

Productivity growth underpins strong economic performance and sustained increases in living standards. Raising productivity growth is critical to meeting the opportunities and challenges of globalisation. Budget 2006 sets out the next steps the Government is taking to strengthen the drivers of productivity growth, including:

- **advancing the goals of the ten-year Science and Innovation Investment Framework to maximise the impact of science funding**, including an intention to create a single health research fund of at least £1 billion per year, to simplify radically institutional research funding, to expand R&D support for mid-sized companies and introduce a package of measures to improve science teaching, raise the quality of science lessons and entitle able pupils to study three separate sciences at GCSE;
- **measures to reduce further burdens on business**, including new commitments to reduce the administrative burden of the tax system, introducing the Hampton Review's principles into law, and a review of how the experiences of large business can be taken into account in administering the tax system;
- **a comprehensive package of measures to enhance the UK's position as a leading location for inward investment, developing an ambitious strategy for marketing the UK:**
 - **promoting London as the world's leading international centre for financial and business services**, with a new strategy to be developed and implemented by a high-level group representing the City's key interests by summer 2006;
 - **establishing a new International Business Advisory Council** comprising some of the world's foremost business people;
 - **a programme of organisational changes to UK Trade and Investment**, with the aim of a fundamental transformation of its effectiveness in marketing the UK;
 - **strengthening the UK's reputation as one of the world's best locations for higher education**, by boosting support for international students to the UK, and establishing three new University Partnership Schemes;
- **building on the Government's commitment to raise skills levels** by investing in the reform of further education and training provision, and asking the Leitch Review of Skills to report specifically on how skills and employment services can complement each other;
- **boosting access to finance to enable early-stage companies with real growth potential to bridge the equity gap and progress through to market**, announcing a further £50 million in 2006-07 and £50 million in 2007-08 for the Enterprise Capital Funds scheme; and
- **taking forward the Government's strategy for tackling the long-term lack of supply and responsiveness of housing and property** and introducing Real Estate Investment Trusts to create greater flexibility for investors.

Globalisation and productivity 3.1 *Long-term global economic challenges and opportunities for the UK*, published alongside the 2004 Pre-Budget Report, identified the opportunities and challenges created by shifting economic activity and rapid technological change as faster information flows and falling transport costs continue to break down geographical barriers to economic activity. *Globalisation and the UK: strength and opportunity to meet the economic challenge*, published on 2 December 2005, set out the UK's existing strengths and where it needs to build on success, in order to thrive in a global environment. The latest data on international comparisons of productivity show that recently the UK has made progress in narrowing the productivity gap as set out in Box 3.1. This Budget sets out the Government's plans in these areas, particularly on science and innovation, attracting global investment to the UK, reducing the burdens on business and enhancing skills.

The UK's productivity framework and performance

The five driver framework 3.2 Alongside the Budget the Government is publishing *Productivity in the UK 6: Progress and new evidence*, which analyses the UK's recent productivity performance relative to comparator economies. It also sets out new evidence underlying the Government's five driver framework, which provides the context for the Government's strategy for raising productivity growth.

This Budget sets out reforms described in the context of the five key drivers of productivity:

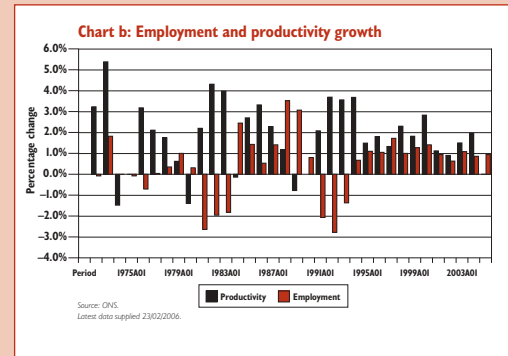
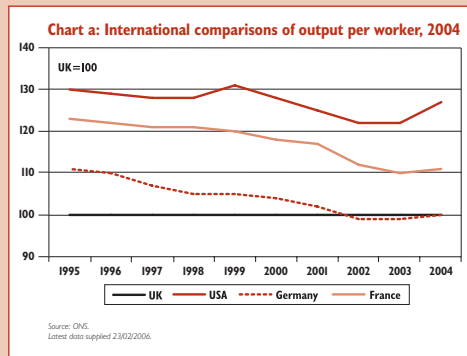
- improving *competition*, vital for the adoption of innovation and increased business efficiency;
- promoting *enterprise*, by removing barriers to entrepreneurship and developing an enterprise culture;
- supporting *science and innovation*, given that increasing rewards to innovation mean that the UK's economic success will depend on its ability to create new knowledge and translate it into innovative goods and services;
- raising *skills* levels, to create a more flexible and productive workforce, which can adopt innovative technologies and enable individuals to move into new areas of work; and
- encouraging *investment*, to increase the stock of physical capital, including through stronger, more efficient capital markets.

Box 3.1: UK productivity performance

An in-depth discussion of the UK's productivity performance can be found in *Productivity in the UK 6: Progress and new evidence* published alongside Budget 2006.

In the long-run, productivity growth is the key driver of wages, profits and ultimately overall prosperity. The latest data on international comparisons of productivity shows that recently the UK has made progress in narrowing the international productivity gap. Chart a below illustrates some of this progress. Since 1995 the UK has halved the output per worker gap with France and closed the gap with Germany. Although the gap with the US remains significant, the UK is the only country in the G7 to have kept pace with the US.

Productivity performance is likely to be dampened by periods of strong employment growth. Historically, the UK has rarely experienced simultaneously strong employment and productivity growth. Since 1997 the UK has witnessed strong employment growth, with over 2.3 million more people being employed, alongside productivity growth. The UK is experiencing the longest sustained period of productivity growth and employment growth since the 1950's when records began. Chart b illustrates the UK's recent success in combining employment and productivity growth.



To assess progress on actual headline productivity performance and remove distortions created by cyclical factors, judgements on productivity performance should be made between on-trend points.

There is evidence that the UK has improved its trend productivity performance. Over the first half of the current economic cycle, 1997-2001, which covers the period between the first and second on-trend points in the cycle, actual productivity (trend output per hour worked) growth was 2.59 per cent per annum. This is higher than the figure of just over 2 per cent annual actual productivity growth over each of the previous two economic cycles.

European economic reform 3.3 Strengthening economic reform in Europe is a key priority for the UK. During the UK Presidency of the EU, further steps were taken to reduce the burden of EU regulation on business, strengthen the transatlantic economic relationship and deliver greater integration in European financial services markets. Member States also submitted their first National Reform Programmes setting out the policies they intend to pursue to promote growth, employment creation and productivity¹. The UK will continue to press for progress on this agenda. Box 3.3 later in this chapter sets out the further steps that are needed to drive up competition in the Single Market.

¹ Lisbon Strategy for Jobs and Growth: UK National Reform Programme, HM Treasury, October 2005

Productivity in the regions **3.4** The Government is also committed to strengthening economic performance across the regions, localities and countries of the UK, and to reducing the persistent gap in growth rates between the regions. The nine Regional Development Agencies (RDAs) were therefore set up to advance the shared growth priorities for each region and local area in England. The three Northern RDAs have worked together with other regional and local partners to develop the Northern Way Growth Initiative, which provides a long-term strategy for transforming the economic performance of the North.

3.5 The RDAs were asked to contribute to the development of Budget 2006 in three key areas: rationalising business support; creating links between the national and regional frameworks on innovation; and increasing private investment in economic regeneration. Budget 2006 announces measures developed with and building on the RDAs' input, set out later in this chapter, including a commitment to a radical rationalisation of the number of business support services.

Cities and regional growth **3.6** The RDAs, together with other regional and local bodies, have developed effective collaboration across city regions, in recognition of the the strong role that cities play in regional economic growth. Examples of this include the Northern Way Growth Strategy and the Regional Cities East Initiative. Through the *State of the English Cities Report*² and *Devolving decision making: 3 – Meeting the regional economic challenge: The importance of cities to regional growth*,³ published alongside the Budget, the Government has been analysing the contribution that cities make to regional economic performance. High performing cities contribute to competitive regions, stimulating growth and employment, promoting excellence in surrounding areas and joining up separate business hubs to expand existing markets and create new ones. The Government's strategy for facilitating the economic growth of London so that it secures its position as a high performing city to meet the opportunities and challenges of globalisation, is set out in Box 3.2.

3.7 Given the importance of strong collaboration across regions, local areas and cities, this analysis raises a series of challenges around how the Government builds on steps already taken to devolve decision-making to the regional and local levels. In seeking to meet these challenges, the Government will conduct a review to feed into the 2007 Comprehensive Spending Review to explore the opportunities for further releasing the economic potential of English regions, cities and localities, and to more effectively respond to the ongoing challenge of tackling pockets of deprivation. *Devolving decision making: 3 – Meeting the regional economic challenge: The importance of cities to regional growth* also sets out the Government's initial assessment of the role that cities play in driving both regional and national economic growth. It explores both the current state of economic performance across English cities, and the different challenges cities face in raising this performance and in reducing disparities in outcomes for their residents.

Local Authority Business Growth Incentive Scheme **3.8** To create a direct financial incentive for local authorities to promote local business growth the Government introduced the Local Authority Business Growth Incentive (LABGI) scheme in April 2005. Local authorities receive a proportion of increases in local business rate revenues to spend on their own priorities, in addition to the grant that they have already received in the local government finance settlement. The Government announced the first year of LABGI payments in February. In England, 266 local authorities received LABGI grants for 2005-06, totalling £114 million. The Government estimates that local authorities in England and Wales could gain up to £1 billion over the three years to 2007-08.

² *State of the English Cities*, ODPM, March 2006

³ *Devolving decision making: 3 – Meeting the regional economic challenge: The importance of cities to regional growth*, HM Treasury, DTI and ODPM, March 2006.

Box 3.2: London – meeting the challenges and opportunities of globalisation

London is well positioned to respond effectively to the opportunities and challenges presented by globalisation, benefiting from a long history of trading links across the world, excellent business connectivity, well developed infrastructure, and a highly skilled and flexible workforce supporting knowledge intensive economic activity. Its successful bid to host the 2012 Olympic and Paralympic Games shows the confidence in London at both a domestic and international level.

