Productivity in the UK:

Enterprise and the Productivity Challenge

June 2001

Enterprise and Productivity

The Government's Strategy for the next Parliament

HM Treasury
Department of Trade and Industry

June 2001

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Productivity Challenge

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Enterprise and the Productivity Challenge

Four years ago the Government set its central economic objective of high and stable growth and employment. In the last Parliament we began by reforming the macroeconomic framework to tackle decades of economic instability. We radically reformed labour market policies to ensure that employment opportunity is open to all. And we began a programme of structural economic reforms, including a new Competition Act. These achievements though have only been the start.

Building on the platform of stability and employment creation, we must now direct our energies to further radical reform and modernisation of product, labour and capital markets to create a new Britain of enterprise for all. We must prepare ourselves to tackle fully the challenge of enterprise and productivity. To succeed over the long term, Britain's productivity must rise faster than our industrial competitors'.

Just as we put stability and work first in the last Parliament, we will put enterprise and productivity first in this Parliament. This document sets out the next steps in this programme of reform.

We will know we have succeeded when:

- Government at every level – national, regional and local – is actively promoting growth;
- starting a business, anywhere in the country, requires talent and potential, not luck and contacts, and the UK is the best place in the world to start and run a business;
- there is a step change in competitive pressures in the economy;
- dramatically more adults, especially those currently low-paid, are equipped with the skills to achieve their ambitions;
- we can honestly say that innovation and ambition at all levels in companies in the UK are genuinely world-class.

Rt Hon Gordon Brown MP **Rt Hon Patricia Hewitt MP**

1 INTRODUCTION

Enterprise and the productivity challenge

The Government is committed to meeting the challenge of enterprise and productivity to achieve its goals of high and stable growth and employment. Radical economic reform is needed to create a truly entrepreneurial culture open to all where talented people in all the UK's regions and communities have the chance to start and succeed in business.

The Government is now announcing:

- major **reforms to the competition regime** including full independence for better resourced competition authorities, a new duty to promote competition across the economy, reform of the complex monopoly regime, and a proposal of criminal penalties for those involved in cartels;
- changes to **capital gains tax** to reduce the effective rate on business assets to 20 per cent after one year and 10 per cent after two years;
- reforms to **insolvency laws** to abolish the Crown's preferential right to recover unpaid taxes ahead of other creditors, and to ensure the use of collective procedures instead of administrative receivership;
- changes to the taxation of share options, enhancing **Enterprise Management Incentives** to help high-growth firms attract high-quality employees, doubling the size of firms that can qualify;
- publication later this year of a Green Paper on **reform of the planning system**;
- the appointment of Ron Sandler, former CEO of Lloyd's of London and Chief Operating Officer of NatWest Group, to conduct an **independent review into the long-term retail savings industry** including life insurance;
- a wide-ranging review led by Sir Howard Davies into the **role of enterprise and business in education**;
- the appointment of Patrick Carter to conduct a **review into the provision of payroll services** for new and small businesses and to consider further action;
- an immediate **review of DTI's support to business**, starting with industrial manufacturing;
- a commitment to **widen the 10 per cent Corporation tax rate**, and new advice and support from Customs for firms experiencing difficulties with VAT;
- the publication of a consultation document setting out the **strategy for ensuring the best environment for businesses to invest in and from the UK**;
- **targets for each of the English Regional Venture Capital Funds**; and
- that, having consulted, the Government intends to introduce a **research and development (R&D) tax credit for large firms** in the next Budget.

1.1 The Government's central economic objective is to achieve high and stable levels of growth and employment. In the last Parliament the Government put in place fundamental reforms to achieve macroeconomic stability and to promote work. The UK has now achieved the highest employment of almost any OECD country and the lowest inflation in the EU.

1.2 But to achieve a sustained increase in the rate of growth, the UK needs also to improve its productivity performance. UK productivity, however measured, lags that of other major industrialised countries. The labour productivity gap with the US was 45 per cent in 1999, that with France was 19 per cent, and Germany 7 per cent (see chart in box 1.1). If the UK were to match the productivity performance of the US, for example, output per head would be over £6,000 higher.

1.3 The challenge is to achieve sustained improvements in our productivity growth, across every region of the country, so that the UK's productivity will rise faster than its industrial competitors as we close the productivity gap. To achieve this aim the Government will put the promotion of enterprise and productivity first in this Parliament. This document sets out how it will approach the challenge.

THE GOVERNMENT'S STRATEGY

1.4 The Government set out its comprehensive strategy for meeting the productivity challenge in "Productivity in the UK: The Evidence and the Government's Approach", which was published alongside the November 2000 Pre-Budget Report. The Government has further set out its policy for enterprise and innovation in two recent White Papers[1] and in the consultation document "Increasing Innovation", which was published alongside Budget 2001.

1.5 The two pillars of the Government's approach are delivering macroeconomic stability, to allow firms and individuals to invest for the future, and implementing microeconomic reforms to remove the barriers which prevent markets from functioning efficiently. These reforms address historic weaknesses in key areas that can drive private sector productivity growth:

- **enterprise and innovation** are at the heart of a dynamic business sector – new ideas for products and processes provide opportunities for productivity gains but to generate prosperity these ideas must be acted upon. Entrepreneurs willing to take risks are thus essential to economic growth;
- strong **competition** drives improvements in efficiency and innovation across the economy. Competition reduces prices and improves the quality of service for consumers whilst rewarding companies that innovate and operate efficiently;
- **investment** both by private firms and in public infrastructure allows firms to expand and grow, and underpins economic performance and future productivity improvements;
- improving **skills** helps to spread and develop new technologies and encourages firms to take up new innovations and working practices.

1.6 In the last Parliament substantial reforms were made in line with these principles. The Government:

- encouraged enterprise and innovation, including through the tax system, with reductions in corporation tax and capital gains tax, the introduction of R&D tax credits for small firms, and 100 per cent first year capital allowances for SMEs investing in ICT equipment;
- created the Regional Development Agencies to drive forward growth in every region;
- took forward the recommendations of the Social Investment Task Force to stimulate enterprise, innovation and wealth creation in disadvantaged communities;
- introduced a new Competition Act, announced that it would reform merger decision making, and established the Cruickshank review on competition in banking;
- increased real investment in the UK science base to reverse years of decline, and encouraged business innovation through significant knowledge transfer funding including for the Higher Education Innovation and University Challenge Funds and Faraday Partnerships;
- committed to double net public investment by 2003–04;

[1] "Excellence and Opportunity – a science and innovation policy for the 21st Century" (Cm 4814), published July 2000 and "Opportunity for all in a world of change" – a White Paper on enterprise, skills and innovation" (Cm 5052), published February 2001, both available at http://www.dti.gov.uk/

- commissioned and took forward the findings of the Myners review of institutional investment;
- made substantial investments in education and training, with real growth of at least 5.4 per cent a year in education spending from 2000–01;
- set national numeracy and literacy targets backed by comprehensive targets;
- created the Small Business Service to help improve the services and environment for small firms, as set out in "Think Small First"; and
- launched the joint CBI/TUC productivity campaign.

1.7 Productivity is the main determinant of living standards. Raising productivity is the key to raising long-term prosperity.

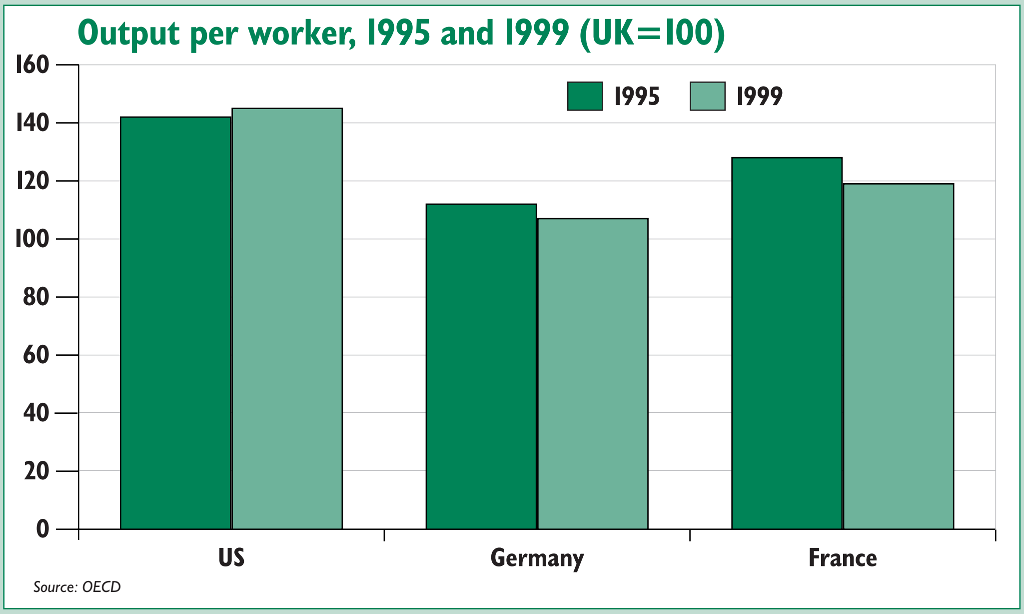
1.8 Productivity refers to how well an economy uses the resources it has available by relating the quantity of inputs to outputs. There are several measures of this relationship:

- output per worker – the productivity of each person in active employment;
- output per hour – a related concept which takes account of part-time work and time not spent working; and
- total factor productivity – this takes account not only of labour inputs, but also capital. It must, however, be estimated rather than directly measured and requires an accurate measure of the capital stock, which is often not available.

1.9 The Government's central measure is output per worker. This has the advantages of being the most straightforward to measure and also being immediately linked to the overall objective of raising trend growth. However, the most important point is that no matter which measure is used, UK productivity lags that of other major industrialised countries.

Box 1.1: UK productivity and the productivity gap

The chart below sets out the productivity gap with the US, Germany and France.



The productivity challenge, which the Government set out in 1997, is to achieve its long-term economic ambition to have a faster rise in productivity than its main competitors.

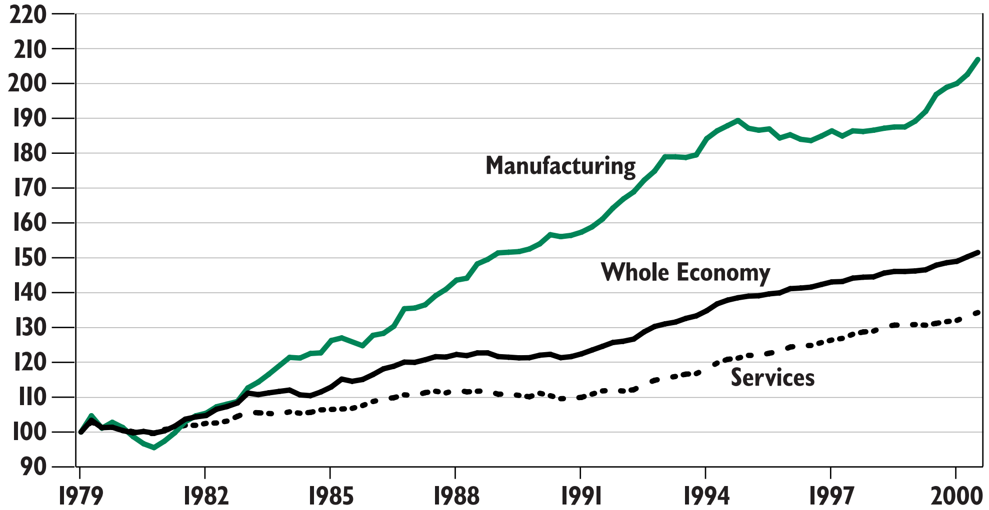
The productivity performance of the US since that time has been especially strong. Between the first and second half of the 1990s, US labour productivity growth accelerated

from 1.5 per cent to 2.5 per cent a year.[1] Commentators in the US have emphasised the role of information and communications technologies (ICT) in generating productivity growth. Investment in ICT has increased the productivity of the workforce, and has generated new ways for firms to operate and interact with each other. Recently, investment in these technologies in the UK has also been strong, although the stock of ICT remains below that of the US. Efficient product, capital and labour markets are essential to ensuring that the UK economy fully exploits the productivity potential of ICT.

