR07 period.

Box 4.2: Transforming government procurement

The Government set an ambitious new agenda with the publication of *Transforming government procurement* (January 2007) to improve procurement for the benefit of taxpayers, users of public services and businesses. The Government is committed to transforming public procurement by:

- **raising the calibre of procurement professionals in key departments with large procurement budgets to achieve better value for money through innovation;**
- **restating that the Government will use innovation and sustainability to drive value for money over the lifetime of the product;**
- **using 'forward procurement' to ask businesses to come up with the innovative solutions the public sector needs; and**
- **working with the TSB to develop technology pilots before proceeding with large high-tech procurement projects.**

Transport

4.28 The Eddington Transport Study[7] highlighted the vital role that transport plays in supporting the continued economic success of the UK. The Study found that a comprehensive and high performing transport system is important for sustained economic prosperity. A 5 per cent reduction in travel time for all business and freight travel on the roads could generate around £2.5 billion of cost savings – some 0.2 per cent of GDP.

4.29 To implement Eddington's recommendations, **the Government announces a new PSA to deliver reliable and efficient transport networks that support economic growth**. This sets out the strategy for managing urban traffic routes and the strategic road network and will build on progress already made on the rail network through a national target to increase capacity.

[6] *A review of UK health research funding*, Sir David Cooksey, December 2006.

[7] *The Eddington Transport Study*, HM Treasury, December 2006.

4.30 To achieve this, **the 2007 Comprehensive Spending Review confirms a $2^1/_4$ per cent annual real increase in the Department for Transport's (DfT) programme budget**, consistent with the Long Term Funding Guideline for transport announced in the 2004 Spending Review. Furthermore **the Government extends its commitment to the Long Term Funding Guideline to 2018-19.**

4.31 This sustained increase in funding will allow the DfT to meet the challenges set out in the Eddington Transport Study. The DfT will prioritise growing and congested urban areas, key inter-urban corridors and major international gateways. Subject to the Office of Rail Regulation's determinations, the majority of the Government's £15.3 billion support for railways over 2009-14 will be used to enhance capacity on the rail network. This will include an extensive network-wide programme of station improvements, a 19 per cent reduction in journey times between Liverpool and Leeds, the Thameslink upgrade, and the addition of 1,300 carriages to increase capacity on key routes. The DfT will also provide funding for the 2012 Olympics alongside the Department for Culture, Media and Sport, and Communities and Local Government, through the single central Government Olympics budget. Further details are set out in Annex D.

4.32 Continued stability in the public finances allows investment in major infrastructure projects and **the 2007 Comprehensive Spending Review also makes provision for Crossrail**. This will be taken forward by Cross London Rail Links, which will become a wholly owned subsidiary of Transport for London, subject to certain rights retained by the DfT to reflect the department's contribution to the project. A significant funding contribution has also been agreed with the private sector. See Box 4.3 for further details.

Box 4.3: Crossrail

Crossrail is a major new infrastructure project which will provide a rapid direct link between London's main economic centres of the West End, the City and Canary Wharf, linking these directly with Heathrow Airport and the Thames Gateway.

London's population and employment are projected to grow by around 900,000 by 2025. Crossrail will support this growth by increasing London's overall public transport capacity by 10 per cent, and by 40 per cent on the east-west corridor.[a] This comes on top of the planned 25 per cent increase in capacity on the Underground network and the major upgrade of Thameslink announced in July 2007. Crossrail is projected to generate transport and economic benefits that are more than double its cost, and to create up to 30,000 high-value jobs. It will open up new employment opportunities to thousands of people in some of London's most deprived areas.

The expected cost of up to £16 billion (including contingency and allowing for inflation) has represented a considerable challenge for successive governments, and agreement has only been possible because of sustainable management of the public finances. Agreement has now been reached with the Mayor of London and businesses on an equitable funding package with the Government, passengers and businesses each contributing approximately one third of the expected cost.

The Government will contribute around a third of the construction cost by means of a grant from the DfT of over £5 billion during Crossrail's construction.