To build on this historically successful foundation and advance economic success in the future, the Government, working in partnership with business and the Greater London Authority, will:

- grant further strategic and delivery responsibilities to the Greater London Authority (GLA), enabling the Mayor to better match provision of public services to specific needs across the capital. The Minister for Local Government and Communities will respond to the outcome of ODPM's consultation in the spring;
- bring together London's world-leading financial and business services industry in a new high-level group to develop a single coherent strategy for promoting the city's competitive advantages as a location for international finance, especially in emerging markets such as India, China and the Middle East (as described in detail later in this chapter and in *Financial Services in London: Global Opportunities and Challenges* published alongside the Budget);
- set out a programme of work which will enhance the delivery of public services in the capital, improve the opportunities available to Londoners – particularly those in disadvantaged areas – and promote continued economic growth; and
- publish *Employment opportunity for all: analysing labour market trends in London*, alongside this Budget, analysing the underlying reasons for low employment rates in London compared to other parts of the country, as a basis for future policy action (set out in detail in Chapter 4).

COMPETITION

3.9 Competition drives productivity by creating incentives for firms to be innovative. A competitive environment is vital to ensure UK businesses continue to thrive in the global market place. In 2004 an independent peer review described the UK competition authorities as having all the necessary powers to develop a world-class competition regime and ranked the UK regime third in the world.⁴ The Government is committed to further improvements, and will commission another independent review of the comparative effectiveness of the UK competition regime with its peers in the OECD, during 2006-07.

European competition policy

Competition and the single market

3.10 The Government's commitment to openness in trade and investment is a key driver of the UK's global competitiveness. A fully open and competitive single market would have similar benefits for the EU. Evidence suggests the creation of the single market has produced over 2.5 million jobs and delivered around £600 billion of extra prosperity for the EU over the past 10 years.⁵ However, just at a time when Europe's commitment to open and liberalised

⁴ *Peer Review of Competition Policy*, KPMG and the Department for Trade and Industry, May 2004. Available at www.dti.gov.uk.

⁵ *The internal market – ten years without frontiers*, European Commission, 2003

markets needs to be stronger than ever, there is evidence of an increasingly protectionist approach emerging. The EU has seen delays in agreeing a vital package of reforms to liberalise trade in the service sector and a number of national governments have moved back towards protecting dominant companies.

3.11 The Government believes that further steps are needed to drive up competition in the Single Market, as set out in Box 3. 3

Box 3.3: Strengthening the European Single Market – levelling the playing field

The Government strongly believes that Europe must continue to strengthen and deepen the Single Market, enabling Europe's firms to compete successfully in the global marketplace, and is seeking:

- full implementation by Member States of existing market-opening legislation across the Single Market, including in the telecommunications and energy sectors;
- swift agreement by Member States and the European Parliament on an ambitious and liberalising Directive to remove barriers to trade in services; and
- rapid action by the European Commission and Member States to tackle the barriers to competition identified by the Commission's sector inquiries into competition in the EU's gas and electricity markets and in financial services.

In addition, the Government welcomes the European Commission's pledge to examine any undue interference by national governments in the process of cross-border corporate restructuring in Europe. The Government also welcomes the proposals to improve competition set out in the Commission's recent Energy Green Paper, including measures which take forward the interim findings of the gas and electricity sector inquiry.

Satisfactory action in all of these areas will be essential to drive up competition in the Single Market. If this is not achieved, the Government believes there should be further work to consider the effectiveness of competition policy enforcement in the EU, including through further independent investigations into sectors where competition is not developing as it should. The Government will continue to raise these issues with the Commission and other Member States.

Energy 3.12 Promoting competitive and secure energy markets in the UK, and beyond, are core Government goals. The UK's well-regulated energy sector has delivered secure supplies at low prices for much of the past nine years. However, more recently global oil price increases have fed through to higher gas prices, while domestic gas production from the UK Continental Shelf is declining faster than expected. This has led to a tight supply situation and higher prices in the UK gas market this winter.

3.13 The 2005 Pre-Budget Report noted that the independent energy regulator – the Office of Gas and Electricity Markets (Ofgem) – and the Government were working to ensure the effective operation of the UK energy market. This included Ofgem action to maximise the use of Liquefied Natural Gas (LNG) facilities and a request from the Government for the European Commission to investigate the operation of the gas interconnector (during the period when gas prices were high in the late autumn the gas interconnector to the continent was under-utilised, despite the price premium on the UK side). As a result, during the winter, LNG import capacity has been used to the fullest possible extent and the flow of gas through the interconnector has risen to the levels forecast by National Grid. Nonetheless questions remain about the operation of the interconnector and the Government is urging the European Commission to complete its investigation, in particular into whether there are any

barriers to the free movement of gas. As set out in Box 3.3, speeding up liberalisation of EU energy markets is a key priority for the Government. This reaffirms the importance of fully liberalised energy markets across the EU to deliver sustainable, competitive and secure energy.

Energy review 3.14 The Government recognises the importance of energy in supporting sustainable growth, as well as meeting our environmental aims (described in Chapter 7). Work is going on across Government to identify how we can meet our long-term energy needs while achieving our goals on security of supply and climate change, particularly through the comprehensive review of UK energy policy announced last November by the Prime Minister. The review will make policy recommendations to the Prime Minister and the Secretary of State for Trade and Industry in summer 2006. Building on the recommendations of the Energy Review, the Government will identify how competitive markets can best be enabled to meet the future energy challenges the UK faces.

Competition in specific markets

Payment systems 3.15 Innovation, price inefficiency, access and governance are key issues in improving competition in payment systems. The Government therefore welcomes the progress made in the Payment Systems Task Force's work on governance across all payment schemes and looks forward to detailed proposals that ensure that payment systems are run in the interests of users and the wider economy. The Government remains committed to legislating if there has not been a significant improvement in competition by the end of the Task Force's four-year lifespan.

Spectrum use 3.16 Radio spectrum is a vital resource for communications and other services, and the public sector uses over a third of the entire spectrum for defence, aeronautical, maritime, scientific and emergency services. In December 2005, Professor Martin Cave published an independent audit of spectrum holdings in the public sector.⁶ The Government agrees with the audit that there is scope for more efficient management in the majority of public sector spectrum.

3.17 The Government has today **published detailed plans for the implementation of changes to public sector spectrum, in response to the audit's recommendations.**⁷ This will create new opportunities for public bodies to make more effective use of their spectrum holdings, by enabling and encouraging trading and increased sharing with other users.

3.18 To support this, Ofcom has agreed to take forward work on defining the spectrum rights of public bodies. Departments will outline specific proposals for the release or sharing of spectrum by the end of 2006, and the Government will produce a spectrum strategy in March 2007. This will examine current spectrum use and forecast future requirements. Spectrum charges will also be more consistently applied across the public sector to provide stronger incentives for efficiency, and Ofcom plans to introduce pricing in aeronautical and maritime radar spectrum from 2008.

⁶ *Independent Audit of Spectrum Holdings Final Report*, December 2005

⁷ *Independent Audit of Major Spectrum Holdings: Government Response and Action Plan*, Cabinet Official Committee on UK Spectrum Strategy (UKSSC), March 2006

Creating competition with public procurement

3.19 The purchase of goods and services by the public sector – public procurement – accounts for a significant proportion of public expenditure, and of demand for goods and services in the economy. In some markets the public sector is likely to be by far the largest buyer, and in a position to affect competition through its purchasing behaviour.

Better public procurement 3.20 Good progress continues to be made on improving value for money through better public procurement. The Government is ahead of schedule in meeting its targets with £2.3 billion of savings having already been made across central civil government. Further improvement is supported by new simplified procurement regulations accompanied by Office of Government Commerce (OGC) guidance on e-auctions, framework agreements, competitive dialogue and the scope to take account of environmental and social issues.

SME procurement 3.21 The (OGC) and the Small Business Service's national Small and Medium Enterprise (SME) procurement programme has continued to make improvements. Data gathered from 95 local authorities indicates that SMEs have a 59 per cent share (in terms of value) of local authority procurement against 51 per cent SME share of turnover in the UK economy. Achievements since the progress report of December 2005 include:⁸

- the imminent launch of the national portal to advertise low value public sector contracts;
- 800 procurers and more than 3,000 SMEs have been trained (including those from the Third Sector) through a nationwide training programme; and
- an investigation into the public sector's use of third-party accreditation services. Recommendations will be published in spring 2006.

Small Business Research Initiative 3.22 The Small Business Research Initiative (SBRI) is monitoring departmental compliance with the mandatory target to procure at least 2.5 per cent of their extra-mural R&D from small firms. The Government comfortably exceeded its target in 2004-05 and 10.6 per cent of the £2.5 billion of extra-mural R&D expenditure in participating Government departments went to SMEs.

Procurement in major government markets 3.23 As part of the Kelly programme to increase competition and capacity in major government markets, proposals for better strategic management of waste management resulting from a comprehensive survey of all local authorities in England will be published in spring 2006.⁹ In addition, the Public Sector Construction Clients' Forum, chaired by Sir Christopher Kelly, has begun work to implement better planning of public sector demand for construction in relation to the capacity of the industry; developing improved whole-life value for money construction procurement performance measurement; and embedding Achieving Excellence in Construction best practice. An in-depth analysis of the impact of construction on the UK, particularly in London and the Southeast, is due in summer 2006.

⁸ http://www.supplyinggovernment.gov.uk/pdf/SBS_progress_rep_Dec_05.pdf

⁹ See *Increasing competition and improving long-term capacity planning the Government market place*, Office of Government Commerce, December 2003.

ENTERPRISE

3.24 In an increasingly open, competitive, global economy, a vibrant and thriving environment for entrepreneurial activity is critical in ensuring that the UK can respond flexibly to new challenges. Total early stage entrepreneurial activity in the UK is the third highest rate of the G7 economies behind the US and Canada.¹⁰ *Productivity in the UK 6: Progress and new evidence* sets out the latest evidence on the contribution of enterprise to productivity growth.

3.25 The Government is committed to improving the UK business environment and tackling barriers to business growth to allow the UK to enhance its competitive position in the global economy. The Government's strategy has focused on five areas: regulatory reform; modernising and simplifying the business tax system; improving access to finance for small business; improving business support services, with a focus on businesses with high growth potential; and promoting an enterprise culture including encouraging enterprise in disadvantaged areas.