It would clearly be premature to draw conclusions about the sustainability of the US productivity breakthrough.[2] At the same time, however, recent data on UK productivity growth has been somewhat encouraging. The most recent figures available show that UK productivity rose by 2.2 per cent in the year to the first quarter of 2001, and that manufacturing productivity rose by 4.1 per cent in the year to April 2001.

The chart below sets out the productivity trend for the whole economy, and separately for manufacturing and services. It shows that there are early signs that productivity growth may be beginning to increase. Aggregate productivity has increased steadily, and after years of modest productivity growth[3], especially in manufacturing, the recent figures have been showing an upward trend. For the UK to meet its productivity challenge and to improve living standards it is clearly necessary for these increases in productivity to be sustained.

UK productivity index[1] by sector, 1979–2001



[1] Productivity is measured as output per worker

Source: ONS 1979=100

[1]See for example S. Oliner and D. Sichel: The resurgence of growth in the late 1990s: is information technology the story? *Federal Reserve Board*, Finance and Economics Discussion Series Paper, May 2000.

[2]The most recent figures for the US indicate a muting of this acceleration. Investment in ICT capital goods has fallen off dramatically and productivity actually fell slightly during the first few months of 2001.

[3]Part of the explanation of this performance in more recent years lies in the fact that employment has also been increasing. Econometric analysis supports the view that new entrants into employment are on average between one-half and two-thirds as productive as existing workers, which is broadly consistent with the evidence that relative entry wages are around half average weekly wage rates. During such a phase it is to be expected that average productivity growth could be dampened, even though aggregate output is increasing.

Raising employment levels by improving the functioning of the labour market may therefore tend to reduce labour productivity growth over an initial transitory period, and the UK may have experienced such an effect over the late 1990s. There is no reason to suppose, however, that long-term trend growth in output per worker has been affected. As the capital stock adjusts to higher employment and as the workforce becomes more experienced and skilled, productivity can be expected to increase.

THE NEED FOR FURTHER REFORM

1.10 Structural economic reform does not yield results overnight. Improvements, for example, in children's education may take a generation to work through into the wider economy. However there is some evidence that the UK has made progress, as set out in the paper "Productivity in the UK: Progress towards a productive economy" published alongside Budget 2001. Over the past four years employment growth has been strong, there are some signs that productivity figures are also improving, and a range of indicators, important to productivity growth, show encouraging signs:

- business investment as a percentage of GDP rose to above 14 per cent in 2000, up from around 10 per cent in 1994;[2]
- literacy levels at age 11 have improved by nearly a third over the last four years. GCSE results for 16 years olds are the best ever;
- research and development by private firms has started to reverse its relative decline with a 7 per cent increase in real terms from 1998 to 1999; and
- OECD and Arthur Andersen benchmarks both rated the UK as the best environment for entrepreneurial activity.

1.11 However, as box 1.1 above shows, a large productivity gap still exists with our main competitors.

1.12 In the last Parliament the Government's overall focus was on delivering macroeconomic stability and sustained increases in employment. In this Parliament the Government believes it must focus its attention on a renewed effort to bridge that productivity gap. The Government's ambition is to narrow the productivity gap with the US, France, Germany and Japan over the economic cycle, as set out in the Treasury and DTI's joint Public Service Agreement (PSA) target.

1.13 The statement by the Chancellor of the Exchequer and the Secretary of State for Trade and Industry of 18 June sets out the next steps the Government will take to deliver its ambition:

- major **reforms to the competition regime** including full independence for better resourced competition authorities, a new duty to promote competition across the economy, reform of the complex monopoly regime, and a proposal of criminal penalties for those involved in cartels;
- **changes to capital gains tax** to reduce the effective rate to 20 per cent after one year and 10 per cent after two years;
- **reforms to insolvency laws** to abolish the Crown's preferential right to recover unpaid taxes ahead of other creditors and to ensure the use of collective procedures instead of administrative receivership;
- changes to the taxation of share options, enhancing **Enterprise Management Incentives** to help high-growth firms attract high-quality employees, doubling the size of firms that can qualify;
- **a commitment to widen the 10 per cent Corporation Tax rate**, and new advice and support from Customs for firms experiencing difficulties with VAT ;
- publication later this year of a **Green Paper on Reform of the Planning System;**

[2] Measured at constant prices.

- The appointment of Ron Sandler, former CEO of Lloyd's of London, to conduct an **independent review into the long-term retail savings industry including life insurance.** Building on work underway in the FSA, the review will identify the competitive forces and incentives which drive the industries concerned and, where necessary, suggest policy responses to ensure that customers and the investment needs of the economy are well-served;
- **a wide ranging review into the role of enterprise and business in education** to see how the UK can develop a stronger enterprise culture. The review will be led by Sir Howard Davies and will report later this year;
- the appointment of Patrick Carter to conduct a **review into the provision of payroll services** for new and small businesses and to consider the case for further Government action;
- an **immediate review of DTI's support to business**, starting with industrial manufacturing, to ensure that it is helping to promote enterprise, innovation and productivity. The review is expected to report initial results to the Secretary of State for Trade and Industry by September;
- that it will shortly **publish a consultation document setting out its strategy for ensuring the best environment for business to invest in and from the UK;**
- **targets for each of the English Regional Venture Capital Funds;**
- **comprehensive modernisation of company law** following the final report of the independent Company Law Review, to be published this summer; and
- the **introduction of a new R&D tax credit for large firms** in Budget 2002.

1.14 Further details of these measures, and their underlying rationale, are set out in the remainder of this document.

THE REGIONAL DIMENSION

1.15 A key productivity challenge that must be addressed are the regional imbalances in productivity within and between regions. Output per capita varies significantly between different regions. For example in May 2001 GDP per capita in the North East was £6,835 (over 40 per cent) below that in London. These differences have persisted over at least the past 30 years. The main sources of these inequalities appear to be regional variations in labour productivity levels. Other factors include differences in demographics. unemployment and participation rates.

1.16 The Government believes that regionally balanced growth, led by the regions themselves, is not only desirable in its own right but is also an essential element of the drive to raise productivity. The Government wants to maximise the potential of all localities – towns, cities, and rural areas.

1.17 The Government's regional economic policy is based on two principles. First, exploiting indigenous strengths in each area and region is likely to be the most effective way of strengthening the essential building blocks of growth – innovation, skills and the development of enterprise. Second, the best mechanisms for achieving this are likely to be based in the regions themselves, and so national Government must enable regional and local initiatives to work by providing the necessary resources within a national framework.

1.18 The Regional Development Agencies are the key agents in driving forward this new industrial policy. As the strategic leaders in regional and local economic development their regional development strategies set out shared visions of the challenge each region faces.

1.19 The Government has strengthened the RDAs' ability to tackle these issues through substantial increases in resources, from £1.2 billion in 2000-1 to £1.7 billion in 2003-4, and significantly increased flexibility over how they use those resources with the introduction of a single cross-departmental budget from April 2002 and the ability to carry resources forward from one year to the next. This increased flexibility must, however, be matched with increased accountability both through national targets and strong and effective regional chambers.

2 Enterprise and Innovation

ENTERPRISE, INNOVATION AND PRODUCTIVITY

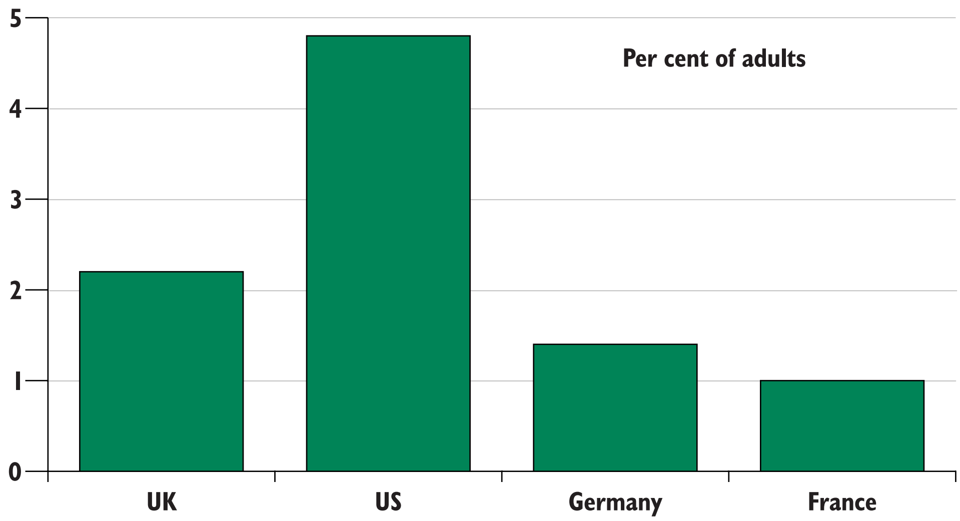
2.1 Enterprise and innovation – people taking opportunities, starting and growing businesses, and making the most of new ideas and technologies – are key to driving productivity.

2.2 New firms bring with them new ways of doing things, and increase the competitive pressure on other firms as well as choice and value to consumers. Research has shown that new firms entering the market account for a significant part of productivity growth.

2.3 New ideas, new products and new ways of doing things provide a catalyst for growth. The evidence shows, for instance, that spending on research and development (R&D) is associated with higher levels of productivity growth. There is further evidence to suggest that the returns to the economy as a whole from investment in R&D can be significantly greater than returns to individual companies which invest.

2.4 The UK compares favourably with other European countries in terms of the proportion of people engaged in new businesses, but the US still has a significantly higher rate, as chart 2.1 shows. The Global Entrepreneurship Monitor shows an even greater figure for the number of US adults trying to start new firms – three times as many as the UK.

Chart 2.1: Business start-ups, 2000



Source: Global Entrepreneurship Monitor, 2000

Enterprise

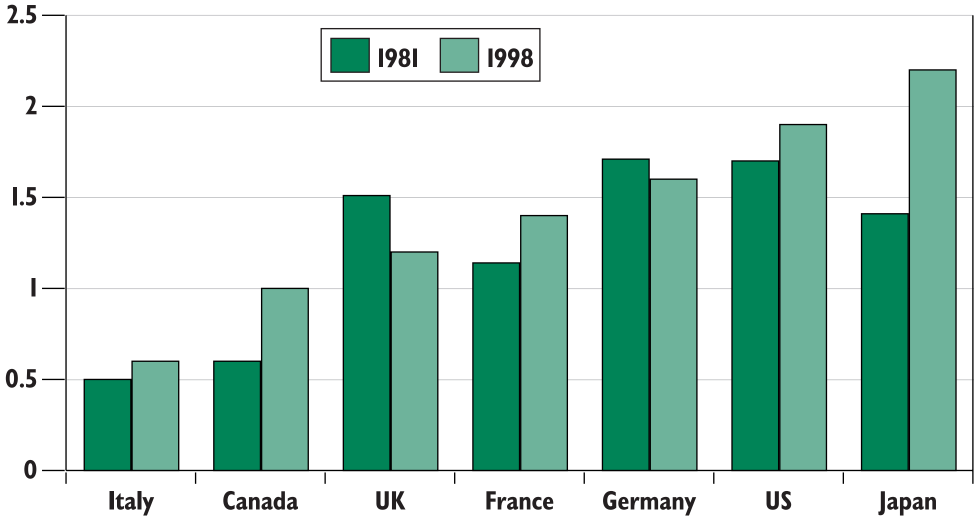
2.5 The OECD compiles indicators ranking countries according to the magnitude of barriers to entrepreneurship. These include factors such as permits, licences and complexity of rules and procedures and administrative burdens. On this index, the UK came out as having the lowest barriers to entrepreneurship of any of the countries studied. This suggests that there are other factors at work to explain the higher level of entrepreneurial activity in the US.