Crossrail farepayers will ultimately contribute around another third of the cost, with revenue servicing debt raised during construction by Transport for London and by Network Rail in repect of works on the national rail network.

London businesses will contribute broadly another third through a variety of mechanisms:

- **Direct contributions have been agreed with some of the project's key beneficiaries along the route. Canary Wharf Group has agreed to make a significant contribution to the project and will in addition be responsible for delivering the Isle of Dogs station on advantageous terms. The City of London Corporation will make a significant contribution from their own funds, and will assist in delivering additional voluntary contributions from the largest London businesses. The Government will offer the Corporation its support, where necessary, to deliver these additional contributions. BAA have also agreed in principle to make a financial contribution.**
- **The Government is separately publishing a White Paper setting out its proposal to introduce a power for local authorities to raise supplementary business rates to fund economic development (see paragraph 4.72). Following discussions with the Government, the Mayor has indicated that, subject to appropriate consultation, he envisages using these powers to levy a supplement of two pence per pound of rateable value across London from April 2010, with relief for businesses with a rateable value below £50,000, which will be used to service £3.5 billion of debt raised by the Mayor during construction.**
- **The Mayor has further indicated that he envisages securing contributions from property developers, particularly those who develop in the vicinity of Crossrail stations, and that subject to any appropriate obligations such as Examination in Public, he expects to bring forward London Plan alterations to this effect.**

The Crossrail Hybrid Bill is proceeding through Parliament and is likely to receive Royal Assent in summer 2008. Full construction is expected to be underway during 2010, with services commencing in 2017.

[a] *Transport 2025 – Transport vision for a growing world city*, Transport for London, November 2006.

4.33 The Local Transport Bill will increase flexibility for local authorities to introduce road pricing schemes as part of packages of measures to tackle local congestion problems. The DfT continues to work with local authorities who have submitted or are considering a bid for Transport Innovation Funding to support such packages. The DfT is also inviting industry to demonstrate the feasibility of distance-based road charging where the charge varies according to time of day and place. A number of companies have expressed interest in participating in these demonstrations.

4.34 The DfT's settlement also supports local and regional investment across the UK including continued investment through the Integrated Transport Block and Regional Funding Allocations (together worth over £1.3 billion in 2008-09).

Supporting the haulage industry

4.35 The Chancellor announced on 1 October 2007 that vehicle excise duty for heavy goods vehicles (HGVs) would be frozen in 2008-09 (see Chapter 7 for further details). By April 2009 the rates will be 21 per cent lower in real terms than in 2001. Building on the additional expenditure announced in Budget 2007, the Government recently announced that a further £2 million a year will be dedicated to enforcing road safety law for hauliers to protect the competitiveness of legitimate hauliers. New measures, planned for introduction next year, will allow inspectors from the Vehicle Operator and Service Agency and the Police to collect on the spot penalties from drivers suspected of an offence without a valid British address.

4.36 The DfT has published a progress report on other ways of delivering more targeted enforcement on foreign vehicles alongside the 2007 Pre-Budget Report.[8] One option under consideration is a 'vignette' – a time-based charge for the use of UK roads designed to ensure foreign hauliers help pay for the wear and tear inflicted by their vehicles.

Airport capacity

4.37 Additional airport capacity will increase competition between airlines and ease congestion, benefiting passengers and the wider economy. The Eddington Transport Study and the Stern Review made clear that infrastructure projects should proceed where there is a net economic benefit once external costs – including environmental impacts – have been taken into account. The Government will consult shortly on whether the expansion of Heathrow, the UK's only major hub airport, can take place while meeting stringent environmental conditions.

Spectrum auction

4.38 Spectrum is a valuable part of the UK's infrastructure. The Government is undertaking digital switchover to ensure optimal use of spectrum and considers that the spectrum released by switchover should be auctioned on a neutral basis, thereby allowing different potential users to compete for it openly. The Office of Communications (Ofcom) will publish its conclusions on future use of the spectrum later this year.