Leading regulatory reform

3.26 Effective and well-focused regulation can play a vital role in correcting market failures, promoting fairness and increasing competition. However, inefficient and over-burdensome regulation can impose a significant cost on business without improving regulatory outcomes. The Government has pursued a programme of reform to deliver better regulation:

- reducing the administrative burdens upon business of understanding regulations and complying with them, including the costs of paperwork, undergoing inspection and complying with enforcement activity;
- examining the existing stock of regulation to ensure that outdated and outmoded regulations, and those encouraging practices that are not risk-based, are removed from the statute book;
- ensuring that there is a clear rationale to new regulations, that the benefits outweigh the costs and that alternatives to regulation are not feasible; and
- pursuing an agenda of regulatory reform in Europe.

Delivering better regulation

3.27 The Government believes that the costs to businesses of administering regulations should be as low as possible without jeopardising regulatory outcomes. Following the publication at Budget 2005 of Philip Hampton's report¹¹ on reducing administrative burdens, and the Better Regulation Task Force (BRTF) report¹² on reducing the administrative cost of regulations on business, the Government launched a Better Regulation Action Plan in May 2005. Progress is shown in Box 3.4.

¹⁰ Global Entrepreneurship Monitor 2005

¹¹ *Reducing administrative burdens: effective inspection and enforcement*, Budget 2005

¹² *Less is More: Reducing Burdens, Improving Outcomes*, Better Regulation Task Force, March 2005

Regulatory scrutiny 3.28 To support the Plan and to strengthen the regulatory scrutiny of all new regulatory proposals that impose a significant cost upon business, the Prime Minister's Panel on Regulatory Accountability (PRA) has been holding departments to account for their regulatory performance since it was established in 2004. To support the PRA in holding departments and regulators to account, and to drive delivery of the Government's ambitious plans for regulatory reform, the Better Regulation Executive (BRE) was established in May 2005 in the Cabinet Office. The Better Regulation Commission (BRC) was also launched on 1 January 2006 and sits alongside the BRE, providing independent, business-focused advice to the Government about its overall regulatory performance. Under the new Chair, Rick Haythornthwaite, former Chief Executive Officer of Invensys Plc, the BRC plays a crucial role in holding departments to account for their plans to reduce regulatory burdens on business.

Box 3.4 Implementing the Better Regulation Action Plan

In May 2005, the Government published an Action Plan, which set out the timetable for implementing the wide-ranging reforms to the UK's regulatory framework that were announced at Budget 2005. The Government has met the milestones set out in that plan and remains on track to deliver these fundamental reforms in full by 2009. Already the Government has:

- introduced the Legislative and Regulatory Reform Bill to Parliament, which will reinforce the principles of risk-based regulatory enforcement as the heart of regulatory practice. It will make the removal of complex or outdated regulation, and the reform of regulatory structures, simpler and quicker;
- published today a draft Code of Practice, which will entrench the Hampton Review's principles in law if the Bill receives Royal Assent;
- following the recommendation of Sir David Arculus and the BRTF, been undertaking a project to measure the administrative burden of regulation, with departments due to present their simplification plans to the Prime Minister's Panel for Regulatory Accountability before the end of the year;
- made progress merging regulatory bodies, with the Horticultural Marketing Inspectorate and Defra Investigations Service being merged into the Rural Payments Agency by 1 April, DTI Companies Investigation Branch being merged into the Insolvency Service on 3 April, and work to merge the Adventures Activity Licensing Authority and the Engineering Inspectorate into the Health and Safety Executive (HSE) to be completed in the near future;
- announced a Local Better Regulation Office to minimise local regulatory burdens on business and work in partnership with local authorities and the national regulators to deliver a risk-based approach to business inspection and enforcement; and
- started a BRE-led review of regulatory penalty regimes, under Professor Richard Macrory. It aims to make penalty systems more consistent across regulatory bodies, ensuring that they reflect the impact of the offence, with tougher penalties for businesses that persistently break the rules.

3.29 The ‘Hampton enforcement principles’ set out in the Hampton Review are that:

- regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most;
- regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take;
- no inspection should take place without a reason;
- businesses should not have to give unnecessary information, nor give the same piece of information twice;
- the few businesses that persistently break regulations should be identified quickly;
- regulators should provide authoritative, accessible advice easily and cheaply; and
- regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection.

Hampton Code of Practice 3.30 The Legislative and Regulatory Reform Bill, currently before the House of Commons, contains powers to enable the Hampton enforcement principles to be established in UK law through a statutory Code of Practice. It is the Government’s intention that these principles should apply at the point where regulators make their policies, rules, codes, and guidance. The Government also intends to ensure that regulators give businesses easy access to complaints procedures. The BRE and BRC will scrutinise regulators’ compliance with the Code, and the Local Better Regulation Office (LBRO) will scrutinise local authorities’ compliance with the Code as part of their wider role in devising a performance management and prioritisation scheme for local enforcement. **The Government today announces that it intends to use powers in the Bill to introduce a statutory Code of Practice, and the Cabinet Office is today publishing an initial draft.**¹³ If the Bill receives Royal Assent, the Code of Practice will be subject to a statutory consultation period.

Reducing burdens on business 3.31 Following the recommendation of the BRTF to adopt an approach first used in the Netherlands, the Government has been carrying out work to measure the total administrative burden on business of complying with government regulations. The baseline methodology will draw on the lessons from the best practice in the Netherlands. This work is currently ongoing and in the course of the next few months, each department will publish detailed targets for the reduction of these burdens. Alongside this, Government departments are being asked to draw up ‘simplification plans,’ which will outline measures being taken by departments to implement the Hampton review, and remove outdated or outmoded regulations. Examples of initiatives already making a difference to businesses, which are being considered for possible future adoption, include removing 50 per cent of HSE’s forms; up to 30 per cent savings in routine planned inspections in the retail sector; and £150 million savings, particularly for small and medium-sized enterprises (SMEs), in reducing the burden of regulatory compliance when trading internationally. Stakeholder views on simplification plans are welcome and many departments have published their plans in draft. Additional suggestions for simplification can be made through the Government’s simplification portal.¹⁴

¹³ <http://www.cabinetoffice.gov.uk/>

¹⁴ <http://www.betterregulation.gov.uk>

3.32 Departments must present their simplification plans to the Prime Minister's PRA over the coming months. The Government will then set stretching but achievable targets for reducing each department's administrative burden over time. **In areas where the administrative burden of regulation appears relatively high compared to international comparators, the Government will set particularly demanding targets.** In areas where the UK is already ahead of other countries, as a result of an active and ongoing simplification programme, the target will reflect progress already made. One such area, although not regulation, is the administrative burden imposed on business by the tax system where targets have been set, and are described later in this chapter.

Local Better Regulation Office

3.33 A key concern for business identified by the Hampton Review was lack of consistency and coordination in local authority regulatory services. To address this concern the Government announced in the 2005 Pre-Budget Report the establishment of the Local Better Regulation Office (LBRO). The LBRO will be responsible for minimising local regulatory burdens on business and working with local authorities and national regulators to deliver a risk-based approach to business inspection and enforcement while maintaining a high level of public protection. A vision statement was published in January 2006 and HM Treasury, DTI and the BRE are now working together to deliver the LBRO. Further details will be published towards the end of 2006 and a draft Bill published as soon as possible in 2007.

3.34 In addition, the Office of Fair Trading (OFT) is working to incorporate some of the smaller regulators and strengthen its relations with Trading Standards to deliver better local regulation.

Consumer Credit

3.35 Today, following discussion with industry and consumer groups, the Financial Services Authority (FSA) and the OFT are publishing a joint statement of intent in order to strengthen their policy coordination, streamline their separate contact with firms, and improve their consumer communications. The intention is to reduce duplication for firms dealing with both bodies. A more detailed action plan will be published by the end of April.

3.36 The Hampton report asked the Government to consider passing the consumer credit functions of the OFT to the FSA. UK regulation of mortgages and consumer credit is undergoing a period of extensive change, with the introduction of FSA mortgage regulation from 31 October 2004, the Consumer Credit Bill currently before Parliament and European Commission proposals for a new Consumer Credit Directive. Following consultation with a range of stakeholders, and in the light of the ongoing changes mentioned above, the Government does not propose additional reforms of the consumer credit regime at this time. It may look again at the regulation of consumer credit, including lending secured on land, when these changes have taken effect.

Haulage Industry

3.37 The findings from the Burns Inquiry into fuel costs, foreign competition and freight taxes have informed the Government's work to ensure that foreign, as well as domestic, hauliers operating in the UK comply consistently with UK road safety regulations. At the 2005 Pre-Budget Report, the Government announced a programme of investment in 'weigh-in-motion' sensors, to allow better targeting of enforcement activities on non-compliant hauliers, and a pilot will be underway in the next few months. Fairer enforcement for hauliers of all nationalities will be further strengthened by the enabling provisions contained in the Road Safety Bill. The Government is also currently consulting on proposals to simplify the operator licensing regime, to reduce hauliers' administrative costs and allow them greater flexibility.

Davidson Review

3.38 The 2005 Pre-Budget Report announced that the Government had asked Neil Davidson QC to conduct a review of the UK's implementation of EU legislation, due to report by the end of 2006. **Neil Davidson QC is today writing to government departments with guidance on how to screen the stock of their legislation that derived from the EU for**

potential ‘over-implementation’. This information will be used when drawing up their simplification plans. Alongside the PRA, the Review will scrutinise the plans and suggest further proposals relating to how EU legislation has been implemented for inclusion. The Review launched a Call to Evidence on 3 March, inviting business, voluntary groups and other stakeholders to submit evidence of over-implementation, including goldplating, double banking and ‘regulatory creep’, which will run until 25 May.¹⁵ As well as submissions of evidence, the Review is drawing on international comparisons to identify further high-risk areas of over-implementation.

Regulation of financial services 3.39 At the 2005 Pre-Budget Report, the Government announced a ten-point action plan of reforms to wholesale and retail financial markets, which reflected the greatest concerns of businesses in relation to the burden of financial services regulation. An update on progress on the plan is described in Box 3.5.