2.6 There is much more that can be done to build a genuine enterprise culture in the UK amongst citizens and companies. Government alone cannot bring this change about but it can play an important catalytic role through reforms to the UK's tax and regulatory systems to ensure that the right incentives are in place to encourage enterprise.

Innovation

2.7 There is evidence that the UK, compared with other major industrialised countries, tends to invest proportionately less in R&D both in the economy as a whole and across many sectors. In terms of international trends, UK business expenditure on R&D declined throughout the 1990s; chart 2.2 shows that UK business spending on R&D fell between 1981 and 1998, whereas in most countries the proportion rose. While part of the UK's fall between 1981 and 1998 can be attributed to a reduction in defence R&D expenditure, in other countries this was offset by a rise in civil spending. UK business has started to reverse this decline, with R&D business spending increasing 7 per cent from 1998 to 1999, but R&D levels must be raised further if the R&D gap is to be closed.

Chart 2.2: Business R&D expenditure as a percentage of GDP, 1981 and 1998

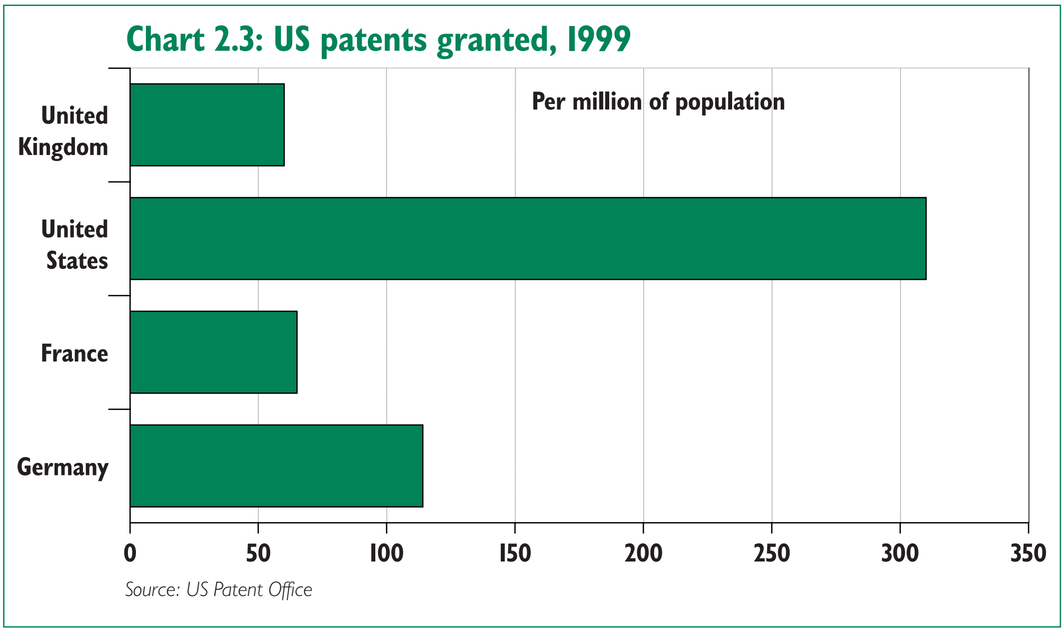


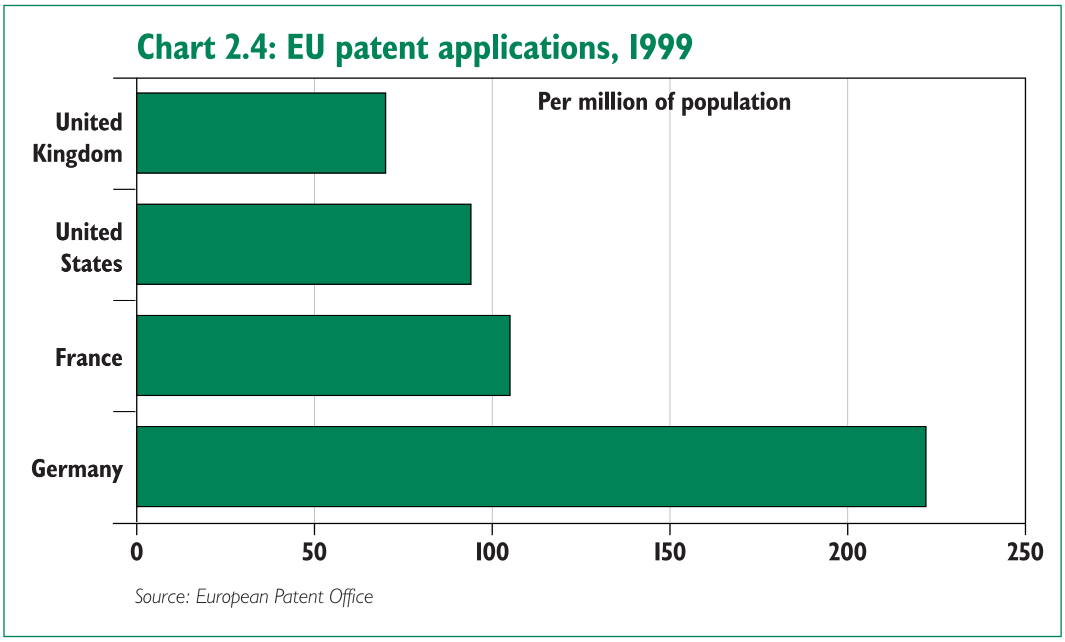
Source: OECD

2.8 While the UK has a strong science base, for example outperforming many countries in terms of the number of published scientific articles, it has in many sectors failed to translate this scientific knowledge into commercial success. Indicators of innovation, such as the number of patents generated by different countries, show that the UK tends to fall behind.

2.9 On applications both to European and US patent offices, the UK trails France, Germany and the US (see charts 2.3 and 2.4). However, comparisons using patent data are fraught with difficulty since patenting cultures and the legal environment can differ considerably between countries. For example, some countries and regions tend to focus on patenting finished products; others tend to patent all the intermediate stages and a number of variations in the final product.

2.10 The adoption of leading-edge technologies is also a key aspect of innovation. Recent studies of US growth performance have emphasised the role of ICT in driving productivity growth – through firms both producing and using these technologies. Comparisons of expenditure on ICT indicate that the UK trails the US but leads France and Germany. Business use of ICT has also increased, with over 1.7 million small and medium sized enterprises now on-line.





RECENT REFORMS

2.11 In recent years the Government has introduced a programme of reforms to aid enterprise and business growth and the development of new ideas and an innovative culture. For example, it has:

- reformed the corporate tax regime, with the lowest rate of corporation tax among major industrialised countries;
- reduced corporation tax for smaller firms, with a starting rate of 10 per cent which is the lowest in the EU;
- introduced a capital gains tax taper reducing the effective tax rate on business assets to 10 per cent after four years;
- established the Small Business Service to help meet the needs of small businesses and act as a strong voice at the heart of Government;

- boosted enterprise in the regions by launching a £75 million Incubator Fund, initiating a new Manufacturing Advisory Service to improve manufacturing productivity and providing £50 million for early stage funding;
- created Regional Development Agencies to promote growth in every region;
- promoted employee share ownership, especially through the All-Employee Share Ownership Plan;
- introduced Enterprise Management Incentives, tax advantaged share options, to help smaller businesses with growth potential recruit and retain the employees they need for success;
- introduced the R&D tax credit for SMEs, and launched a consultation on a similar incentive for larger enterprises;
- helped to make universities centres of economic growth, and to turn more ideas into commercial success, with seed funds created by University Challenge, twelve new Science Enterprise Centres, the Higher Education Innovation Fund and new university innovation centres and technology institutes; and
- invested in the research infrastructure, with the announcement of new investment programmes worth £750 million in 1998 and £1 billion in 2000, both in partnership with the Wellcome Trust.

FURTHER REFORMS FOR ENTERPRISE AND INNOVATION

2.12 The rest of this chapter sets out a package of measures designed to promote enterprise and improve the incentives on companies and individuals to invest and innovate.

Capital gains tax

2.13 Equity investments in companies are a vital source of capital for new and growing firms. In the last Parliament the Government reformed the capital gains tax (CGT) regime to create incentives for investment aimed at generating sustained growth. The Finance Acts 2000 and 2001 introduced:

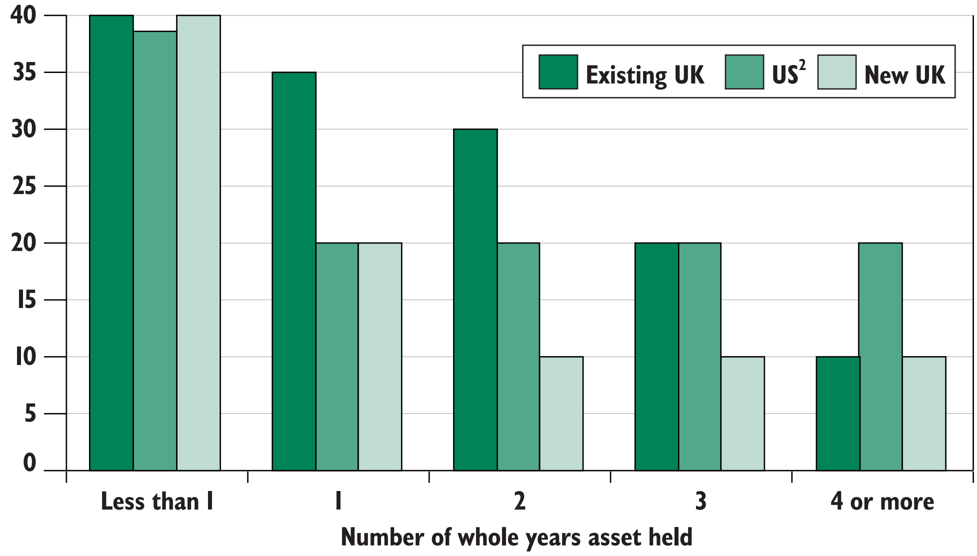
- a four year taper that reduces the effective rate of CGT on business assets from 40 per cent to 10 per cent;
- automatic access to the business assets taper for almost all shares held by employees; and
- automatic access to the business assets taper for all external investors in unlisted trading companies, and investors holding more than 5 per cent of listed trading companies.

2.14 The UK's CGT regime for business assets is now one of the most competitive in the world. However the Government believes it is now time to go further and ensure that our regime is among the most favourable to enterprise in the developed world.

2.15 For disposals from next April, **the Government will improve the CGT business assets taper so that the effective rate of tax for a higher rate taxpayer is reduced to 20 per cent after one year and 10 per cent after only two years.**

2.16 **In addition, the Government will consider whether, during the lifetime of this Parliament, it is necessary to improve the CGT treatment of those assets that do not qualify for the business taper** in order to promote access to finance for other businesses and improve incentives to invest.

Chart 2.5: Existing and new effective rates of CGT on business assets for higher rate tax payers



[1] This includes only the main federal rate of tax. Some States may impose additional taxes on these gains

2.17 **The Government will also consult on ways to simplify CGT.**

Employee incentives

2.18 Employees' participation in business success is an important way of giving them a stake in productivity improvements. In the last Parliament the Government introduced a number of measures to incentivise companies to offer employees direct stakes either in the form of directly owned equity or share options. This included the most tax-advantaged all employee share ownership scheme ever introduced in the UK, as well as a tax advantaged option scheme designed to attract high-quality employees to new higher risk start-ups.

Share options

2.19 The changes to CGT on which the Government is consulting will provide further incentives for individuals to benefit from share ownership. The Government believes that the time is now right to provide further incentives for companies to offer their employees share options.