Planning system

4.39 The Government remains committed to ensuring that the planning system delivers sustainable housing and economic development and will shortly bring forward legislation creating a new planning regime for major infrastructure projects. This will be based on the recommendations from the Barker Review of Planning[9] and the Eddington Transport Study, and follows consultation on the Planning White Paper, *Planning for a Sustainable Future* (May 2007). It will increase the speed and certainty with which applications are dealt, improve and extend public and community engagement, and ensure that the planning system helps deliver the UK's infrastructure needs. To make developer contributions through the planning system fairer and more certain, the Government will introduce a new statutory planning charge (see Chapter 6).

[8] *The Freight Data Feasibility Study Progress Report*, Department for Transport, October 2007.

[9] *Barker Review of Land Use Planning, Final Report – Recommendations*, Kate Barker, December 2006.

BUSINESS ENVIRONMENT

4.40 Globalisation will intensify competition across many sectors. It is therefore increasingly important that the Government creates conditions that attract both domestic and foreign investment, support business and encourage enterprise. **The Government announces a new PSA to deliver the conditions for business success in the UK**. This commits to provide a competition regime and corporate governance framework ranked among the best in the world, open competitive energy markets which deliver supplies at competitive prices, regulation that is appropriate and justified, and a target to reduce administrative burdens on business.

BERR spending settlement

4.41 **The new Department for Business, Enterprise and Regulatory Reform (BERR) will lead the delivery of this PSA, with an annual budget of £3.2 billion fixed on average in nominal terms over the CSR07 period.**

Gibbons Review

4.42 The BERR settlement provides funding for the programme of measures proposed by the Government on employment law simplification. This will result in savings to business of around £500 million. Proposed measures include better guidance on all aspects of employment law and improvements to the system for resolving disputes in the workplace as recommended by Michael Gibbons' Review, *Better Dispute Resolution: a review of employment dispute resolution in Great Britain* (March 2007).

Encouraging enterprise

Business support simplification

4.43 To tackle the proliferation of business support schemes and simplify the current large number of uncoordinated schemes provided by different tiers of government, the Business Support Simplification Programme is working with business and all tiers of government to reduce the number of business support schemes from over 3,000 to 100 or fewer by 2010. This will reduce complexity and the time business spends understanding what support is available and accessing it, and will improve the quality, effectiveness and efficiency of schemes.

4.44 To meet this goal, the Government has identified the support it is most appropriate to provide, reflecting the existence of market failures or social equity considerations. Following extensive analysis and public consultation, **the Government is announcing the high-level portfolio of products from which business support will be provided in the future**. Details of these products are set out in Box 4.4 and on the BERR website. The schemes developed on the basis of these products will begin to be phased in from March 2008.

Box 4.4: The new business support portfolio of products

Innovation collaborations – helping businesses to work with the science and research base;

Innovation finance – helping develop and commercially exploit innovative ideas;

Growing internationally – increasing the contribution of foreign direct investment;

Preparing to go international – helping businesses enter new overseas markets;

Export credits guarantee – helping business manage non-payment risks overseas;

Getting into new overseas markets – tailored help to access specific markets;

Risk capital targeted at the equity gap – equity financing for high growth Small and Medium Sized Enterprises (SMEs);

Financial awareness and capability – providing SMEs with the skills and expertise to secure private sector funding;

Debt finance – security and loan finance for young SMEs with viable business plans;

Capital investment grants – supporting capital investment projects either by SMEs or by companies operating in the assisted areas;

Promoting resource efficiency and sustainable waste management – helping create a low carbon economy and tackle climate change;

Business creation – helping to overcome barriers to setting up a new business;

Business expertise for growth – helping get expertise for targeted SMEs to grow;

Local community business coaching – helping disadvantaged individuals start up in business;

Skills solutions for business – helping improve skills for business;

Business collaboration networks – helping businesses to work together to improve performance and exploit market opportunities; and

Shared business support environments – helping businesses share premises and facilities in which to develop and grow.