Box 3.5: Progress on reforming the regulation of financial services

Substantial progress has been made on the ten point plan announced at the 2005 Pre-Budget Report for further modernising the regulation of financial services:

- **reviewing the “controllers regime” in Part XII of Financial Services and Markets Act (FSMA)** a consultation launched today proposes wide ranging deregulatory reforms;^a
- **broadening exemptions for employers:** a consultation launched today proposes more freedoms for employers to advise employees on work-related financial services;^a
- **introducing a Regulatory Reform Order:** the Government is considering responses to this consultation, including additional proposals for further deregulation;
- **improving consumer credit regulation:** the Financial Services Authority FSA and the OFT have today published a joint commitment to strengthen their policy coordination, streamline their contact with firms, and improve their consumer communications;
- **conducting a value for money review into the FSA:** the Government has discussed what should be covered with industry and consumers and will launch the review soon;
- **reviewing the effectiveness of mortgage and general insurance regulation:** the FSA is assessing how far the intended outcomes for consumers are being met;
- **enhancing consumer education and understanding of financial services:** the FSA is devoting more resources and implementing the national strategy for financial capability, including in schools and workplaces, in partnership with other stakeholders;
- **introducing simplification plans and quantified burden reduction targets:** the FSA and HM Treasury will publish regulatory simplification plans in the near future;
- industry has asked for work on **reviewing the Financial Promotion Order and the financial promotion restriction in FSMA and reviewing the Regulated Activities Order** to start after the EU Markets in Financial Instruments Directive has been implemented.

^a http://www.hm-treasury.gov.uk/Consultations_and_Legislation/consult_index.cfm

¹⁵ www.cabinetoffice.gov.uk/regulation/davidson_review/

Regulatory reform in Europe

3.40 The Government placed regulatory reform at the centre of its presidency of the EU. In the second half of 2005, the UK Presidency worked closely with the Commission and the other 24 member states and achieved significant progress on this agenda including:

- agreement to simplify over 1400 existing rules and regulations;
- withdrawal of 68 proposed EU regulations;
- a commitment to test the competitiveness impact of all new EU regulations in impact assessments; and
- a commitment for administrative burdens to be measured in all EU proposals.

3.41 The Government recognises that significant challenges remain if the EU and its Member States are to have an appropriate regulatory environment that will enable Europe to compete in the global economy while protecting other legitimate policy objectives. At their December 2005 meeting, EU finance ministers welcomed proposals tabled by the UK presidency in collaboration with the incoming Austrian and Finnish Presidencies that set out the next steps on the European better regulation agenda in 2006 and beyond.¹⁶ This stressed the importance of all EU Member States and institutions implementing the agreed measures to improve both the stock and flow of regulation. The Government will continue to prioritise the integration of the methodology for measuring administrative burdens into the regulatory simplification programme; greater focus on improving the EU's approach to implementation and enforcement; and strengthened stakeholder consultation, including business input to the process of regulatory design.

3.42 During the UK presidency the Commission also committed to examine systematically new EU proposals to ensure that the needs of SMEs are properly prioritised. Research consistently shows that small businesses suffer disproportionately from poor regulation. Greater consideration will now be given to measures including exemptions, longer transition periods, reduced fees, and simplified reporting requirements. In consultation with business groups, **the Small Business Services will lead efforts within the UK to identify regulations for which measures to reduce the regulatory burden for SMEs would be appropriate and will work with the Commission to deliver these proposals.**

Modernising and simplifying tax administration

Modernising the tax system for small businesses

3.43 HMRC has today published *Progress towards a new relationship: How HMRC is working to make life easier for business* - the third in a series of reports on how the department is delivering improvements to SMEs' experience of the tax system. The paper provides an update on the extensive package of work that HMRC are undertaking to make it cheaper, quicker and easier for small business to comply with their obligations.

3.44 The paper sets out the conclusions of research carried out by KPMG into the administrative burdens of the tax system. The research has found that the UK tax system imposes burdens of 0.41 per cent of GDP, or 1.1 per cent of tax take. This compares well with the results in the Netherlands (0.82 per cent of GDP) and Denmark (0.57 per cent of GDP), the only other countries that have so far carried out a similar exercise, and confirms the recent findings of a National Audit Office report¹⁷. Nevertheless, the Government is determined to reduce burdens further, while continuing to collect and repay the right amount of tax and credits.

¹⁶ *Advancing Better Regulation in Europe* — a joint UK, Austrian and Finnish Presidency discussion paper, December 2005

¹⁷ *Corporation Tax: Companies managed by HM Revenue and Customs' Area offices*, National Audit Office, 13 January 2006 <http://www.nao.org.uk/>

Reducing the administrative burdens of tax **3.45** The KPMG research has shown that 85 obligations relating to dealing with forms and returns impose 85 per cent of total costs, but that there is a large ‘tail’ of another 2607 obligations that, although they only apply to a small number of businesses, collectively can cause irritation and contribute to an impression that the tax system is complex and difficult to understand. HMRC will tackle both aspects of the burden on business. To reduce the impact of the most costly burdens, HMRC will:

- **reduce the administrative burdens on business of dealing with HMRC forms and returns by at least 10 per cent over 5 years; and**
- **reduce the administrative burden on business of dealing with HMRC’s audits and inspections, by 10 per cent over three years and at least 15 per cent over five years.**

Administrative Burdens Advisory Board **3.46** To deal with the remaining ‘tail’ HMRC is launching a new **business-led Administrative Burdens Advisory Board that will be independently chaired by Teresa Graham**, non-executive director of four businesses and Deputy Chair of the Better Regulation Commission. The Board will use the KPMG research to identify the areas of future work HMRC should focus on, proposing and developing reforms to the way the tax system is administered that will make a noticeable difference to businesses.

Review of HMRC links with business **3.47** The 2001 Review of Links with Business led to the establishment of the Business Tax Forum to foster a stronger relationship and greater understanding between large businesses and the former Inland Revenue. To build on that work, the Chancellor has asked Sir David Varney to work with business representatives to identify opportunities to further improve the extent to which the views and experiences of large business are taken into account in the administration of the tax system.

Deregulating tax administration **3.48** The Government is committed to simplifying and updating tax administration for all taxpayers. This Budget announces that the Government will:

- **simplify and clarify the stamp duty land tax treatment** of a range of transactions, including commercial leases, transfers of partnership interests and the reallocation of assets within settlements;
- **undertake a radical reform of the excise duty deferment guarantee system**, in light of consultation responses from business. Subject to further consultation on the details, HMRC plan to introduce the new system during 2006-07 delivering considerable cost savings for compliant businesses;
- **repeal or simplify over 40 provisions in alcohol legislation** which are obsolete or over-burdensome, and simplify or clarify a number of provisions in the Tobacco Products Duties Regulations; and
- **simplify administrative aspects of amusement machine licence duty**, easing financial and compliance burdens for licence holders.

3.49 This programme of work will continue, and further discussion with industry is planned during 2006 to identify other provisions that can be repealed or simplified. This will allow further reductions in compliance costs and allow process and regulation to fit better with trade practice.

Compliance cost reviews **3.50** As part of the Government's continuing commitment to review regulations after they are implemented, HMRC has introduced a rolling programme of compliance cost reviews. These aim to confirm whether estimates of compliance costs and savings included in Regulatory Impact Assessments were reasonable. HMRC will publish the results for their programme for 2005-06 shortly and feed directly into future improvements to the impact assessment process.

Supporting small businesses

3.51 As set out in *Devolving decision making: 2*, the Government believes that support to help businesses start up and grow should be regionally led, in order to address local and regional enterprise challenges.¹⁸ Responsibility for co-ordination of Business Link services has therefore been devolved to RDAs since March 2005. There is concern at all levels that the proliferation of business support schemes has created a complex picture making it difficult and time consuming for businesses to access relevant support. **The Government will work with RDAs and other local and national bodies to reduce the number of business support services from around 3,000 now, to no more than 100 by 2010.**

High growth SME coaching **3.52** Increasing the number and performance of high growth SMEs in the UK is central to improving our levels of productivity. Building on the current services available via Business Link, all nine RDAs are rolling out **a structured programme of intensive coaching and assistance for high growth SMEs** on a phased basis from April this year. Subject to the outcome of a robust evaluation at the end of the first year, the support programme will be scaled up in every region in the coming years.

Promoting creativity **3.53** UK businesses have a strong tradition of applying creative and innovative approaches to maintain a competitive edge. Increasing competition in international markets is demanding even higher quality products and services from businesses, and the application of creativity and design can be a key route to building competitive advantage through the distinctiveness and value added of goods and services. The Government has been taking forward the recommendations made to the public sector by the Cox Review in response to these emerging global challenges.¹⁹

3.54 The Government intends to extend additional support through the R&D tax credit system, as recommended by the Cox Review, subject to the outcome of state aids discussions with the European Commission, as described in further detail later in this Chapter. The Government is encouraging the RDAs to build on the progress since the Cox Review in making the Design Council's Design for Business programme available, including a number of pilot initiatives already underway. In addition, a feasibility study for a London creativity and innovation hub, at the centre of a wider network of creativity and innovation centres has been launched and is being overseen by a high-level group of leading figures from design, the arts and business led by Sir George Cox.

¹⁸ *Devolving decision making: 2 – meeting the regional economic challenge*, HM Treasury, March 2004

¹⁹ *Cox Review of Creativity in Business – building on the UK's strengths*, December 2004, www.hm-treasury.gov.uk

Access to finance 3.55 Availability of appropriate sources of finance is crucial for businesses seeking to invest and grow. Following on from *Bridging the finance gap*, the Government is committed to tackling market failures in the supply of risk capital and improving access to finance for small businesses.²⁰ In July 2005 Government invited bids from experienced fund managers to run the first pathfinder Enterprise Capital Funds (ECFs). ECFs will invest a mixture of public and private capital in early-stage companies with real growth potential, with up to £2 million per company. **The first two Enterprise Capital Funds have now been selected**, subject to contract. One of the funds focuses on sustainable technologies and the other fund supports high technology firms. The Government will finalise the full list of the first pathfinder ECFs in the coming months.

3.56 The success of the first stage of the ECFs pathfinder in attracting the private sector to work with Government to bridge the equity gap has led the Government to **decide to continue with the pathfinder, with a further £50 million in 2006-07 and £50 million in 2007-08.**

3.57 In Budget 2004 the Government introduced a two-year increase to the rate of income tax relief for investments in Venture Capital Trusts (VCTs). This provided the intended stimulus to VCT fundraising, which reached a record £520 million in 2004-05. **The Government today announces a new 30 per cent rate of income tax relief for investments in VCTs from 6 April 2006.** This is an increase from the original 20 per cent rate and will help ensure that the VCT industry has a solid foundation for stable fundraising and continued growth.