2.20 Under present arrangements, businesses are not always able to deduct the cost of share options against their corporation tax liabilities. **To encourage more businesses to consider the awarding of share options to their employees, the Government will consider whether a corporation tax deduction should be made available and how access to it could be streamlined.**

Enterprise Management Incentives

2.21 Enterprise Management Incentives (EMIs) are designed to help small high-risk companies attract the high quality management they need to fulfil their growth potential. EMIs allow small companies, whose assets are valued at no more than £15 million, to offer employees options over shares worth up to £100,000 (at grant), up to a total value of £3 million per company. These options are then taxed as capital gains at the time of sale rather than exercise. In practice this means most of those that hold EMIs will be taxed at an effective tax rate of 10 per cent on the gain. The EMI scheme has proved attractive to business; by March 2001 over 1,000 companies had awarded options.

2.22 The Government believes that it is now right to build on the success of EMI and offer its advantages to more businesses. This may be of particular help to particular small dynamic manufacturing enterprises which are more likely to have assets in excess of the current £15 million limit.

2.23 Budget 2002 will, subject to consultation, double the EMI asset limit to £30 million.

Business birth-rate strategy

2.24 The data set out above show that although the UK does relatively well in generating new businesses compared to our EU competitors, it still lags the US. But it is also important that these firms once founded grow and flourish. The Government believes that to succeed in meeting the productivity challenge the UK needs to improve its record of both business creation and growth. To cut the costs of starting a business and improve the chances of survival the Government intends to implement a substantial package of further reforms to improve the environment for small firms.

2.25 Alongside these tax reforms the Government will develop a comprehensive strategy for support and advice for those trying to start a firm. There is currently a considerable amount of support available, both in the private and public sectors, for such people. However, public sector support is fragmented and spread across a range of different agencies and arms of Government. The Small Business Service will consult later this year on a comprehensive strategy to bring together these different activities in support of business start-ups.

Small companies corporation tax

2.26 In the last Parliament the small companies corporation tax rate was cut from 23 per cent to 20 per cent and a new 10 per cent rate was introduced for the very smallest companies. **Building on this, the Government intends to extend the 10 per cent rate in Budget 2002.**

2.27 The Government intends also to introduce a substantial reduction in the regulatory burdens placed on new businesses. The Government wants to change the assumption that revenue collection agencies are seen as interfering or threatening. Instead it would like them to be seen as agencies of support. To this end the Government will consult on changing the system:

- **introducing a new flat-rate VAT scheme for companies with a turnover of less than £100,000, designed to reduce the tax and compliance cost burden for more than three hundred thousand businesses; and**
- **where smaller companies are late in paying VAT, the Government's first response will in the future be to offer advice and support rather than simply imposing automatic fines.**

2.28 Following Budget 2001, the Inland Revenue has been consulting on reducing the regulatory burdens on small business through aligning their profits for tax purposes much more closely with those reported in their accounts. The Government will bring forward proposals for consideration in the Pre-Budget Report.

Review of DTI support for business

2.29 The Government also needs to ensure that help to business is directed effectively towards increasing growth and productivity. Firms should be helped to innovate and take advantage of technological developments. To make sure this is happening, **the Secretary of State for Trade and Industry has announced a review of the DTI's business support,** in consultation with stakeholders and customers. This will start with industrial manufacturing and initial results should be reported to the Secretary of State by September.

Payroll services

2.30 Running payroll services is a major task for new and very small businesses. New information technology can make this task easier and cheaper. But there are some barriers to the take up of this new technology. Government has an important role in helping small firms to find the most effective ways of performing the task, and ensuring that payroll can be done as efficiently as possible. **The Government has therefore asked Patrick Carter to undertake a review to identify ways in which Government can help to increase the efficiency of payroll, and so reduce costs to small firms.**

Insolvency

2.31 The success of the Government's strategy for small business success relies not only on improving the incentives and rewards for people to succeed but also on ensuring that businesses that get into difficulty do not fail unnecessarily. Fear of failure can act as a powerful disincentive to potential entrepreneurs considering starting their own businesses and the failure of one business can impose significant costs on its creditors. The UK's insolvency regime is generally regarded as the most friendly to secured creditors of any major jurisdiction, as shown by table 2.1.

Table 2.1: Statutory Creditors' Rights

Country	No Automatic Stay	Secured Creditors First Paid	Restrictions For Going into Reorganisation	Management Does Not Stay in Reorganisation
Australia	–	*	–	–
United Kingdom	*	*	*	*
United States	–	*	–	–
France	–	–	–	–
Germany	*	*	*	–

Source: Dorta, Schliefer, Lopez de Silones and Vishny, Journal of Political Economy, 1998.

2.32 The laws on insolvency and bankruptcy have their origins in the nineteenth century, and some of the principles underlying them are now out of date. **The Government will introduce new legislation to bring them into the twenty-first century.** The key reforms on personal insolvency (bankruptcy) will include:

- **reducing the penalties for those who go bankrupt but who have not been dishonest;** and
- **increasing the maximum penalties against those who have been dishonest.**

2.33 **The Government will also bring forward proposals to modernise the law on corporate insolvency,** with two simultaneous reforms.

2.34 First, there will be reforms to ensure that collective procedures have clear primacy. **The Government believes that administrative receivership should cease to be a major mechanism for handling insolvencies.** The system should instead be based firmly on collective procedures, in which there is a clear duty of care to all creditors, and all creditors have an opportunity to influence the outcome. Administration will be streamlined to make it more attractive and accessible. The ability to appoint an administrative receiver will be restricted or abolished. Special arrangements may be needed for securitisations.

2.35 At the same time that it introduces these reforms, **the Government is willing to abolish the Crown's remaining preferential rights as a creditor, to benefit unsecured creditors.** Crown preference means that the Government stands ahead of some creditors for the repayment of some debts.

2.36 **The Government will bring forward detailed proposals in a White Paper in July.**

Advice and support for small firms

2.37 Advice and support for small firms needs to be available in the most convenient form, making full use of modern technology. The Government is investing to modernise the way in which it delivers these services, making more advice available on-line and on the telephone. The Small Business Service's new on-line Business Link is now up and running and the new Business Link contact centre is taking calls from businesses across England.

2.38 The Government is also supporting a project, the Comprehensive Business Directory, planned to allow businesses to register just once with Government, saving everyone time and money. This facility will be piloted later this year.

Company Law Review

2.39 In March 1998 the Government launched the independent Company Law Review to modernise the framework of core company law. Much of the current framework dates to the mid-nineteenth century, and piecemeal reform has produced a system which imposes unnecessary costs and is excessively complex and inaccessible.

2.40 The Company Law Review's final report will be published shortly. Its key proposals include:

- a radical simplification of the requirements for small firms;
- a statutory statement of directors' duties; and
- improved transparency and accountability for large firms.

2.41 **The Government will respond to the Review's final report in a White Paper.** The Government is determined to modernise company law so that it is up-to-date and promotes enterprise and productivity.

Enterprise for all

2.42 The Government is committed to taking forward the work of Sir Ronald Cohen's Social Investment Task Force, which reported to the Chancellor in October of last year. In order to make enterprise a real opportunity for everyone the Government has:

- committed £20 million in Government matching funding for the Community Development Venture Capital Fund which Sir Ronald Cohen is currently raising from the private sector. The fund is an innovative approach to fostering entrepreneurship and business success in our most deprived communities. It is on track to be up and running by the end of the financial year subject to State Aids clearance; and
- published a consultation document on Community Investment Tax Credits to increase the flow of private sector funding to enterprises in disadvantaged communities. The credit will offer investors a generous incentive to put their money into both for-profit businesses in disadvantaged communities and social enterprises. The consultation is continuing until July and it is expected that the tax credit will be included in the next Finance Bill.

2.43 In addition to taking forward proposals from the Social Investment Task Force the Government has put in place a number of other measures designed to encourage enterprising activity in disadvantaged communities. The Government has:

- launched the £96 million Phoenix Fund which has made its first round of commitments to enterprise development and community development finance;
- promoted enterprise in the deprived inner city by supporting the "Inner City 100", a campaign to identify and promote the fastest-growing 100 businesses in our poorest inner cities; and
- committed funds to developing City Growth Strategies which will provide cities with the tools to bring business success into the heart of their regeneration activities.

2.44 The Government has also responded to the recommendations of Lord Rogers' Urban Task Force. Budget 2001 included tax incentives aimed at reversing the physical economic and social neglect that characterises some parts of the UK's towns and cities:

- reducing VAT on residential property conversions at a cost of £115 million per year;
- accelerating tax relief for cleaning up contaminated land worth £85 million a year;
- introducing 100 per cent capital allowances for bringing empty flats over shops back into the residential market, supporting up to 1,300 conversions per year; and
- abolishing stamp duty on all property transactions in the most disadvantaged areas of the UK, at an estimated annual cost of £100 million.

R&D tax credit

2.45 Encouraging research and development is a vital component of the Government's strategy for improving productivity. Comparisons with other countries show that the UK business sector underinvests in R&D relative to its major competitors and this has translated into lower overall levels of innovation. In the last Parliament the Government introduced an R&D tax credit for SMEs in order to address the particular difficulties such firms face in accessing capital to invest in innovation and R&D.

2.46 To complement this in Budget 2001 the Government published a document "Increasing Innovation" which set out proposals for a new tax credit to encourage R&D and innovation among larger firms. **The Government intends to introduce an R&D tax credit for large firms in Budget 2002.**

The Roberts review

2.47 The Government is also keen to ensure that businesses' research and development efforts are not constrained by a shortage of suitably qualified scientists and engineers. In Budget 2001 the Government therefore asked Sir Gareth Roberts to undertake an independent study into the provision of skilled scientists and engineers in the UK, reporting by February 2002.

2.48 A consultation paper which sets out the key issues to be considered during the review, and which seeks the views of business and education representatives, will be published later this week.

Review of radio spectrum management

2.49 Radio spectrum is an asset of large and growing importance, crucial to the success of many industries, such as communications, which have a major bearing on future prosperity and in which the UK can excel. At the same time, it is vital to ensure that adequate spectrum is available for the delivery of essential public services such as defence, broadcasting, air safety and the emergency services.

2.50 The UK has already taken great strides towards making more productive use of spectrum: it was the first in the world to auction the spectrum for the next generation of mobile phones, and the first in Europe to apply incentive pricing to encourage greater efficiency in other areas of spectrum use.

2.51 But the pace of change in technology and rising demand for communications mean that the Government must continually assess what more can be done to encourage innovation and productivity in this area. New entrants must be able to compete in wireless technology with incumbents. The regulatory regime must be flexible and responsive to market changes. Users in public and private sectors must have incentives so that they do not waste or hoard what has previously been a free good.

2.52 For these reasons the Government commissioned Professor Martin Cave, in Budget 2001, to lead an independent review to advise on the economic principles of spectrum management going forward. **The Chancellor and the Secretary of State for Trade and Industry are pleased that the review is today setting out its initial analysis of the spectrum management challenge facing the Government, along with suggested approaches on which the review will be consulting in the next few months.** The Government believes that there is an opportunity here to build on reforms already in train and to identify further regulatory changes which should bring long-term benefits to UK consumers, public services and businesses.

Broadband

2.53 Broadband networks will give us the next leap forward in communications capability. The ability to access the internet cheaply and easily, and to exchange significant amounts of data whether in the form of video, graphics or text, is likely to be key to the success of businesses of all sizes. This is why the Government is committed to having the most extensive and competitive broadband market in the G7 by 2005.

2.54 Achieving this goal will not be easy. The Government is taking action to ensure that public sector demand for broadband services can be brought together locally to help build the market and make for better procurement. Regional Development Agencies are also being provided with extra funding to identify innovative ways of meeting local needs for broadband networks, and the Government will continue to monitor the roll-out of broadband in rural areas. The Government will look closely at the action plan proposed by the Broadband Stakeholders' Group later this year. It is vital that the market remains dynamic and competitive, with a regulatory environment that serves the long-term interests of consumers.