4.45 Arrangements will be put in place to subject the portfolio to regular review and robust evaluation, to ensure the products most effectively meet business needs and deliver value for money. Business will be strongly represented in this process.

4.46 Businesses also need a simple route to access the support they need to thrive and grow. The Government is therefore bringing together information, diagnosis and brokerage services, currently supplied by many providers, and integrating them with Business Link. Following the recommendation in the *Review of sub-national economic development and regeneration* (SNR),[10] BERR and DIUS are committed to the **launch of a single, integrated business support brokerage service in April 2009, to include skills brokerage as a major component.**

Enterprise in disadvantaged areas

4.47 The Government is committed to promoting enterprise and reducing worklessness in deprived areas by giving local areas the freedom and flexibility to develop approaches that respond to local needs. A new enterprise and renewal fund will foster enterprise in these areas and will place a stronger emphasis on economic development in tackling neighbourhood deprivation. Further details of the fund can be found in Chapter 6.

[10] *Review of sub-national economic development and regeneration*, HM Treasury, Department for Business, Enterprise and Regulatory Reform, and Communities and Local Government, July 2007.

Social enterprise **4.48** The Government recognises the potential of businesses that want to combine profit generation with social and environmental goals. It will therefore invest further in raising awareness of the social enterprise business model. As set out in the recent review of the third sector,[11] this will include coverage of social enterprise in business studies education, improving access to finance and advice for social entrepreneurs – consistent with the Business Support Simplification Programme – and investigating how the social enterprise business model can improve government policy delivery and outcomes.

Simplifying business tax

4.49 The Government is committed to ensuring that the UK provides a world-class environment for business. To help achieve this, Budget 2007 announced improvements which made the tax system fairer, simpler and more efficient by:

- modernising and simplifying both the personal and business tax systems;
- publishing the implementation plan[12] for the 2006 Review of HM Revenue & Customs' (HMRC) Links With Large Business; and
- delivering £300 million of administrative savings to business, helping HMRC towards achieving its administrative burden targets.[13]

4.50 Building on these and other reforms, **the Government is renewing its commitment by launching a significant programme of tax simplification** – setting out new principles, new reviews and a package of measures – to enhance UK productivity and competitiveness.

Principles of simplification **4.51** **The Government commits to three principles of tax simplification**, which underpin this new programme:

- simplification will be a priority when designing and reviewing tax policy, alongside sound public finances and fairness;
- the Government will work in partnership with business to identify further opportunities to simplify the tax system; and
- the Government will share its findings on the viability of tax simplifications with business.

Simplification reviews **4.52** **The Government today publishes its findings, for discussion with business, on the case for administrative alignment of the income tax and national insurance systems** (see Chapter 5 for more detail). This autumn **the Government will launch three reviews where HM Treasury and HMRC will work in partnership with business to evaluate how a range of tax policies could be simplified**. These initial reviews will cover:

- how to simplify VAT rules and administration in the UK and the EU;
- how anti-avoidance legislation can best meet the aims of simplicity and revenue protection; and
- how to simplify the Corporation Tax (CT) rules for related companies.[14]

[11] *The future role of the third sector in social and economic regeneration: final report*, HM Treasury and Cabinet Office, July 2007.

[12] *Making a difference: delivering the review of links with large business,* HM Revenue and Customs, March 2007.

[13] At Budget 2006, the Chancellor announced targets for HMRC to reduce the administrative burdens imposed on business by the tax system, focusing on forms and returns, and on audits and inspections. Further progress against these targets will be reported at Budget 2008.

[14] Further details of these reviews and how to participate are available at: www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_index.cfm

Delivering simplifications

4.53 As part of this new approach, **the Government will make immediate progress with over 20 tax measures**, set out at Box 4.6. Together, these simplifications will help businesses across the UK economy, by:

- reducing their administrative burdens by up to £100 million;
- making improvements to income tax self-assessment, benefiting 1.6 million small businesses;
- benefiting up to 0.5 million employers and 3 million self-employed; and
- enhancing the City's competitiveness by simplifying and modernising the tax system for financial services.