3.58 This new rate of income tax relief is introduced as part of a package of changes to VCTs, the Enterprise Investment Scheme (EIS) and the Corporate Venturing Scheme. These changes will renew the schemes' focus on providing incentives for long-term investments in small companies facing the most severe barriers to accessing equity finance. These measures will be introduced from 6 April 2006 and include:

- **a refocusing of the 'gross assets test' to £7 million immediately before investment and £8 million afterwards**, to focus on the companies most in need of improved access to finance;
- in response to industry representations, **an increase to the minimum holding period for new shares in VCTs to five years** to incentivise more stable, longer-term investments; and
- **a doubling of the annual EIS investment limit eligible for income tax relief to £400,000**, to incentivise greater investment in growth companies.

Small Firms Loan Guarantee 3.59 The newly enhanced Small Firms Loan Guarantee (SFLG), launched on 1 December 2005, is focused on those businesses that face the greatest difficulty in accessing debt finance. The administrative processes underlying SFLG have been streamlined, making it easier for lenders to administer loans and enabling them to provide quicker decisions to their customers. The changes, in response to the recommendations made by the Graham Review, are also encouraging lenders to be more innovative in their use of SFLG. **The Small Business Service is working to accredit a number of additional lenders to operate SFLG, thus ensuring that it is accessible to all sections of the small business community.**

²⁰*Bridging the finance gap: next steps in improving access to growth capital for small businesses*, HM Treasury and SBS, December 2003

Tax-motivated incorporation **3.60** The 2005 Pre-Budget Report announced a package of measures simplifying corporation tax through a single small companies' rate and enhanced support for small business investment. The Government will continue to examine further simplification of business taxation and will bring forward proposals for discussion with business and other representatives that are consistent with fairness between businesses, irrespective of their legal form; simplicity for compliant businesses; support for businesses in their aspirations to grow; and maintaining the attractiveness of the UK as a business location. It will also consult on action to tackle those who undermine competitive business by disguising employment through managed service company schemes. Chapter 5 sets out these next steps.

Alignment of income tax and NICs **3.61** The Government has received representations to build on previous work aligning the income tax and national insurance systems with the objective of reducing burdens on employers, especially smaller employers. Chapter 5 sets out action on this issue.

First year capital allowances **3.62** The Government also announced in the 2005 Pre-Budget Report an extension to first year capital allowances available to small businesses investing in plant and machinery. **For expenditure in the year from April 2006, the first year capital allowance for small businesses will be set at an increased rate of 50 per cent.** This measure will assist small businesses' cashflow and provide enhanced support for new investment.

VAT **3.63** From 1 April 2006 the Government will increase the VAT registration threshold in line with inflation from £60,000 to £61,000, thereby keeping around 2,000 businesses out of the VAT system and maintaining the highest threshold in Europe.

3.64 The 2005 Pre-Budget Report announced that, to help small businesses with cashflow difficulties and reduce administrative burdens, **the turnover threshold up to which businesses are able to take advantage of the Annual Accounting Scheme would be increased from £660,000 to £1,350,000.** This change will take effect from 1 April 2006. The Government also wrote to the European Commission last December for derogation to increase the Cash Accounting Scheme threshold to the same level.

3.65 Following an informal consultation on possible changes to the VAT Bad Debt Relief scheme, the Government did not identify any immediate changes that would be simple for business to operate without unacceptable risk of fraud. HMRC will continue to work with businesses affected by customer insolvency, and consider ways in which businesses in these circumstances could be further supported.

Enterprise in disadvantaged areas

Local Enterprise Growth Initiative **3.66** Budget 2005 announced a Local Enterprise Growth Initiative (LEGI) to provide flexible, devolved investment in some of the most deprived areas to support locally developed and owned proposals to stimulate economic activity and productivity through enterprise. The first round of LEGI has allocated £126 million over three years to transform and stimulate deprived areas, on the basis that the successful bids demonstrated clear plans to create sustainable change in the region, making them more attractive places for businesses to start up and grow. A national advisory panel, which included senior private sector representatives, recommended that 10 applications, from 15 local authorities, should receive full multi-year funding from 2006-07 under LEGI. **LEGI funding has been awarded to proposals from Bradford; St Helens; Croydon; Ashfield, Mansfield and Bolsover; Derwentside, Easington, Sedgfield and Wear Valley; Great Yarmouth; South Tyneside; Coventry; Hastings, and Barking & Dagenham.**

3.67 The next round for local authorities to apply for funding is now underway for projects starting in 2007-08, and central and local government are working together to ensure that lessons from the first round are learned. A national event will be held in the coming months

to enable bidding authorities to discuss their proposals and applications for the second round with representatives from the LEGI National Advisory Panel and successful applicants from the first round, ahead of the closure date for applications in the autumn. In addition, the Government will consider targeted support for future rounds for Local Authorities with the least capacity to bid, including those in this group shortlisted by the Government Offices in the regions for the first round.

Creating an enterprise culture

Enterprise Education 3.68 Enterprise culture encourages positive attitudes towards entrepreneurship and risk. A more enterprising culture can only be achieved through widespread engagement by individuals and organisations across the UK. This must begin with helping young people develop the enterprise skills and aspirations necessary to start up and grow their own business, or to bring a more innovative approach to the workplace. The Government will take a number of new steps to ensure that young people in the UK continue to experience the world of enterprise including:

- **creating a Schools Enterprise Education Network (SEEN) as part of the £60 million roll out of enterprise education to all pupils at key stage 4;**
- **creating 23 enterprise summer school pathfinders to be delivered by Young Enterprise to 1000 pupils across the UK in summer 2006; and**
- **launching a US enterprise scholarship scheme for UK university students in 2006.** This scheme is for students who have excelled in engineering, science and technology and will be administered by the National Council for Graduate Entrepreneurship and the Ewing Marion Kaufmann foundation in the US.

Enterprise Education through LEGI 3.69 A number of successful LEGI bidders (Bradford; St Helens; Croydon; Ashfield, Mansfield and Bolsover; Great Yarmouth; Coventry; Hastings; Barking and Dagenham) will focus on delivering enterprise education to children in primary school and early secondary school to influence attitudes and behaviour on entrepreneurship. These bids include:

- an improved enterprise education programme for young people in schools;
- better opportunities for involvement in extra-curricular enterprise activities and entrepreneurial programmes for the young; and
- enhanced personal development through more targeted coaching and mentoring in order to create a more 'can do' entrepreneurial attitude amongst young people.

Women and enterprise 3.70 The Government recognises the high potential of women's enterprise to contribute to economic growth in the UK and is keen to emulate the success of the US, where the number of women-owned businesses continues to grow at twice the rate of all US firms. Progress has been made on increasing levels of female entrepreneurship, with total entrepreneurial activity for women in the UK rising from 3.3 per cent to 3.9 per cent between 2002 and 2004 but huge opportunities for development remain. In recognition of this potential, **RDAs from five regions will be establishing Women's Enterprise Units, subject to contract, to pilot different approaches to supporting the start-up and growth of female-owned businesses.**

3.71 The 2005 Pre-Budget Report announced that the Government is establishing a Task Force on Women's Enterprise to drive implementation of specific steps to increase levels of women's business ownership in the UK. The Government is currently recruiting a chairperson to lead the Task Force, which will play a key role in the evaluation of the Women's Enterprise Units, helping to ensure that best practice identified is shared across all nine English regions.

SCIENCE AND INNOVATION

3.72 Innovation is a key catalyst for productivity growth. New ideas drive enterprise, create new products and markets, and improve efficiency, delivering benefits to firms, customers and society. In July 2004 the Government published the *Science and Innovation Framework 2004-14* which set out the Government's framework for securing its long-term vision for UK science and innovation, together with the ambition that public and private investment in R&D should reach 2.5 per cent of GDP by 2014. The first annual report published in July 2005²¹ found that good progress had been made on key indicators for implementing the framework. The UK science base is retaining its strong position, second only to the US in global scientific excellence as measured by citations, and remains the most productive among G8 nations. The annual report also identified some key challenges, notably on further increasing levels of business investment in R&D, and making more rapid progress on improving science, engineering, technology and mathematics skills.

Maximising the impact of science funding

3.73 The Government is investing an additional £1 billion in science and innovation over the period of the 2004 Spending Review, in support of the objectives set out in the ten-year framework. Together with the commitments made in previous Spending Reviews, this amounts to an unprecedented increase in public funding: by 2007-08 total UK science spending will be £5.4 billion representing an average annual growth of 5.8 per cent in real terms in the 2004 Spending Review period. If the impact of additional public investment in science on the economy is to be maximised, it is essential to ensure that the right structures are in place to deliver the benefits of this investment. *Science and Innovation Investment Framework 2004-2014: Next Steps*²² published today, takes forward policy to ensure that this is the case.

Impact of science on innovation

3.74 The Government is keen to create a more effective science and innovation system, which maximises the impact of public investment in science on business innovation, and provides greater incentives for businesses to collaborate with the science base to meet the challenges of globalisation. **The Technology Strategy Board will now have a wider remit to stimulate business innovation in those areas which offer the greatest scope for boosting UK growth and productivity, and plans for it to operate at arms length from central Government are being developed.** The Government is also taking forward a new strategy to better market the UK science base to business and attract foreign R&D investment, set out later in this chapter. The Government is also seeking views on how the UK can best support higher-risk, high-impact research in novel fields of scientific enquiry; how national and regional policies can work together more effectively to increase innovation and business-university collaboration in the regions; and on how, building on the Lambert Review, a wider spectrum of business-university interaction can be encouraged, spreading best practice across different regions and sectors.

Research Councils

3.75 In order to increase the responsiveness of the science base to the needs of the economy and enhance the UK's capacity to conduct internationally excellent science, the Government believes that there is scope for reviewing the effectiveness of the Research Councils' existing structures and operations. **The Government is inviting views on whether a Large Facilities Research Council should be created to improve the strategic management of public investment in large research facilities such as telescopes, light sources and space programmes. The Government is also inviting views on whether the funding arrangements for the physical sciences should be simplified in the wake of these changes, and what further measures could be taken by Research Councils to improve their effectiveness.**

²¹ *Science and Innovation Investment Framework Annual Report 2005*, HM Treasury/DTI/DFES July 2005 available at: <http://www.ost.gov.uk/policy/sifreview05.pdf>

²² *Science and Innovation Investment Framework 2004-2014: next steps*, HM Treasury, March 2006

University research 3.76 In order to maintain the UK's world-class university system, the Government is keen to ensure that excellent research of all types is rewarded, including user-focused, and interdisciplinary research. It also wants to ensure that institutions continue to have the freedom to set strategic priorities for research, undertake blue skies research and respond quickly to emerging priorities and new fields of enquiry. The Government is strongly committed to the dual support system and to rewarding research excellence, but recognises some of the burdens imposed by the existing Research Assessment Exercise (RAE). The Government's firm presumption is that after the 2008 RAE the system for assessing research quality and allocating 'quality-related' (QR) funding from the DfES will be mainly metrics-based. **In May 2006, the Government will launch a consultation on its preferred option for a metrics-based system for assessing research quality and allocating QR funding, publishing results in time for the 2006 Pre-Budget Report.** The Government is aware that preparations for the 2008 RAE are well underway. It is therefore the Government's presumption that the 2008 RAE should go ahead, incorporating a shadow metrics exercise alongside the traditional panel-based peer review system. However, if an alternative system is agreed and widely supported, and a clear majority of UK universities were to favour an earlier move to a simpler system, the Government would be willing to consider that.