3 Competition

THE IMPORTANCE OF COMPETITION

3.1 Competition is at the heart of the Government's strategy to close the productivity gap. Vigorous competition between firms leads to increased innovation and greater efficiency – and in turn to increased productivity growth.[1]

3.2 A competition policy which addresses barriers to entry also enables new entrants, many of whom will be small and medium sized enterprises (SMEs), to challenge the power of incumbents. It promotes an environment in which entrepreneurs have a fair chance to take opportunities, start and grow their businesses.

3.3 Competition also ensures that consumers get a good deal. Greater competition means that firms must work to win customers – by reducing prices and by improving the quality of products and services available.

3.4 The Government has already taken a number of steps to improve competition across the economy. In doing so it has strengthened the overall competition regime and taken action to promote competition in some specific markets.

THE COMPETITION FRAMEWORK

3.5 The Government has built a sound framework for competition authorities to address anti-competitive behaviour across the economy:

- the **Competition Act 1998** gives the Office of Fair Trading (OFT) much stronger powers to address anti-competitive behaviour. It prohibits anti-competitive agreements, and abuses of dominant market position. Firms which breach the law face penalties of up to 10 per cent of their turnover in the market in question for up to three years of an infringement;
- the Government has announced its intention to reform the **merger regime** – so that decisions on individual cases are taken by independent competition authorities using a competition-based test;
- the **Financial Services and Markets Act 2000** gives the OFT and Competition Commission new powers to scrutinise the competition effects of financial services regulations;
- the Government has increased the **OFT's budget** – from £20 million in 1997 to £32 million in this financial year. The Government has also appointed a new Director General, John Vickers, a leading economist with strong expertise in competition matters;
- the Government has announced that it intends to legislate to provide the OFT with a new **board structure**. This will help to broaden the basis for deciding the OFT's strategy;
- the Government announced earlier this year that it would confer a new role for the OFT (and the sectoral regulators) to assess when **laws and regulations** create barriers to entry and competition; and

[1] See, for instance, SJ Nickell: "Competition and Corporate Performance", *Journal of Political Economy*, 104(4) 1996.

- the Government commissioned a **peer review** of the UK's competition regime. The findings of the report, published in early May, are in box 3.1.

Box 3.1 – Peer Review of Competition Policy

The Government commissioned a peer review of the UK's competition regime[1] to provide a benchmark against which to measure progress against the DTI's Public Service Agreement target of having 'the most effective competition regime in the OECD'.

The review asked over 100 competition experts from around the world to rank various aspects of the UK regime against that in their own country and against the EU regime. The key conclusions were:

- **the UK regime ranks in the top half of its peer group, behind those of the US and Germany, but ahead of a number of other OECD regimes;**
- **only 10 per cent of British respondents thought that competition policy was important to the UK public. This compared with 83 per cent in the USA;**
- **the complex monopoly provisions of the Fair Trading Act 1973 are particularly well regarded;**
- **the UK's current merger regime ranks less well, but respondents welcomed the merger reform proposals; and**
- **83 per cent of respondents in the UK believed that criminal penalties would improve the effectiveness of the UK regime, by increasing its deterrent effect.**

The review recommended:

- **measures to enhance the status and role of competition policy in the UK;**
- **measures to improve the visibility and transparency of the UK regime, and to give the OFT a more proactive role;**
- **retaining the complex monopoly provisions of the Fair Trading Act, which are widely seen as a very useful part of the UK system; and**
- **considering the introduction of criminal sanctions.**

[1] Available at http://www.dti.gov.uk/CACP/cp/cppeer/index.htm

3.6 There have also been important developments in a number of specific markets.

Banking

3.7 In 1998 the Government asked Don Cruickshank to conduct an independent review of competition in banking. The review concluded that banking markets lacked effective competition – and that as a result, consumers and small firms were being charged more than they should. The Government followed the review's recommendations, and has introduced a number of measures to promote competition in the banking industry:

- Budget 2000 announced the Government's intention to legislate to open up access to payments systems and oversee access charges. The Government will give the Office of Fair Trading new powers to promote effective competition in payment systems for the benefit of consumers;
- the Government issued a public consultation document on its legislative proposals in December last year. Consultation closed in March this year. The Government is currently studying the representations received during consultation, and expects to bring forward its response shortly; and
- the Government has set up an independent group to review whether self-regulatory codes such as the Banking Code are delivering sufficiently strong benefits to consumers. The group submitted its report at the end of May and the Government is now studying its findings.

3.8 The Government has referred the supply of banking services to SMEs to the Competition Commission. The inquiry is underway and the Competition Commission has already published its provisional findings on the existence of a complex monopoly.

Energy markets

3.9 Energy markets in the UK have been fully liberalised, with all types of customers free to choose their own supplier. By October 2000, over 12 million domestic gas and electricity customers had switched suppliers – often in response to the lower prices offered by new suppliers. New Electricity Trading Arrangements were introduced in March, bringing greater competition and transparency into the wholesale electricity trading market.

The water industry

3.10 The Government is proceeding with plans to introduce competition in the water industry. It will publish proposals in the Autumn to open up markets for the retail and abstraction of water, allowing greater customer choice and improving efficiency while maintaining key environmental, supply security and public health safeguards.

The professions

3.11 The Government asked the OFT in November 1999 to conduct a review of competition in the professions. The OFT report, published in March 2001, concluded that there were numerous restrictions on competition in the professions – and that they should be fully subject to competition law. The Government will remove the entitlement to exclusion from the Competition Act 1998 and, beyond that, will consult on how to remove any further unjustified restrictions on competition.

New cars

3.12 The OFT referred the market for new cars to the Competition Commission in March 1999, under the complex monopoly provisions of the Fair Trading Act 1973. The Competition Commission's report found that British motorists were paying more for new cars than their European counterparts. The Government has taken action to implement the Commission's recommendations – legislating to secure fair purchasing terms for dealers of equivalent value to those enjoyed by fleet buyers. It will also be pushing for major reforms to the European cars block exemption to secure prices for consumers. Last year, new car prices in the UK fell by over 10 per cent.

Over-the-counter medicines

3.13 The OFT has successfully taken action to outlaw resale price maintenance for branded over-the-counter medicines. Pharmaceutical suppliers withdrew their opposition to the OFT's case in May – within days the price of many medicines had fallen by up to 50% in leading supermarkets.

THE NEED FOR FURTHER REFORM

3.14 In Budget 2001, the Government declared its commitment to ensuring that the UK's competition regime does all that it can to promote competition in the economy, and pointed to a number of questions that would be reviewed.

3.15 The Government's reforms to the competition regime have been underpinned by six principles:

- competition decisions should be taken by strong, pro-active and independent competition authorities;
- the regime should root out all forms of anti-competitive behaviour;
- there should be a strong deterrent effect;
- harmed parties should be able to get real redress;
- Government and the competition authorities should work for greater international consistency and co-operation; and

- competition policy should have a high profile – because of its importance for economic performance.

Independent, strong and pro-active competition authorities

3.16 The Government believes that, in relation to each of these principles, there is scope for further improvement in the UK competition regime. The Government is committed to moving swiftly in this area. **It will publish a White Paper on competition policy in July, setting out proposals for reforms to produce a significant strengthening in the regime – and consulting on how best to proceed.** This consultation will close at the end of September.

3.17 **The Government will take steps to ensure that the UK competition authorities are as strong, independent and pro-active as possible:**

- **the OFT will be given a stronger legal basis actively to promote competition across the economy**;
- **the OFT and the Competition Commission will have a formal role (and relevant powers) to alert Government to both existing and proposed regulations which are (or have the potential to be) significantly anti-competitive.** The Government will consider carefully the advice it receives – balancing the competition considerations against other public policy considerations. Where the Government receives a public report, it will commit to publishing a response setting out its decision and its underlying reasoning;
- **consumer groups will have the ability to bring a new category of 'supercomplaint' to the OFT.** Where they bring complaints in this way, the OFT will consider carefully whether there are sufficient grounds to launch an investigation, or to refer the relevant market to the Competition Commission. The complainant will have a right to a reasoned public response within 90 days;
- the Government will also **consider the level of further resources the OFT and the Competition Commission will need** in order to ensure that they are able to recruit the highest-quality staff, achieve a higher profile for competition policy and to support the OFT's new Markets and Policy Initiatives Division – which will work pro-actively to uncover markets which are not working well for consumers;
- the Government will **publish a mission statement which sets out its objectives for competition policy – and what it promises to do to achieve them.** The OFT and the Competition Commission will also publish their own statements. These three documents – the mission statements of the key players in competition policy – will strengthen accountability by setting out criteria against which Parliament and others can hold our competition institutions accountable;
- the Government will, in future, **only appoint those with expertise relevant to competition as members of the Competition Commission**; and
- the Government will **legislate to allow UK competition authorities to share information with competition authorities abroad** – both in countries which have civil regimes, and those where there are criminal regimes. Information obtained from firms during the course of merger investigations will be excluded.

Mergers **3.18** The Government has already announced that it will legislate to modernise the mergers regime:

- decisions on mergers will be taken by independent competition authorities, rather than Ministers;
- the competition authorities will judge cases against a new competition-based test rather than the current public interest test;
- it is proposed that the authorities should be able to consider benefits to UK consumers affected by the merger, and should, in exceptional circumstances, be able to clear a merger or allow it to proceed with lesser conditions where such benefits arise;
- Ministers will only have the right to intervene and decide cases in the small minority of cases where clearly defined exceptional public interest issues arise. To do so, they would have to signal their interest at the time of the reference;
- national security criteria will be defined as grounds for Ministerial intervention in the legislation. Ministers will be able to add additional exceptional public interest criteria by statutory instrument and subject to affirmative resolution in Parliament. The Government has confirmed that it has no current plans to use this power; and
- in the vast majority of cases, where Ministers do not signal that exceptional public interest issues arise at the time of reference, the Competition Commission's decisions will be final.

Complex monopolies **3.19** The Government believes that there is a strong case for modernising the complex monopoly provisions of the Fair Trading Act 1973 – the key basis in UK law for looking at the workings of markets – along the same lines as the merger reforms, with decisions taken by independent competition authorities, acting against a competition-focused test, rather than Ministers.

3.20 However, in some cases, complex monopoly cases can raise wider and more intrusive issues than merger cases. This is likely to require some greater flexibility for Ministerial intervention, where clearly defined exceptional public interest issues arise, or where divestment remedies are proposed. It would be essential to constrain both the boundaries of Ministerial intervention and the process for intervention so that the overwhelming majority of decisions are made by independent competition authorities.

3.21 **In addition, the Government believes that aspects of the procedure for complex monopoly inquiries should be modernised:**

- **there should be a new more flexible reference test** – which allows the OFT to refer markets for investigation where it has reasonable grounds for suspecting that competition may be being undermined;
- **there should be a new duty for the Competition Commission to develop remedies in order to address the problems identified through the promotion of competition and the consumer interest**; and
- **the OFT should report on the effectiveness of remedies at promoting competition in markets which have previously been investigated**.

3.22 These reforms will complement procedural changes now envisaged by the Competition Commission – in particular, a **new two-stage process for remedy-setting with a provisional finding published, along with a report setting out the key parts of the analysis, before moving to a separate remedy-setting stage.**

Deterring anti-competitive behaviour

3.23 The Competition Act 1998 provides a strong deterrent to anti-competitive behaviour. **The Government will continue to ensure that anti-competitive behaviour is effectively deterred – and that firms and individuals who are harmed have an effective right of redress:**

- the Government intends to **consult upon a proposal that there should be a new criminal offence for individuals who engage in cartels,** the most serious form of competition breach. The threat of imprisonment would act as a strong deterrent;
- there will be **new procedures improving the ability of those harmed by anti-competitive behaviour to seek redress.** For example, there is a strong case for parties to be able to bring actions before a specialist competition court or tribunal; and
- there will be **a new right of appeal when seeking interim measures under the Competition Act to stop anti-competitive behaviour while a case is under consideration.**

The European dimension

3.24 The Government believes there are significant advantages from ensuring that our domestic competition regime on anti-competitive behaviour is consistent with the European regime. The prohibitions in the Competition Act 1998 closely follow Articles 81 and 82 of the Treaty of Rome.