Maintaining international competitiveness

Business tax reform

4.54 Budget 2007 announced a major package of reforms to the business tax system designed to enhance the UK's international competitiveness, encourage investment, promote innovation and ensure fairness across the tax system. The package was designed to increase the efficiency and simplicity of the system through:

- a reduction in the main rate of CT from 30 per cent to 28 per cent;
- a new Annual Investment Allowance of £50,000 for all firms, to replace the existing first-year capital allowances: 95 per cent of firms will now be able to write off all of their capital expenditure in the year it is incurred;
- extensive reforms of the capital allowances system;
- an increase in the value of the R&D tax credits for SMEs to 175 per cent and large companies to 130 per cent from April 2008; and
- an increase in the small companies' rate of CT to 22 per cent by April 2009.

4.55 In July 2007 the Government launched a consultation on the details of the changes to the capital allowances system, *Business tax reform: capital allowances changes*. Later this year, the Government will publish draft legislation for further comment.

Taxation of foreign profits

4.56 The Government released the discussion document *Taxation of the foreign profits of companies* in June 2007. The Government welcomes the very constructive dialogue to date and continues to work with business to consider the issues raised. The Government will now develop a more detailed, broadly revenue neutral package of proposals to improve the competitiveness of the UK's corporate tax system in relation to foreign profits.

Private equity

4.57 The UK's internationally competitive position has contributed to the development of a strong private equity industry in the UK. The scale of private equity buy-outs has increased over recent years, although recent sharp moves in credit markets may alter the frequency of large-scale deals in the short term. Large-scale buy-outs have raised concerns over reduced transparency, most obviously when a listed company is taken private. The Government welcomes the private equity industry's resolve to become more transparent and the commissioning of Sir David Walker to develop a voluntary code to promote high standards of disclosure and valuation. The Government looks forward to the outcome of this work and to the development of a code that has strong industry buy-in; that results in meaningful disclosure of a breadth and depth to carry credibility with wider stakeholders, especially in relation to employee impacts; and that sets in place an effective monitoring framework with sufficient independence to command acceptance.

4.58 In March 2007 the Government announced a review of the rules that apply to shareholder debt where it replaces part of the equity element in leveraged private equity deals. Following completion of this review the Government is satisfied that the 2005 changes to the Transfer Pricing rules have sufficiently extended the scope of the rules to include all private equity transactions. However, the Government is concerned that these rules may be less effective in the context of highly leveraged private equity transactions. The Government will therefore continue to monitor the operation of the rules where a tax deduction is being claimed for interest on shareholder debt in these types of transactions.

4.59 The reform of capital gains tax to a single rate of 18 per cent from 6 April 2008 (see Chapter 5) establishes a system that is more sustainable, straightforward for taxpayers and internationally competitive. Along with measures to address loopholes and anomalies in the residence and domicile rules (see Chapter 5) this will increase the fairness of the tax system, including for individuals in the private equity industry. The Government remains interested in wider aspects of the ways in which those involved in the private equity and other industries are rewarded, including the application of the legislation on employment related securities, in the context of the need to ensure that the tax system as a whole is fair and sustainable.

Improving competition

Enhancing competition enforcement and redress

4.60 Undistorted competition within the UK and wider European Union (EU) markets is critical to encouraging efficiency, innovation and flexibility in the economy. The UK has a world-class competition regime, but it can be improved. By the end of the year **the Government intends to consult on measures to further enhance the speed and simplicity of the UK merger regime and to reduce the barriers preventing those suffering loss as a result of anti-competitive behaviour from obtaining redress**, through the courts where necessary, without encouraging ill-founded claims.