World-class health research 3.77 The Government believes that there is scope for creating more effective structures to support world-class health research in the UK, aligning research priorities more closely with wider health objectives, and providing a more coherent approach for translating the results of research into economic benefit. Research budgets in the Office of Science and Technology are already ring fenced. Following the reforms to the medical research environment announced in the 2005 Pre-Budget Report, together with the willingness of the biomedical industry to significantly grow R&D investment in the UK by up to £1 billion a year in the medium to long-term, the **Government is today announcing its intention to ring fence the Department of Health's R&D budget and that the Secretaries of State for Health and Trade and Industry will create a single, jointly held health research fund of at least £1 billion per year. The Government will invite a leading independent individual to advise on the best institutional arrangements to deliver a more coherent framework for health R&D under this new structure.** A consultation will be launched shortly in order to report on options to the Government in time for the 2006 Pre-Budget Report.

Improving the supply of scientists 3.78 A strong supply of highly qualified STEM graduates is essential to underpin the Government's long-term objectives for science and innovation, and a key factor in making the UK an attractive location for business investment in R&D. The *Science and Innovation Investment Framework 2004-2014* outlined the Government's ambition to create an education and training environment that delivers the best in science teaching and learning at every stage. Despite the progress in taking forward the framework, the Government is concerned that progress towards meeting its ambitions is relatively slow in some areas and that there is scope for further action to improve the quality of STEM education and increase the supply of STEM skills. **Budget 2006 announces new ambitions, including to:**

- **achieve year on year increases in the number of young people taking A levels in physics, chemistry and mathematics so that by 2014 entries to A level physics are 35,000 (currently 24,200); chemistry A level entries are 37,000 (currently 33,300); and mathematics A level entries are 56,000 (currently 46,168);**
- **continually improve the number of pupils getting at least level 6 at the end of Key Stage 3 (11-14 year olds);**
- **continually improve the number of pupils achieving A*-B and A*-C grades in two science GCSEs; and**

- **step up recruitment, retraining and retention of physics, chemistry and mathematics specialist teachers so that by 2014 25 per cent of science teachers have a physics specialism, 31 per cent of science teachers have a chemistry specialism and the increase in the number of mathematics teachers enables 95 per cent of mathematics lessons in schools to be delivered by a mathematics specialist (compared with 88 per cent currently).**

3.79 To meet these ambitions the Government announces a package of measures to improve the skills of science teachers, the quality of science lessons and increase progression to A level sciences including new commitments to:

- **make science a priority in schools by including science in the School Accountability Framework;**
- **entitle, from 2008, all pupils achieving at least level 6 at Key Stage 3 to study three separate science GCSEs to increase progression to and attainment at A level science;**
- **continue the drive to recruit science graduates into teaching via Employment Based Routes with new incentives to providers of £1,000 per recruit to attract more physics and chemistry teachers; and**
- **develop and pilot a continuing professional development programme leading to an accredited diploma to give existing science teachers without a physics and chemistry specialism the deep subject knowledge they need to teach these subjects effectively.**

Business Research and Development

R&D tax credits 3.80 The Government remains committed to improving the experience of companies claiming the R&D tax credit. In *Supporting growth in innovation: next steps for the R&D tax credit*, published in December 2005, the Government announced that HMRC would set up dedicated R&D units to handle all SME claims for tax credits. It is envisaged that these units will be fully operational across the country before the end of the year. At the same time, a statement of practice will be published presenting the standard of service and support that SMEs can expect from the new units. These changes should ensure that all R&D performing companies can receive the full value from R&D tax credits.

3.81 At present, only companies with up to 250 employees can qualify for higher relief under R&D tax credits. Following discussions with business, the Government has noted evidence of lower levels of innovation among companies with 250-500 employees.²³ In the light of the recommendations of the Cox Review, the Government wishes to better support R&D investment in growing firms. **The Government therefore intends to extend additional R&D tax credit support to companies with 250-500 employees, subject to the outcome of state aids discussions with the European Commission.**

²³ Based on *Creativity and Design Study for the DTI using the Community Innovation Survey*, Haskel, Cereda, Crespi & Crisuolo 2005. Further details available at www.dti.gov.uk.

Gowers Review of Intellectual Property **3.82** At the 2005 Pre-Budget Report, the Chancellor asked Andrew Gowers to lead an independent review to examine the UK's intellectual property (IP) framework. The review will examine how the IP regime functions in the digital age and consider the challenges that rapid technological change pose for the system. The review will undertake a rigorous analysis of the IP system in the UK and will provide practical policy recommendations. The review is committed to consulting widely, and to this end, a formal Call for Evidence was published on 23 February 2006. Andrew Gowers will report to the Chancellor, the Secretary of State for Trade and Industry and the Secretary of State for Culture, Media and Sport in autumn 2006.

SKILLS

3.83 The quantity and quality of skilled labour in an economy is a key driver of economic performance and productivity growth. As well as contributing to productivity, a highly skilled workforce also enables firms to update working practices and products faster, making the economy more flexible and competitive. Despite improvements over the last few years, the UK still has a large stock of workers with low or no skills, including poor basic literacy and numeracy. This stock of low skills directly accounts for some of the productivity gap between the UK and peer economies, as well as wider impacts on social welfare. *Productivity in the UK 6: Progress and new evidence* published alongside the Budget sets out the latest evidence on the contribution of skills to productivity.

Leitch Review of Skills **3.84** Alongside the 2005 Pre-Budget Report, Lord Leitch, the former chief executive of Zurich Financial Services and the chairman of the National Employment Panel, published *Skills in the UK: The long-term challenge* detailing the interim findings of his independent review of the UK's long-term skills needs. It highlighted that, though skills levels have improved the UK must urgently raise skills levels further and set itself a greater ambition to have a world-class skills base by 2020. The next phase of the Leitch Review will build on this analysis and address:

- the skills profile that the UK should aim to achieve in 2020 to support the needs of the economy and society over the longer-term;
- the appropriate balance of responsibility between Government, employers and individuals for the action required to meet this level of change; and
- the policy framework required to support this.

3.85 The Review will report its conclusions and recommendations to the Government in 2006.

Skills and employment **3.86** *Skills in the UK: The long-term challenge* not only emphasised the importance of skills for UK productivity and competitiveness, but also their importance in preparing the economy and individuals for the challenges of globalisation. Changing patterns of production and employment across the world put a greater premium on economic flexibility. Skills are vital to achieve this flexibility, allowing individuals to adapt and move into new jobs or across economic sectors, increasing their security in the labour market, as businesses compete for opportunities in an increasingly global market for goods and services.

3.87 In this environment, skills will become increasingly important for the individual – supporting moves into and progression within work, reducing the risk of unemployment or inactivity and increasing family income and security. For the Government, skills policy will be key to promoting a flexible labour market and to ensuring that work pays, to support individuals as they move between jobs, between sectors of the economy or from benefits into work so that we create a high skills economy. The forthcoming white paper on further education (as described later in this chapter) will set out further measures being taken to better align skills and employment policies. Within the framework of reform set out in the White Paper, the Chancellor has also **asked Lord Leitch, in the final phase of his review on skills, to report specifically on how skills and employment services can complement each other even more effectively in supporting labour market flexibility, better employment outcomes and greater progression to productive and sustainable jobs for those with skill needs.** Chapter 4 sets out the latest development in the New Deal for skills and specific measures the Government is taking in response to the recent Women and Work Commission report.²⁴

3.88 Since September 2002 the Government has been testing the effectiveness of a radical new policy approach aimed at stimulating the demand for work-based training for low-skilled employees. So far these Employer Training Pilots have benefited over 29,000 employers and 240,000 employees. All evaluations of the pilot have shown high levels of satisfaction among learners and employers, relatively high completion rates and learners and employers identifying skill and work performance gains. Final evaluation is expected to be published by May 2006. **As announced in Budget 2005, a national programme, Train to Gain, based on lessons learned from the pilots will begin to roll-out from April 2006.** It will create a step-change in participation of workplace training among the low-skilled, when the programme is operating at full capacity, it is forecast to benefit 50,000 employers and 350,000 employees each year. By 2009-10 it is forecast that Train to Gain will have contributed over 500,000 first, full Level 2 achievements towards the Adult Skills PSA target.

Young people 3.89 The Government has introduced a number of measures to encourage all young people to take part in some form of education or training up to the age of 19. However despite this and other progress in recent years, the UK ranks among the lower performing OECD countries in terms of post-16 participation. The *14-19 Education and Skills White Paper*, published in February 2005 set out the next steps the Government will take to tackle this problem. An implementation plan, setting out in detail how these changes will be put into effect was published in December 2005.²⁵

3.90 From April 2006 new Learning Agreements will be piloted in eight areas of the country. These will be aimed at 16 and 17 year olds who are in work but not receiving accredited training, to improve training options. Building on the existing statutory right to paid time off to train or study for this group, the pilots will test the effectiveness of formal learning agreement, financial incentives and wage compensation in encouraging greater involvement in training by young people and their employers.

Further education reform 3.91 High quality training, responsive to the needs of employers and individuals is essential for meeting the Government's ambitions for skills. To ensure that further education colleges and training providers in England are ready for more stretching ambitions, the Government is setting out a far-reaching programme of reform. The details of this reform programme will be contained in a White Paper to be published on 27 March. Box 3.8 sets out the key themes of the reform programme.

²⁴ *Shaping a fairer future*, Women and Work Commission, 2006.

²⁵ *14-19 Education and Skills: Implementation Plan*, Department for Education and Skills, 2005.