3.25 The Government welcomes the European Commission's proposals for modernising the way in which Articles 81 and 82 are implemented. In particular, the removal of the notification system will also ensure that competition authorities are able to dedicate greater resources to rooting out serious anti-competitive behaviour. Decentralising decision making to national competition authorities will also increase the effectiveness of the OFT in tackling cases which cross national boundaries.

3.26 However, the Commission proposals are major changes to the rules and it is important to get the details right. The UK Government is concerned to ensure the proposals afford adequate legal certainty and do not undermine the effective operation of key parts of our domestic regime – in particular, the complex monopoly provisions, and the existing regimes for utility regulation. The Government is working with the European Commission and other member states to resolve these difficulties.

4 INVESTMENT

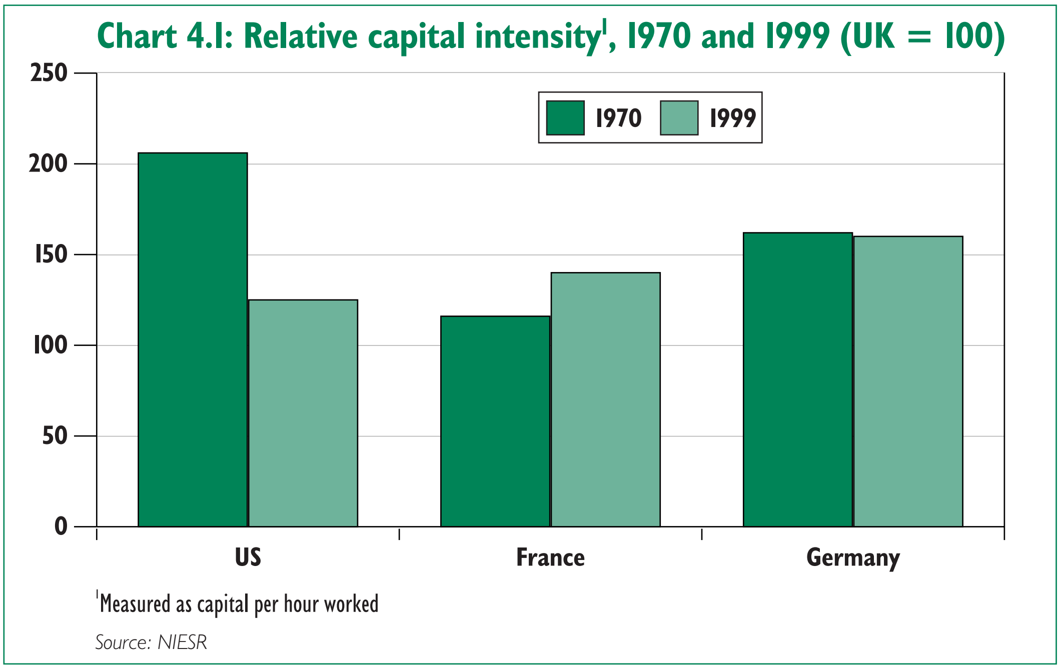
INVESTMENT, PRODUCTIVITY AND ENTERPRISE

The role of investment

4.1 Growth in the economy depends heavily on investment in physical capital.[1] Analyses of UK productivity performance relative to other competitor countries[2] suggest that a large part of the UK's productivity gap with other countries can be accounted for by relative deficiencies in physical capital.

4.2 The UK is fortunate to have highly developed capital markets. However, it has suffered from prolonged under-investment in the private and public sectors. This results in a relatively low physical capital stock. Chart 4.1 sets out the UK's capital to labour ratio by comparison with the US, Germany and France.

Chart 4.1: Relative capital intensity[1], 1970 and 1999 (UK = 100)



[1]Measured as capital per hour worked

Source: NIESR

4.3 In 1970, the UK had less capital per hour worked than the US, Germany or France; in 1999, this was still the case. The US now has 25 per cent more capital stock per hour worked, France 40 per cent more and Germany 60 per cent more.

4.4 The Government's approach to promoting investment relies firstly on establishing macroeconomic stability. This provides businesses and entrepreneurs with the confidence to be able to plan effectively for the future.

4.5 This will not be enough in itself, however: capital markets need to work efficiently and barriers sometimes need to be removed to ensure that firms have access to finance for potentially profitable projects.

THE EFFECTS OF GREATER STABILITY

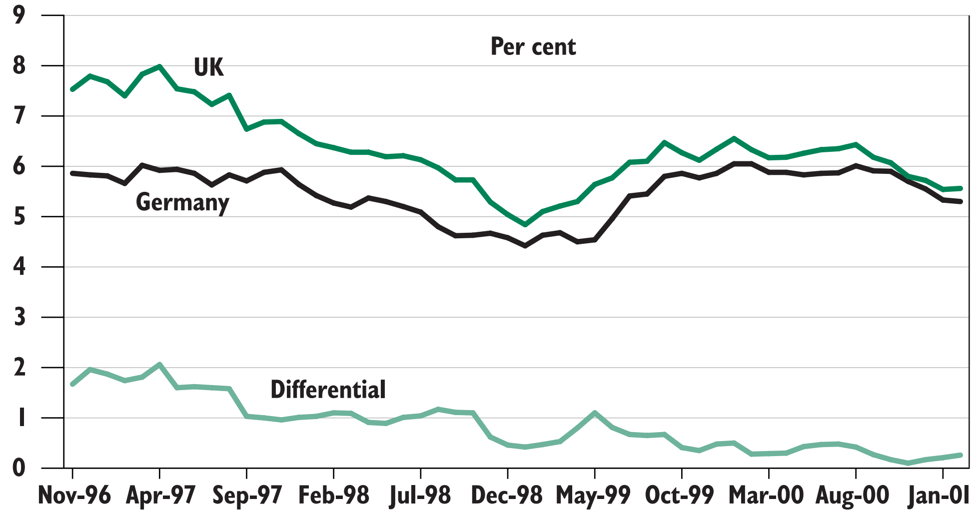
Cost of capital

4.6 A more stable economic environment reduces the risk of undertaking investment. This means that the cost of capital should fall. This cost will vary between projects according to the method of financing and degree of risk, so no direct measure is available. However, it is possible to use proxy measures. For instance, yields on UK corporate bonds fell sharply between 1997 and 1998, closing the gap with Germany. Chart 4.2 shows this pattern.

[1] Empirical studies examining the relationship between physical capital and growth include DeLong and Summers: "Equipment investment and economic growth", *Quarterly Journal of Economics* 106(2) 1991.

[2] For example, O'Mahony: *Britain's productivity performance 1950–96: An International Perspective*, NIESR, 1999.

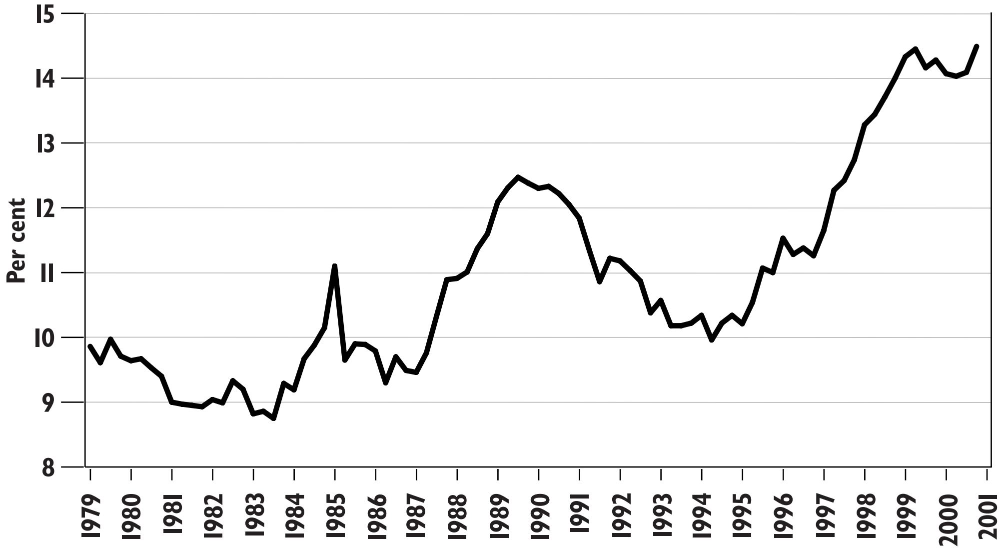
Chart 4.2: Monthly 10 year corporate bond yields, Nov 1996 to Feb 2001



Source: Bloomberg.
Note: Corporate bond yields are for AAA rated companies quoted on Euro/Sterling and Euro/DM markets.

4.7 Business investment has also increased substantially in recent years, as chart 4.3[3] shows.

Chart 4.3: Business Investment as a percentage of GDP, 1979–2000 (1995 prices)



Source: ONS

[3] This series adjusts for changes in the real prices of capital goods over time and thus seeks to measure the volume of investment on a constant basis. It is the subject of some methodological debate. However the same chart, measured on constant prices, would also show a significant rise in business investment since the mid-1990s.

IMPROVING THE CLIMATE FOR INVESTMENT

Tax reforms

4.8 The tax system affects firms' investment decisions. So, the Government has introduced a series of reforms to improve the climate for long-term investment. It has:

- reduced corporation tax rates, providing companies with greater access to retained profits which are usually the cheapest way to finance new investments;
- abolished payable tax credits on dividends, thereby removing the distortion that encouraged firms to pay out dividends rather than to retain them in the firm;
- abolished advance corporation tax which distorted the investment decisions of firms with large foreign relative to domestic earnings, moving to a system of payment on account that is more in line with modern international collection systems; and
- introduced 40 per cent first year capital allowances for SMEs.

Venture capital

4.9 The Government has also facilitated the provision of venture capital through continued commitment to tax-advantaged schemes such as Venture Capital Trusts and the Enterprise Investment Scheme, and the introduction of the Corporate Venturing Scheme to increase the availability of venture capital from corporate investors.

4.10 Through the Small Business Service, the Government is also supporting new Regional Venture Capital funds in every English region, targeting the "equity gap". This is the market for small equity investments that tends not be served by the private sector without additional incentives. The Regional Venture Capital Funds will operate as public/private partnerships, with investment by Government on terms that will also attract private sector fund management and financing. The funds will target firms initially seeking equity investment of up to £250,000.

4.11 The European Commission has now given State Aids clearance to the Regional Venture Capital Funds. The Government has also reached agreement in principle with the European Investment Fund, the venture capital arm of the European Investment Bank Group, that the EIF will invest up to £60 million in the initiative, subject to detailed terms and due diligence.

4.12 Negotiations are now under way to finalise each fund. The Government itself will invest up to £80 million. The Government's indicative regional targets for the total size of each fund (including other investors) are £30 million for the North West, £20 million for the East of England, £30 million for the South East, £25 million for the South West, £25 million for Yorkshire and Humberside, £15 million for the North East, £20 million for the West Midlands, £50 million for London, and £20 million for the East Midlands. This initiative will be a major step towards achieving the £1 billion target that the Government set for public/private venture capital in Budget 2000.

Myners review

4.13 UK institutional investors control over £1,500 billion in assets. To address the operation of institutional investment in the UK, in Budget 2000 the Government asked Paul Myners of Gartmore Investment Management to undertake an independent review. He concluded that there were a number of distortions affecting institutional investment decision-making. The review made a number of recommendations, in particular:

- a code for institutional investment decision-making, the central principles of which include:
  - decisions to be taken only by those with the right skills and expertise;
  - clear objectives and timescales for managers;

    - performance measurement of all advisers; and
    - regular reporting of investment strategy and returns to members and the public;

- the replacement of the MFR with a scheme-specific regime based on transparency and disclosure;
- incorporation of the US ERISA principles on shareholder activism into UK law, making intervention in companies, where it is in shareholders' interests, a duty for fund managers;
- the Law Commission to look at clarification of the legal ownership of surplus pension fund assets;
- reduction of the rate of tax on withdrawal of the surplus;
- a legal change which would raise the duty of care for trustees, requiring them to be familiar with investment matters where they take investment decisions;
- a proposal for an independent review of capital and information flows relating to personal investment products; and
- a number of measures which take account of the special nature of private equity as an asset class for institutional investors - including changes to the maximum number of partners in a limited partnership and to the taxation of the proceeds from the investments of such partnerships.