Competition in the water and sewerage industry

4.61 The introduction of competition in the UK's utilities has delivered significant benefits. A limited competition regime came into force in the water sector in December 2005, which the Government committed to review within three years. The Government has already said that it will bring forward the review, since competition has not developed in the sector. The review will look at all the necessary elements to ensure the regime delivers benefits for consumers and the wider economy, giving specific consideration to investment in infrastructure, innovation and the environment. The Department for the Environment, Food and Rural Affairs will set out further details of the review in the Government's Water Strategy, which will be published early next year.

EU reform

4.62 Ongoing reform of the EU is also required for the UK to realise the full benefits of globalisation. The Single Market has delivered real benefits for the UK, but the need for significant reform continues – particularly in network industries like energy. The Government will continue to oppose unnecessary bureaucracy arising from EU rules and to push for the European Commission to increase the level of competition throughout the EU. Reform in each Member State will be important. For these reasons, the Government looks forward to the Review of the Single Market and a robust update to the Lisbon Strategy for Jobs and Growth in March 2008.

A strong and competitive global financial centre

4.63 The financial sector remains a significant area of comparative advantage for the UK economy, in 2006 contributing around 9 per cent to UK GDP output, supporting 1.1 million jobs, and producing a trade surplus with the rest of the world of £25.1 billion, the largest in the world.

Global market disruption

4.64 The UK financial system, in common with other financial systems, has been affected by the recent disruption in global markets triggered by deterioration in the US sub-prime mortgage market. Although direct exposures to losses from sub-prime mortgages have been less significant in the UK than in some other countries, some financial institutions have found themselves under significantly more funding pressure due to the seizing up of the asset-backed commercial paper markets and the contraction of liquidity in the inter-bank markets. Northern Rock plc faced specific difficulties in these circumstances. Following advice from the Governor of the Bank of England and the Chairman of the Financial Services Authority (FSA), the Chancellor concluded that it was appropriate and necessary for the Bank of England to provide liquidity support to Northern Rock plc. Subsequently the Chancellor has announced that, should it be necessary, the Government, with the Bank of England, would put in place arrangements that would guarantee all the existing deposits in Northern Rock plc during the current instability in the financial markets.[15] The Government recognises the need to learn lessons from these events and will bring forward proposals for further reforms to give consumers confidence that their savings and deposits are accessible, safe and secure, and to handle banks facing difficulties.

City competitiveness

4.65 The Government will ensure that financial sector regulation remains effective, proportionate, and risk-based, protecting investors and consumers appropriately and ensuring market integrity whilst encouraging innovation and keeping pace with market developments. Supporting and promoting the sector's competitiveness, including through the High-Level Group on the City of London's international competitiveness, remains a key priority. A number of substantive proposals were announced at the second meeting of the High-level Group in May, as set out in Box 4.5, and the third meeting will take place in November. The Government also continues to facilitate the development of new areas of finance, for example encouraging growth in Islamic Finance (see Annex B) and carbon markets.

Taxation of financial services

4.66 The ongoing development of an innovative, flexible and internationally competitive financial sector also requires a tax system that reflects commercial developments. The 2007 Pre-Budget Report simplification measures on areas such as 'Schedule 19' within Stamp Duty Reserve Tax, direct tax treatment of financial derivative transactions, offshore funds and the Investment Manager Exemption (outlined in more detail on Box 4.6) will give businesses and investors greater certainty about how the tax system will operate given recent market developments, as well as reducing administrative and compliance costs. Box 4.6 also outlines simplification measures on Stamp Duty on Shares and on life insurance, and publication today of a discussion paper setting out proposals to simplify and modernise the offshore funds tax regime, with the aim of providing more certainty to UK investors and offshore funds.

[15] The Treasury has issued further statements on the scope of these safeguards. For further details see HM Treasury press notices 95/07 and 96/07 and RNS 2413E from the Regulatory News Service provided by the London Stock Exchange.