Box 3.8: Further Education Reform White Paper

The reforms in the forthcoming White Paper will address the system for further education and training provision for 14-19 year olds and adults. The key themes cover:

- **Mission and Specialisation:** putting the economic mission of the sector at the heart of its role, with new support and incentives for colleges and training providers to develop their own areas of specialist excellence.
- **Meeting Employer and Learner Needs:** putting real purchasing power in the hands of the customer – learners and employers and more government support for those that need it.
- **Raising Quality, Achieving Excellence:** new performance indicators, emphasising employability; tougher measures to address poor performance; lighter touch regulation on high-performing providers; and support for a more highly-skilled FE workforce.
- **Funding and Organisation:** provider competitions will be used to expand participation or remove poor quality provision.
- **A New Relationship with Colleges and Providers:** the Learning and Skills Council (LSC) will streamline its operations, working more strategically with colleges, at regional level to support Regional Economic Strategies, and at local level, to deliver 14-19 reforms.

Higher education 3.92 At the 2005 Pre-Budget Report, the Government announced measures to help the Higher Education sector benefit from the opportunities of globalisation, and ensure the UK retains its reputation as one of the most attractive places for students to study abroad. The Government is today announcing further reforms, set out later in this Chapter.

INVESTMENT

3.93 The accumulation of physical capital through investment is an important determinant of an economy's productivity performance. Physical capital stock is closely correlated with productivity performance, as it directly influences how much a unit of labour can produce. Total investment in fixed capital in the UK economy, incorporating investment by businesses and government, and investment in housing, has been low relative to comparable economies over long periods of the UK's post-war history. This has had significant impacts on the productivity of the business sector, on the nature of the UK's housing stock and housing market, and on the quality of public services.

3.94 The Government's macroeconomic reforms have provided an environment of low and stable interest rates and a flexible labour market. These reforms help to provide a certain and rewarding environment for businesses to invest for the future. However, measured rates of UK business investment as a percentage of GDP have not yet caught up with rates in Germany, France and the US. Business investment data are prone to relatively large revisions and, as discussed in Chapter B of the *Financial Statement and Budget Report*, the ONS has recently published details of improvements to the way in which computer software is measured, suggesting that firms' own account in-house software investment has been significantly underestimated in the UK. The UK has a strong record in attracting foreign inward investment but will increasingly face further challenges from emerging markets stimulated by their rapid integration into the financial markets.

The UK as a competitive centre for global investment

Strategy for promoting the UK **3.95** In *Long-term global economic challenges and opportunities for the UK*, published alongside the 2004 Pre-Budget Report and *Globalisation and the UK: strength and opportunity to meet the economic challenge*, published on 2 December 2005, the Government has set out how the UK is well-placed to meet the challenges and opportunities of globalisation, and especially the rise of China and India. The UK has many strengths, including the stability of its macroeconomic framework, its openness to competition and trade and the strength of its science base. Building on its strengths, an ambitious strategy for marketing the UK economy internationally, led at the most senior levels of Government, is vital to securing an effective response to globalisation.

3.96 Before the summer, the Government **will publish a new five year strategy for a step-change in the Government's drive to market the strengths of the UK economy internationally**. This will have a number of themes, including a particular focus on high-growth countries of strategic importance such as India and China, and a focus on innovative and R&D intensive sectors.

3.97 The five year strategy will form the basis of a partnership between all Government departments and agencies, RDAs, devolved administrations, and numerous private sector bodies active in this field. Responsibility for co-ordinating and driving this strategy across Government lies with UK Trade & Investment (UKTI). It will embrace UKTI's twin roles of trade development and inward investment, both of which are vital.

UK Trade and Investment **3.98** In order to deliver this new strategy, **UKTI will undertake a programme of organisational change**, under the leadership of its new chief executive, Andrew Cahn, with the clear aim of a fundamental transformation in its effectiveness in marketing the UK. Details of this programme will be published alongside the strategy.

3.99 The overall goal is to ensure that within UKTI there is the capability and sense of mission to deliver the Government's objective that the UK should be a key location of choice for many more high value-added international businesses, including from high-growth countries of strategic importance such as India and China, with:

- an entrepreneurial culture of recognised professional marketing excellence throughout the organisation;
- more strategic use of resources internationally, redeploying savings into front-line activities; and
- a clearer role for UKTI in co-ordinating the UK's international marketing drive overall.

3.100 As a first step towards implementing its strategy, UKTI will build on the findings of the Asia Task Force. Recognising the strategic importance of high growth markets such as India and China, **UKTI will allocate further resources to increasing trade activities between the UK and these emerging markets**.

3.101 The strategy will also build on the UK's strengths in scientific discovery, to attract knowledge intensive businesses to the UK. At the outset, UKTI will **implement an international R&D strategy with funding of £9 million, in partnership with the academic and business communities**, to attract more business research and development to the UK, and to promote Britain's innovative firms abroad. UKTI will spearhead this effort across Government, deploying a new cadre of technology specialists with expertise in key technology sectors.

Financial services 3.102 The Government is also committed to doing more to promote London as a centre for financial and business services. As set out in *Financial Services in London: Global Opportunities and Challenges*, published alongside the Budget, London starts from a strong position. London is the location for 70 per cent of the global secondary bond market; over 40 per cent of the derivatives market; over 30 per cent of world foreign exchange business; over 40 per cent of cross-border equities trading and, 20 per cent of cross-border bank lending. It is the world's most competitive financial centre with: a proportionate regulatory regime for its wholesale financial markets that is widely regarded as the best in the world; a tradition of openness that allows UK companies to attract the most talented individuals to London; a central location between the US and Asian time zones; and the use of English as the main language of international finance and English law as the law of choice for international contracts.

3.103 London is the world's leading international financial centre, and the Government's objective is for it to be even more successful in an integrated global economy. Recognising the opportunity that emerging markets such as China and India present and the strength of international competition from other financial centres, **key stakeholders in London's financial sector are joining forces with the Government to promote London as the world's leading international financial centre. Leading London markets and financial sector industry bodies have endorsed plans to set up a high-level group to agree before the summer a strategy to consolidate London's position.** The group will also include representatives of HM Treasury; the Corporation of London and the Lord Mayor; International Financial Services London; and the Mayor for London.

Education exports 3.104 Higher education is an increasingly international market. Traditional barriers are falling as international collaboration increases. There are real benefits to these changes, for example, allowing researchers better access to global networks. The UK is at the forefront of developments – only the USA has a larger share of the international market for overseas students. This market is worth over £3 billion to the economy each year. However, competition is increasing as existing providers raise their performance and new entrants join the market. At the 2005 Pre-Budget Report, the Government announced measures to help the Higher Education sector benefit from the opportunities of globalisation, and ensure the UK retains its reputation as one of the most attractive places for students to study abroad. On 7 March, the Home Office announced proposals for redesigning the migration system, providing a more efficient, transparent and objective application process for those coming to the UK for work or study.²⁶ Students who obtain degrees from UK universities will get extra points within the new system, making it easier for them to work here on a long-term basis. Building on this progress the Government will:

- **implement early, from 1 May 2006, the announcement made in the 2005 Pre-Budget Report to allow all international students on completion of a post-graduate degree, or an undergraduate degree in a shortage sector, to work in the UK for up to 12 months, benefiting up to 50,000 students;**
- **establish three new University Partnerships Schemes** to enhance long-term sustainable links between UK universities and centres of excellence in India, Russia and South Africa through academic exchanges, scholarships and research collaboration in science and technology; and
- **lead more high-level education trade missions** to help universities and businesses open new markets and expand existing ones.

²⁶ *A Points-Based System: Making Migration Work for Britain*, Home Office, 2006

Building a future strategy 3.105 The Government is committed to working closely with and listening to business leaders, to ensure the UK has the flexible and supportive environment it needs to attract business investment in a global environment. **As the next stage in this ongoing dialogue, the Government has established an International Business Advisory Council for the UK. The council will advise the Chancellor of the Exchequer over the next three years on how to respond to the challenges and opportunities of globalisation.** Membership details of the new council are set out in Box 3.9.

Box 3.9: International Business Advisory Council

The Government has established a new International Business Advisory Council for the UK comprising some of the world's leading business people. The council will advise the Chancellor of the Exchequer over the next three years on how to respond to the challenges and opportunities of globalisation to ensure the UK continues to be one of the top locations for international companies' high value-added activity. The first members of the Council are renowned internationally for their expertise and have first-hand experience of global business across a range of sectors and regions:

Bernard Arnault, Chairman and CEO, LVMH;

Lord Browne, Group Chief Executive, BP;

Bill Gates, Chairman and Chief Software Architect, Microsoft Corporation;

Dr Jean-Pierre Garnier, CEO, GlaxoSmithKline;

Sir Ka-shing Li, Chairman of the Board, Hutchison Whampoa Ltd;

Sir Terry Leahy, CEO, Tesco;

Sir John Rose, CEO, Rolls Royce;

Robert Rubin, Director and Chairman of the Executive Committee, Citigroup Inc;

Lee Scott, President and CEO, Wal-Mart;

Ratan Tata, Chairman, Tata Group;

Meg Whitman, President and CEO, eBay; and

James Wolfensohn, Special Envoy for Disengagement and Former President of the World Bank.

Investing in housing and property

Investing in housing supply 3.106 A stable and responsive housing market is essential for the UK's future economic and social success. *The Government's Response to Kate Barker's Review of Housing Supply*, published alongside the 2005 Pre-Budget Report, set out how achieving the Government's aim of improving affordability for future generations of homebuyers requires housing supply to become much more responsive to demand. Current projections suggest that to improve affordability, new housing supply in England will need to increase over the next decade to at least 200,000 net additions per year. The Government's response to the Barker Review therefore set out a comprehensive package of proposals to help deliver investment in the infrastructure necessary to support housing growth, and to reform the mechanisms, particularly planning, by which new housing and infrastructure are delivered.

3.107 This drive to increase housing supply has delivered an upward trend in new housebuilding, with new housing completions in England reaching 160,000 in 2005 – the highest level since 1990. However, the Government is determined to see faster progress and will bring forward further measures to increase and speed the delivery of new, sustainable, housing. This includes the publication in the summer of a new Planning Policy Statement for Housing (PPS3), to ensure that local and regional plans prepare and release more land in response to demand.