4.14 His findings were accepted in full by the Government in Budget 2001. In particular, the Government:

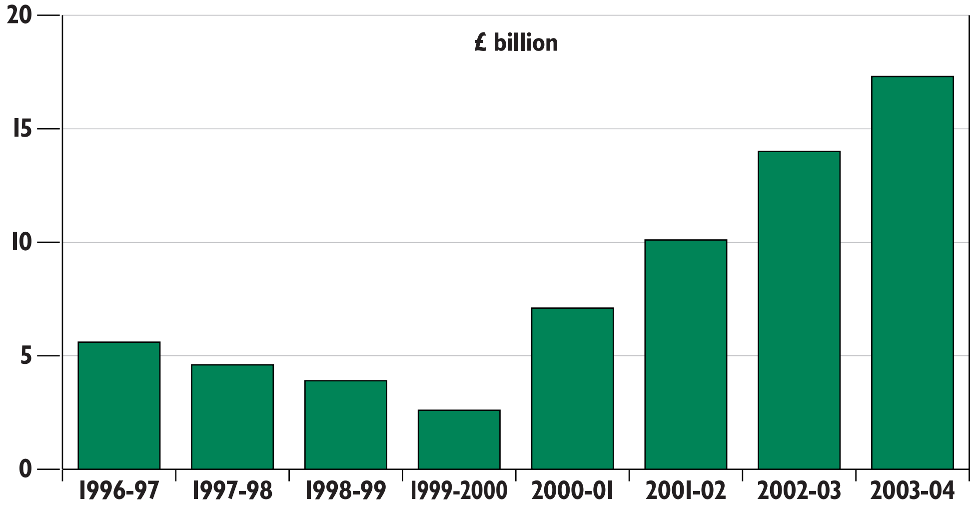
- has held a short consultation on the detail of a set of principles of a code for investment decision making. **Its conclusions will be announced in the coming months.** The Government will, as recommended, undertake an assessment in 2003 of the effectiveness of the principles in bringing about behavioural change;
- will legislate, including to replace the Minimum Funding Requirement with a long-term scheme specific funding standard, with additional protective measures.

Public investment

4.15 Alongside investment in the private sector, investment in the public sector is an important element of improving the UK's capital stock, as well as a means of ensuring better delivery of public services. The public sector has long suffered from low levels of investment and a short-term approach.

4.16 The Government has worked through successive Spending Reviews to reverse the trend of underinvestment in the public sector. Whereas public sector investment in 1999-2000 was only 0.3 per cent of GDP, this figure is due to increase to 1.8 per cent of GDP in the year 2003-04. Chart 4.4 shows this in real terms.

Chart 4.4: Public sector net investment[1], 1996-97 to 2003-04 (1999-00 prices)



Source: Spending Review 2000

[1] These data include figures for committed investment.

4.17 To ensure that this investment is used effectively, the Government has reformed the procedures and incentives for investment, including by:

- requiring Departments to develop Departmental Investment Strategies which set out how they will deliver value for money for their assets;
- creating the Capital Modernisation Fund to provide finance for innovative capital projects to enhance public service delivery, such as delivering services on-line;
- introducing resource accounting and budgeting, which ensures that financial planning takes account of the cost of holding assets as well as the purchase price; and
- developing the National Asset Register to bring accountability to existing assets.

4.18 A central element of this public investment commitment is, in partnership with the private sector, to be directed at transport. The 10 year plan published by the DETR in July 2000 set out a long-term programme with substantially increased resources from both the private and public sectors. Sustained investment will, over time, rebuild our infrastructure, tackle congestion and improve public transport. The plan sets out investment and spending plans of:

- £60 billion to improve the national rail network with new track, signalling, stations and rolling stock;
- £21 billion for national roads to tackle congestion through widening schemes, bypasses and junction improvements;
- £59 billion to improve local transport, including up to 25 new light rail projects in our major cities;
- £25 billion for London; and
- £15 billion held in reserve for future schemes.

TAKING REFORM FURTHER

4.19 The environment for investment has become more favourable in recent years, particularly as a result of macroeconomic stability and an improved tax system. The findings of the Myners review have set in train a process of reform in institutional investment. But the Government recognises the importance of taking forward further reforms to provide an environment where businesses, entrepreneurs and the public sector are able to invest for the longer-term.

Capital Gains Tax reform

4.20 As set out in chapter 2, the Government will **make further reforms to CGT** which learn from overseas experience, especially in the US. This will improve further the incentives for investment.

Review of retail savings

4.21 The Government is, as recommended by Paul Myners, commissioning an independent review of the long-term retail savings industry, including life insurance. **The Chancellor has today appointed Ron Sandler, former chief executive of Lloyd's of London and chief operating officer of the NatWest Group, to carry out the review.**

4.22 The review will cover the markets for medium and long-term savings products purchased by retail customers – large pools of assets which have a significant impact on the allocation of capital in the UK economy.

4.23 Its purpose will be to identify the competitive forces and incentives which drive the industries concerned, in particular in relation to their approaches to investment, and, where necessary, to suggest policy responses to ensure that consumers and the investment needs of the economy are well-served. It will look at the applicability of the principles of investment proposed by the Myners review of institutional investment.

4.24 In order to do so, building on the work underway in the FSA of topics relevant to these questions, and changes envisaged in the regulatory regime, it will examine such important influences as:

- the drivers underlying competition;
- information flows to consumers, and consumers' understanding of them;
- the nature and quality of consumer advice;
- advisers' incentives and skills;
- charging structures for products; and
- the principles of governance within the relevant products.

4.25 The review will issue a consultation document in the coming months.

Reforming planning

4.26 The Government is looking fundamentally at the operations of the land use planning system.

4.27 The Government is already committed to streamlining the planning process for major infrastructure projects. It has consulted on proposals to allow Parliament to approve projects in principle and to improving public inquiry procedures and will announce its conclusions shortly. Through its Modernising Planning programme, it has already been promoting improvements in the operational efficiency and effectiveness of the system.

4.28 However, the Government believes that there is a case for making further and wider reforms to the planning system. There is potential to make planning decisions speedier, to reduce the uncertainty and risk which can damage the incentives for businesses to invest and grow, and to introduce greater flexibility and diversity in the system to address differing regional needs.

4.29 Later this year the Government will publish a Green Paper on reforming planning. It will make proposals for significantly improving the way that planning policy is produced and the processes for determining planning applications, making sure that the system is well-adapted for the differing needs of business across the regions while continuing to protect the interests of other stakeholders.

Corporate Investment

4.30 Chapter 2 set out the changes that the Government is proposing to make to the small business taxation framework further to encourage investment.

4.31 Investment by large businesses is also important. In the last Parliament the Government introduced significant reforms of the corporation tax system to improve incentives for investment including the removal of payable tax credits on dividends and substantial cuts in the main rate of corporation tax.

4.32 These changes and other factors, including sophisticated capital markets, make the UK business environment particularly attractive and the natural European location for business headquarters.

4.33 For large companies, the Government has already cut the main rate of corporation tax from 33 per cent to 30 per cent, the lowest ever rate in the history of the UK. The Government's approach to the taxation of large business is centred around a broad tax base combined with low tax rates. It believes in a transparent tax system with fair tax competition, freeing companies to focus on real business opportunities. As the next step, **the Government will publish a further consultation document shortly, setting out the Government's strategy in detail and taking forward the proposals to relieve from tax gains made on disposals of substantial shareholdings and consulting on aspects of the taxation of foreign income.**

5 SKILLS

SKILLS FOR ENTERPRISE AND GROWTH

The role of skills

5.1 Businesses and entrepreneurs need to be able to recruit and retain workers with the capabilities, knowledge and attitudes to enable them to make a full contribution to starting and growing firms. New technologies demand new skills in order to be used effectively.

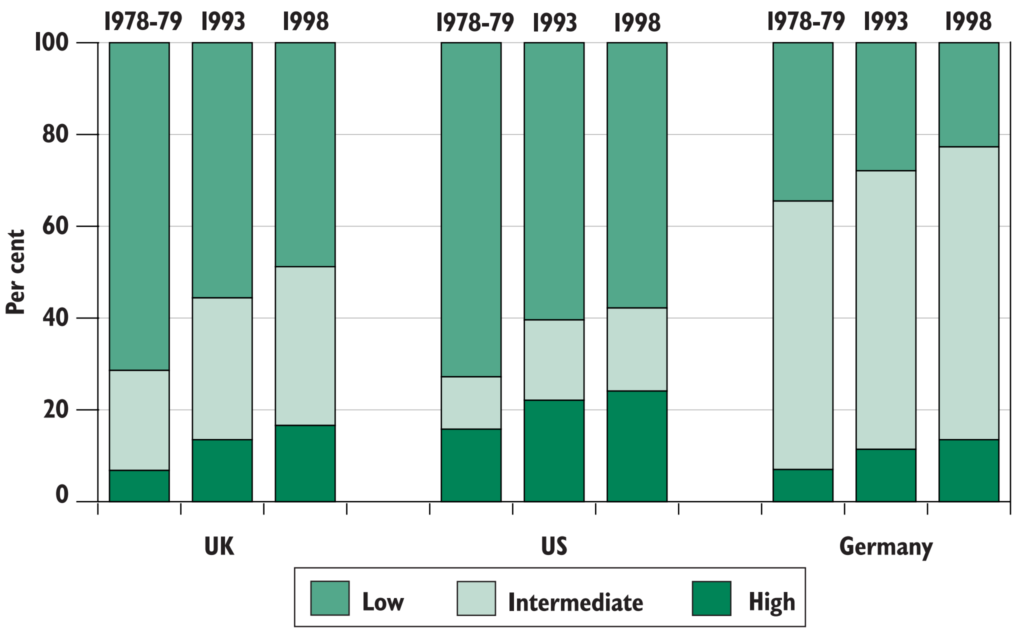
5.2 Education and training also provide people, especially young people, with an insight into the possibilities and challenges of enterprise and the contribution that they can make.

5.3 However, while increases in the number of people working have made a strong positive contribution to economic performance in recent years, the skills of the workforce in the UK remain below those of many competitor countries. Improving the skills base is critical to long-term economic growth. The Government is committed to stimulating substantial improvements in UK human capital, including by increasing the demand for skills and training.

5.4 At basic skill levels, for instance, over 20 per cent of the adult UK population lacks functional literacy according to the International Adult Literacy Survey, with only Ireland and Poland of the thirteen countries surveyed faring worse. In contrast, in Germany less than 10 per cent of the workforce lack such basic skills.

5.5 Similarly, the UK has a much smaller number of people with intermediate skills (levels 2 and 3) or above than a wide range of countries surveyed. Again the most marked difference is with Germany, but most other western European countries also outperform the UK in this area.

Chart 5.1: Employees by skills levels by share of total employees 1978-79 to 1998



"High" refers to degree or above
"Intermediate" refers to vocational qualifications above high school but below degree level

Source: Crafts and O'Mahony (2000)

5.6 UK performance at the upper end of the skills range is better, with a higher rate of participation in higher education than most of our competitors. Even here, however, the UK is well behind the best in the world. As chart 5.1 shows, the US has a significantly higher proportion of the workforce with high skills (degrees or equivalent qualifications) than the UK.