Box 4.5: High-Level Group on the City of London's international competitiveness

At its second meeting on 9 May 2007 the High-level Group, chaired by the Chancellor, discussed progress on a number of substantive proposals, including:

- **a package of regulatory simplification measures designed to increase the global competitiveness of the UK's fund management industry by reducing costs for fund managers by up to £290 million per year;**
- **the launch of a prospectus setting up a new world-class International Centre for Financial Regulation (ICFR) in London. Mervyn Davies is chairing the interim executive committee, representing donor interests, that will now prepare the centre for launch;**
- **the work of Lord Levene and the London Insurance Market Review Group on modernisation of the wholesale insurance market, which will report to an 'Insurance Summit', which is scheduled to be held on 7 November 2007; and**
- **delivery of the new strategy for overseas promotion of the UK-based financial sector, with the launch of new promotional materials including a brochure and a new website, www.thecityuk.com by UK Trade & Investment, the Corporation of London, Think London and International Financial Services London.**

The next meeting of the High-level Group, which will be chaired by the Chancellor, is scheduled to be held on 14 November 2007.

PROMOTING REGIONAL ECONOMIC GROWTH

4.67 The most recent data show that the economies of all English regions have grown between 2002 and 2005 and that progress is being made on narrowing the gap in growth rates between the regions. This progress has been underpinned by stronger employment performance in the North, Midlands and South West regions than in London, the South East and East of England. A narrowing in the intermediate skills gap may also have played a part. The Government will only be able to fully assess trends in regional economic activity and disparities when a full economic cycle is complete.

4.68 The Government believes that unfulfilled economic potential in every nation, region, city and locality must be released to increase the long-term growth rate of the UK. **The Government therefore announces a new PSA to improve the economic performance of all English regions and reduce the gap in economic growth rates between regions** by maintaining macroeconomic stability to help businesses and individuals plan for the future, implementing reforms to tackle market failures in the underlying drivers of growth, and devolving decision making to the regional and local levels to ensure that delivery is responsive to the challenges of each particular area.

Sub-national review

4.69 The Government published in July 2007 the *Review of sub-national economic development and regeneration* (SNR) which set out a comprehensive package of reform aimed at enabling more effective and efficient delivery of improved economic performance at the regional, sub-regional and local levels. This review announced an enhanced strategic role for the RDAs, supported by increased freedoms and flexibilities and a simplified sponsorship framework. The outcomes and recommendations of the SNR are set out in more detail in Annex D.

4.70 This refined role for the RDAs enables them to deliver significant efficiency and value for money savings. **The 2007 Comprehensive Spending Review provides for the RDAs' single programme budget to be £2,220 million in 2008-09, £2,191 million in 2009-10 and £2,140 million in 2010-11**. Underpinning this, the RDAs have committed to an ambitious value for money programme that will release significant savings over the CSR07 period.

4.71 The 2007 Comprehensive Spending Review has benefited from advice from each of the regions, as well as from the Northern Way, which provides a clear strategy for improving the economic performance of the North of England. Building on their role as strategic leaders of growth in each region, and increasing regional input to national decisions, the RDAs will also be asked to contribute to the development of Budget 2008 in four areas: building regional intelligence of business priorities; implementing the SNR; responding to the long-term challenge of globalization; and ensuring that all regions can benefit from the Olympics legacy.

Business rate supplements

4.72 Following the recommendations of the Lyons Inquiry[16] and SNR **the Government has today published a White Paper setting out proposals to allow local authorities to invest in economic development through levying a local business rate supplement**. This power will be subject to four levels of protection for business, with spending only available for a specified economic development purpose and subject to detailed statutory consultation, a maximum limit of two pence per pound of rateable value, an exemption for properties with a rateable value less than £50,000 and a requirement to ballot where the supplement supports more than a third of the cost of the project.

Business rate reliefs and exemptions

4.73 The Government accepted a Lyons Inquiry recommendation to review all reliefs and exemptions within business rates. The review has now concluded. In addition to its reform of Empty Property Relief, **the Government will now simplify a number of smaller reliefs** (see Box 4.6). There will be no other substantive changes arising from this review, or to Business Improvement Districts. However the Government will continue to consider the merits of extending business rates to include derelict and vacant previously developed land, and will keep business rates policy more generally under review.