Infrastructure 3.108 To ensure that appropriate infrastructure will be provided to support housing and population growth, the Government has announced a cross-cutting review into supporting housing growth to inform the 2007 Comprehensive Spending Review (reviews informing the CSR are listed in full in Chapter 6). The review will examine the different infrastructure costs of housing growth in different spatial forms and locations, explore the wider costs and benefits of different spatial forms of growth and assess the mechanisms for planning and delivering housing growth-related infrastructure provision. The review will run over the course of 2006 and will engage with stakeholders along the way.

Planning gain-supplement 3.109 To help finance this infrastructure to support growth and ensure that local communities directly share in the benefits that growth brings, the Government consulted on a proposed Planning-gain Supplement (PGS) alongside the wider response to the Barker review of housing supply. The consultation, which closed on 27 February 2006, directly engaged a wide range of stakeholders across the UK. The Government is considering responses to the consultation and discussions with stakeholders will continue. Further announcements on PGS implementation will be made by the end of the year.

3.110 In developing policy and considering responses to the consultation, the Government will continue to assess PGS, and the proposed revised scope of planning obligations (s106 agreements), against the following objectives:

- to finance additional investment in the local and strategic infrastructure necessary to support growth, while preserving incentives to develop;
- to help local communities to better share the benefits of growth and manage its impacts;
- to provide a fairer, more efficient and more transparent means of capturing a modest portion of land value uplift; and
- to create a flexible value capture system that responds to market conditions and does not inappropriately distort decisions between different types of development.

3.III To maintain critical links to local delivery, the Government will ensure that a significant majority of PGS revenues are retained for infrastructure priorities within the local authority area where the revenues derived. PGS revenues would be separate from the local government funding settlement to serve as an incentive to support growth. Hypothecating PGS revenues would provide certainty that planning gains created locally would directly benefit local communities. The remaining PGS revenues would be dedicated to strategic infrastructure of regional importance to help unlock development land.

Derelict land tax credit **3.112** The Barker Review also recommended that the contaminated land tax credit should be extended to long-term derelict land, provided that it would encourage genuine new investment. It is unclear how this can be done in a cost-effective way and without encouraging dereliction or subsidising development that would have taken place anyway. However, the Government remains committed to redeveloping brownfield land through a range of policy levers and will continue to examine the potential for tax measures to bring forward land that would not otherwise be developed.

Business premises renovation allowance **3.113** The Government is committed to introducing a business premises renovation allowance scheme, to provide 100 per cent capital allowances for the costs of bringing empty business properties in disadvantaged areas back into use. The scheme will be introduced as soon as state aids approval is received.

Social housing sinking funds **3.114** In the 2005 Pre-Budget Report, the Government announced that the Finance Bill would include legislation to provide relief from the 40 per cent trust rate of tax for sinking funds of registered social housing landlords. This will be extended to service charges and sinking funds in other types of social housing.

Shared equity **3.115** The Government intends to help extend home ownership to another 1 million over the next five years, taking the UK towards the Government's aspiration of 75 per cent home ownership. As part of this strategy, Government will be directly assisting over 100,000 households that could not otherwise afford a home of their own with subsidised shared-equity products, including a joint shared-equity scheme operated in partnership with lenders. **The Government is today establishing a Shared Equity Task Force to consider the scope for shared equity products to assist more households into homeownership.** It will work with the finance industry, house builders, local authorities, housing associations, and others to determine whether there are market or state failures holding back the development of affordable shared-equity products for the 'intermediate' housing sector.

3.116 Investment in social housing has almost doubled since 1997, but the Government made clear at the Pre-Budget Report that the supply of social housing needs to rise further and would be a priority in the Comprehensive Spending Review. The Government will pilot an extra homes scheme to invest in bringing sites back into use and build more social housing for rent, potentially reducing Housing Benefit costs.

Real Estate Investment Trusts **3.117** The Government will legislate in the 2006 Finance Bill to create Real Estate Investment Trusts (UK-REITs). As set out in the 2005 Pre-Budget Report, the Government's objective for the UK-REIT regime is to improve the efficiency of both the commercial and residential property investment markets by providing liquid and publicly available investment vehicles. This reform was recommended by the Barker Review and will encourage increased institutional and professional investment to support the growth of new housing, as well as the Government's wider objectives for raising productivity.

3.118 Following consultation on draft legislation released in December 2005, the Government is able to announce the following significant changes:

- to provide greater flexibility for companies to operate within the regime, **a reduction in the required distribution rate to 90 per cent of net profits;**
- in line with industry's response, **a reduction of the interest cover test to 1.25 on a pre-capital allowances basis;** and

- to enable companies to operate the 10 per cent shareholding limit effectively without preventing normal market activity, HMRC will set out in guidance mechanisms through which companies can operate the limit through their Articles of Association, in accordance with the listing rules of the Financial Services Authority.

3.119 To meet the Government's objectives for UK-REIT legislation to be introduced at no overall cost to the Exchequer, **a conversion charge will be levied on companies electing to join the new regime at a rate of 2 per cent of the gross market value of investment properties.** The Government believes that this package of measures, along with a number of further technical amendments, will enable the successful launch of Real Estate Investment Trusts from 1 January 2007 and lead to a better functioning and more efficient UK property investment market.

Barker Review of Land Use Planning **3.120** The Government is committed to further reform of the planning system of England. At the 2005 Pre-Budget Report, the Chancellor and the Deputy Prime Minister asked Kate Barker to conduct a review of land use planning. The purpose of the review will be to consider how, in the context of the opportunities and challenges of globalisation, and building on the reforms already put in place in England, planning policy and procedures can better deliver economic growth and prosperity alongside other sustainable development goals. The review will focus on the town and country planning system, but will, where appropriate, consider wider aspects of land use regulation, for example other development consent regimes and the relationship with Regional Economic Strategies. Where appropriate, the review will take account of the emerging findings of related studies, including the Eddington Study of transport, the Government's Energy Review and the Lyons Inquiry on the future role and function of local government. Though the focus of the review is on the economy, where improvements to achieve wider environmental and social objectives are identified these will be considered. An interim report will be published in summer 2006.

Public investment and infrastructure

3.121 The performance of the public sector asset base is crucial for the delivery of public services, such as health and education. Government investment in public infrastructure also underpins private sector activity, contributing to productivity growth and labour market flexibility. The approach to capital being taken in the Comprehensive Spending Review 2007 is set out in more detail in Chapter 6.

Eddington Study **3.122** Transport plays a vital role in equipping the UK to respond to the opportunities and challenges of globalisation, through attracting and maintaining investment in the UK and supporting international trade. It also supports the efficient and flexible functioning of the economy, playing a significant role in the operation of labour markets and facilitating the movement of goods and services. Sir Rod Eddington has been asked to advise on the long-term impact of transport decisions on the UK's productivity, stability and growth. The Eddington Study, which will report to the Chancellor and Secretary of State for Transport in mid-2006, is continuing its comprehensive analysis of the links between the transport system and the UK economy, within the context of the Government's objectives for sustainable development.

Haulage industry **3.123** In response to the Burns Inquiry into fuel costs, foreign competition and freight taxes, the Government invited the main haulage industry associations to participate in a joint task group at the 2005 Pre-Budget Report. The task group is making good progress in analysing the competitive position of the industry, and its findings will inform future decisions on how to ensure that haulage continues to fulfil its important role in the UK economy. The task group is due to conclude its work in the early summer.

National road pricing 3.124 Congestion delays and the resulting uncertainty in journey times impose a significant cost on business and private motorists. The Government's strategy to tackle congestion includes increased investment in the road network and public transport, and better management of the road network. A well-designed system of national road pricing could deliver substantial benefits, with the potential to reduce congestion by up to a half.

3.125 The Government has announced that it will make funding available from the Transport Innovation Fund (TIF) to support forward-looking local authorities that are considering introducing road pricing as part of a package of transport measures in their areas. As well as helping to tackle congestion in places where it is already a significant problem, the implementation of local road pricing schemes would help to inform future decisions on the potential to move towards a national system of road pricing. The design of any national scheme would need to be considered in the context of meeting the Government's environmental objectives (described in detail in Chapter 7).

Box 3.10: Globalisation and product and capital market flexibility - report on progress

In an increasingly integrated global economy, flexibility is fundamental to ensure that the UK economy can meet the changes and capture the benefits that globalisation can bring. Flexible product, capital and labour markets allow more efficient allocation of resources and clearer price signals, promoting competition and encouraging innovation – critical to enable firms to respond rapidly to changing market conditions. *Globalisation and the UK: strength and opportunity to meet the economic challenge*, published alongside the 2005 Pre-Budget Report, set out the core domestic challenges the Government intends to respond to, to ensure the UK has the flexibility needed to respond to globalisation:

Skills – so the workforce has the flexibility to adapt to changes in technology and new opportunities offered by globalisation. The UK has made substantial real terms investment in education linked to reforms. To make further progress the UK needs to tackle gaps in basic and intermediate skills and ensure training is more responsive to changing economic needs. The Further Education White Paper, published next week, will set out the first part of the Government's response and the Leitch Review, published later this year, will set out the long-term challenge for skills attainment.

Science and innovation – so the economy has the capacity to expand in knowledge-based industries. The Science and Innovation Framework sets out a target to raise R&D to 2.5 per cent of GDP backed by new investment; to make further progress the UK needs to build more R&D intensive firms, including through FDI, and improve research links with business. The Budget takes forward reforms in all of these areas including extending innovation support to medium sized companies through the R&D tax credit system.

Reducing regulatory burdens to reduce unnecessary costs to business. The Government has established a far-reaching regulatory reform strategy. The Budget sets out further steps including implementing the Hampton Review's risk-based approach to reducing the burdens on business and new commitments from HMRC to reduce the administrative burden of the tax system.

Planning to ensure the planning system promotes sustainable development and employment. Reforms already implemented include a simplified planning structure. To make further progress the UK needs to ensure the planning system is flexible and responsive to changing economic needs. The Budget sets out further progress on implementing the Barker review of housing supply. Kate Barker's second review into the wider planning system will be published later this year.

Transport infrastructure needs to facilitate sustainable economic growth by providing effective and efficient global connectivity for business. The Budget confirms that the Government is continuing to invest to address historic under-investment in transport. Looking forward the Eddington Transport Study is analysing the long-term impact of transport on growth and employment.

This Budget also sets out a wider strategy to promote the UK's long-term strengths in the global economy including a high-level industry group to coordinate the marketing of London as the world's leading financial centre, a new International Business Advisory Council to advise Government on how to ensure the UK remains one of the world's key contenders as a location and further measures to promote UK Higher Education as a global destination of choice for students to study abroad.