[16] *Place-shaping: a shared ambition for the future of local government*, Lyons Inquiry, March 2007.

Box 4.6: Delivering tax simplification

As part of the Government's new approach to tax simplification, it will make immediate progress with over 20 tax measures:

Business

- beginning this year, doubling the three line account threshold to £30,000 and introducing shorter self-employment pages for businesses with turnovers below the VAT registration threshold, helping 1.3 million businesses submit shorter tax returns;
- doubling the payment on account threshold for income tax self assessment to £1,000 from April 2009, simplifying the payment system for 320,000 businesses;
- consulting this autumn on how best to collect tax on benefits in kind and expenses through the payroll, helping up to 500,000 employers by removing the need for a separate end of year process;
- including consultation on removing the £8,500 a year threshold at which most benefits in kind become taxable, making it simpler for employers when reporting benefits;
- consulting on how to improve the present separate systems for collecting Class 2 and 4 national insurance contributions (NICs), to make it easier for around 3 million self-employed to understand and pay their NICs;
- working closely with business to improve the guidance on tax and NICs, making it easier for all employers to understand and meet their tax obligations;
- repealing outdated legislation relating to expenditure on fire safety equipment from April 2008, making the tax code easier to understand;
- consulting on principles-based responses to avoidance involving income stripping to improve clarity and certainty; and
- consulting on principles-based responses to avoidance involving disguised interest to improve clarity and certainty.

Assets

- removing the need for 250,000 non-residential and residential Stamp Duty Land Tax (SDLT) returns by introducing a notification threshold of £40,000 for all freehold and leasehold transactions at Budget 2008. In addition, notifications will only be needed for certain high-value leases;
- simplifying the relevant legislation for companies that choose to invest in life insurance policies;
- responding to industry concerns about pensions taxation by simplifying the rules for protecting rights to pre-April 2006 lump sums and by cutting the administrative burden of a lifetime allowance anti-avoidance rule; and
- consulting on proposals to rationalise and simplify the business rate relief system while protecting those currently covered by reliefs and continuing the support offered to charities.

Financial Sector

- removing a range of smaller financial and other transactions from the charge to Stamp Duty – cutting the number of forms that need to be presented for stamping by more than 60 per cent;
- consulting on options to make 'Schedule 19' of the Stamp Duty Reserve Tax (SDRT) legislation simpler to administer and easier for investors to understand. This will benefit collective investment funds, improving the industry's international competitiveness;
- publishing HMRC guidance to clarify the direct tax treatment of financial derivative transactions, making it easier for investment funds and investors to deal with the tax system by giving more certainty on future tax treatment of investment strategies;
- publishing a discussion paper today setting out proposals which simplify the offshore funds tax regime, remove tax barriers impacting on the development of offshore funds of funds and ensure the regime continues to prevent UK investors gaining unfair tax advantages. This follows the Budget 2007 announcement that, subject to consultation, the Government intends to legislate for a modernised offshore funds tax regime in Finance Bill 2008;
- modernising the Investment Manager Exemption legislation to clarify and simplify the scope of exempt transactions and ensure a proportionate tax response if a single condition for exemption is not met, so increasing certainty for UK-based fund managers involved in a wider range of activities;
- continuing to consult with the life insurance sector on proposals for further simplification, including on the repeal of complex inherited estates legislation; and
- publishing the latest draft of regulations as part of the final step toward the simplification of rules relating to transfers of life insurance business.

Charities

- continuing to consult with charities to identify ways of making the Gift Aid system – already worth more than £800 million a year to the charitable sector – simpler and easier to use. Further detail on the consultation is available in Chapter 5.

The Environment

- reviewing the hydrocarbon oil duties legislation to simplify the duty rates structure and remove obstacles to the introduction of more environmentally friendly fuels.

Tax Appeals

- consulting on how to streamline and make more consistent across all taxes the process for reviewing decisions and handling appeals before they come before a tribunal, in the context of wider tribunal reform.