IMPROVING THE EDUCATION SYSTEM

Reforms in education

5.7 The Government has engaged in a programme of reform since 1997 to improve the performance of the education system. Elements of the Government's approach include:

- in primary schools literacy and numeracy strategies, and demanding new targets for literacy, numeracy, science and ICT at age 14;
- modernisation of the comprehensive school system;
- expansion of specialisms for schools and the development of advanced specialist schools such as City Academies and Beacon Schools;
- introduction of Education Maintenance Allowances to help young people overcome financial barriers to study;
- establishing the Learning and Skills Council to unify funding of post-16 education and training, and to improve the quality of provision;
- working to develop a genuine ladder of vocational development, including vocational GCSEs and the new Foundation Degree;
- setting an ambition for the majority of the UK's young people to have the opportunity to benefit from higher education, supported by reversing the decline in funding per student; and
- promoting lifelong learning through Individual Learning Accounts, a national learning e-network learndirect, the Union Learning Fund and the National Training Organisations.

Recent evidence

5.8 The UK's education and training performance has shown some encouraging signs in recent years, including:

- for the population as a whole, basic skills levels are gradually improving. The proportion of adults of working age in England with no formal qualifications fell from 18.4 per cent to 15.1 per cent between 1996 and 2000;
- literacy and numeracy at age 11 have improved over recent years. Between 1996 and 2000, nearly a third more 11-year olds achieved the reading levels expected for their age;
- the proportion of school-leavers obtaining at least five GCSEs at grades A*-C has increased by nearly 15 per cent between 1994 and 2000; and
- in 2000, between 32 and 34 per cent of UK 18-21 year olds went into higher education, and the UK has the highest first degree graduation rate in the EU. Graduate employment levels remain high.

5.9 These improvements in the flow of skills will take time to feed through into the stock of human capital in the workforce as a whole.

THE AGENDA FOR RAISING SKILLS

5.10 The Government is committed to going further. It will drive forward reforms so that UK skills make a full contribution to enterprise and growth.

5.11 The policy measures outlined above have achieved substantial change in the functioning of the education and training system. The Government is continuing with this programme of reform. For instance:

- the Schools Green Paper, issued earlier in 2001, set out plans for promoting diversity and autonomy within the schools sector, for improving the status and structure of the teaching profession, and developing stronger vocational pathways especially at GCSE level;

- the Learning and Skills Council has taken responsibility for funding post-16 education since April 2001. It has consulted on a corporate plan which develops its mandate to promote learning; and
- the first Foundation Degrees will be piloted from the Autumn of 2001. Closely related to employment and designed along strongly vocational lines, they will also provide a route to Bachelors' degrees for capable students.

Business and enterprise awareness

5.12 Enterprise offers the chance not only for individuals to achieve but for them to contribute to society – creating jobs, opportunities and prosperity. Creating a positive culture for business and enterprise is fundamental to economic success.

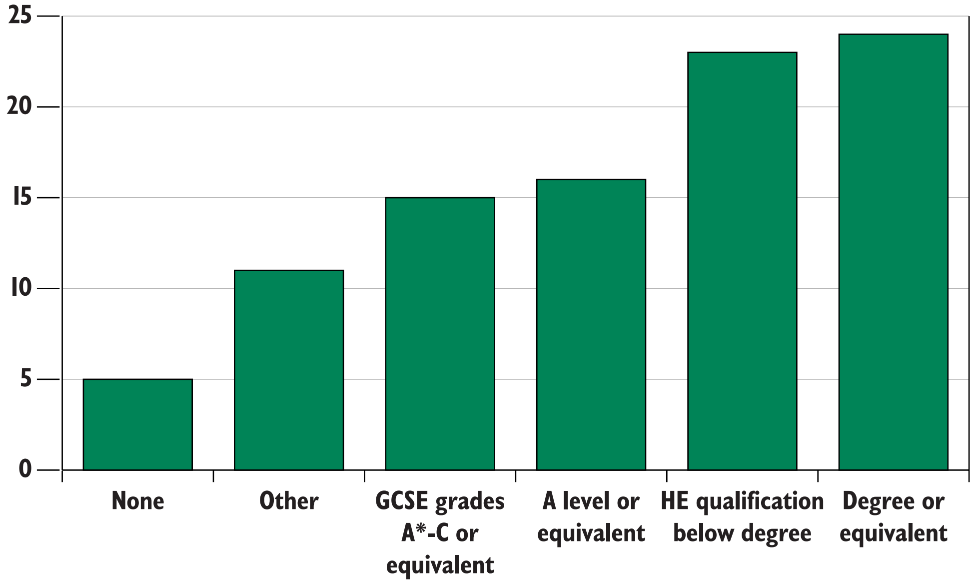
5.13 There have been some advances in promoting awareness of these opportunities through education, including creating a new category of business and enterprise secondary schools and developing City Academies with an enterprise specialism. However, there is more to do to ensure that these initiatives deliver real change.

5.14 **To ensure that schools and further education do more to fulfil their responsibilities for fostering enterprise, the Government has today asked Sir Howard Davies to conduct a review of how better to raise awareness of business, enterprise and the economy in education, and how to promote a positive environment for economic success and developing enterprise skills in young people.** It will examine the approach currently taken and make proposals for change by January 2002.

Workforce training and the Government's ambitions

5.15 Workforce training can play a key role in improving the skills of those people who have already been through the initial education system. There are approximately 7 million people in the workforce who do not have qualifications of at least five GCSEs above grade C (equivalent to level 2). These workers are significantly less likely to receive training than more highly skilled workers.

Chart 5.2: Employees receiving training in the last four weeks by highest qualification, 2000



Source: Labour Force Survey, Autumn 2000

5.16 The responsibility for investing in training lies with:

- individuals – if they wish to make the most of the opportunities provided (individuals with no qualifications earn 30 per cent less than average earnings);
- business – as good employers investing in their workforce to increase productivity (a study by the Institute for Fiscal Studies suggested that increasing the number of employees trained by 5 percentage points could increase productivity by 4 per cent); and
- Government - to ensure that the right opportunities and incentives are in place.

5.17 Many employers recognise that more training is beneficial. Although it may not always seem to be in the immediate interest of employers to train those without a minimum skill level, there are clearly wider economic and social benefits of increasing training for this group.

5.18 The National Skills Task Force (NSTF) demonstrated that individuals with families and who are in full-time work may struggle to find the time to participate in learning. This suggests the need to do more in the workplace.

5.19 The current voluntary approach has secured an increase of 33 per cent in workplace training since 1995. But this is not enough: the scale of the problem is significant and the Government agrees with the NSTF that tackling this "chronic UK problem of low skilled adults" must be a priority and that a step change on the part of all – employers, individuals and Government – is required. The Performance and Innovation Unit in the Cabinet Office is looking at how the UK's performance in workforce skills and training can be improved and will report in the Autumn.

5.20 The Government recognises the urgent need to improve UK skills and to make clear its commitment to giving everyone the opportunity to reach their full potential. The UK needs a step-change in the skills of those in work.

5.21 As announced in Budget 2001, **the Government is prepared to consider what more it can do, as part of its joint responsibility with employers and employees, to ensure that there is opportunity for continued training for all in the workforce, especially to attain up to NVQ level 2 (5 GCSEs A*-C or equivalent).** One possibility is on the model of a tax credit, but other options are being considered.

5.22 The Government will bring forward proposals in the Pre-Budget Report. But Government action alone will not be enough to secure the necessary impact, and it will be important that everyone – employers, individuals and the Government – takes seriously their responsibility to deliver a high skill, high productivity economy.

5.23 To help everyone – employers, employees and Government – raise their game the Government will, in the Pre-Budget Report, set a new ambition. Alongside the four existing ambitions set in the November 1999 Pre-Budget Report, the Government will specify a new target to raise the level of skills of the adult workforce by 2010.

Universities

5.24 The UK's universities should be major drivers of economic growth, providing high-level skills crucial for enterprise and productivity. Historically, the sector has suffered from declining funding, and regulation and control has held back expansion, dynamism and diversity. Despite growth in the number of students, the mix of people in higher education remains skewed away from disadvantaged backgrounds.

5.25 During the last Parliament, the Government undertook reforms in higher education which enabled expansion to restart and which began the process of rebuilding by reversing under-investment.

5.26 But substantial barriers remain. The Government will ensure that the right freedoms and incentives are in place for universities, and that talented people from all backgrounds are able and encouraged to get the best education.

Management Skills

5.27 High quality management and leadership skills are an important element of raising the productivity of the UK economy. The National Skills Task Force found evidence of both skills shortages and deficiencies in UK management and leadership.

5.28 In contrast with the situation in many countries, the vast majority of SME owner/managers in the UK do not hold formal management qualifications. The Government will work with the business community to identify ways in which more can be done to stimulate small business demand for management development.

Work permits

5.29 The Government is committed to ensuring that the UK competes for the best skilled workers in the world. The Government has overhauled the work permits regime – to ensure that employers are able to recruit high-skilled workers from abroad, especially in IT. Employers are also able to recruit talented overseas students graduating from British universities. The impact of these changes has been significant – with the number of work permits granted up from 54,000 in 1997 to an expected 150,000 this year.

5.30 The Government will this year introduce a new pilot scheme to attract people of outstanding ability from around the world. The scheme will allow particularly skilled individuals to enter the UK to seek work in their field of specialism.

A

Annex A: European economic reform

A.1 In undertaking its domestic reforms, the Government recognises that the UK does not act in a vacuum. Other European Union (EU) nations are facing the same challenges, and UK businesses operate in an international environment, increasingly with other EU Member States:

- eight of the UK's top ten trading partners are in Europe;
- in 1999, 59 per cent of UK trade in goods was with EU partners; and
- 30-40 per cent of UK SMEs trade in the EU.

A.2 The progress made so far in moving towards completing the single market project is one of the EU's major achievements. EU businesses now operate in a market of 375 million people. A 1996 European Commission study found that participation in the single market had created one million extra jobs and increased output by nearly 1.5 per cent.

A.3 The UK is well placed to gain from further development in the single market and the greater access to EU markets that will bring – through more jobs, greater competition and lower prices. However opening up the single market by itself will not be enough to ensure continued European prosperity. The EU also needs to embark on further structural reform of its capital, labour and product markets to ensure it can compete effectively in the global economy.

A.4 In recognition of the task faced by the EU as a whole, and the mutual benefits of co-ordinated action, Europe's leaders committed themselves to an ambitious ten-year strategy for economic reform at the Lisbon summit last year. They agreed that the EU should become "the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion."

Chart A.1: Employment and productivity levels in EU countries and the US, 1999

Note: Employment for Greece is 1998 data

Source: OECD

A.5 As chart A.1 shows, delivering the Lisbon goal is a major economic challenge: in effect, to raise the EU's employment and productivity performance beyond that of the US by 2010. Matching US performance on employment and productivity would raise the EU's output by an estimated 40 per cent.

A.6 The Government has identified three key areas within the EU's productivity agenda where it believes action at the EU should be focused:

- reinvigorating the single market;
- addressing the EU's R&D and innovation performance; and
- developing e-Europe

A.7 The Government published a paper on European economic reform for the Stockholm European Council in March 2001. It will follow this up by publishing a White Paper on economic reform in Europe for the Spanish presidency.

REINVIGORATING THE SINGLE MARKET

A.8 The benefits of completing the single market are considerable. The Cecchini report of 1988 concluded that further market integration and increased competition in the EU would, over the medium term:

- add an extra 4.5 per cent to Europe's GDP;
- deliver substantial reductions in costs and consumer prices; and
- boost employment by up to 1.8 million jobs.

A.9 However, significant sectors of the EU economy have yet to be fully opened to EU-wide competition, and EU prices are still significantly above those enjoyed by US consumers for many products. The Government believes that to make further progress there should be a focus on outcomes as well as on the necessary legislative processes, and on setting clear timetables and action plans for reform.

A.10 Key sectors of the economy for further market liberalisation include:

- financial services;
- the service sector;
- energy markets;
- aviation; and
- competition policy.

Financial services

A.11 Developing a dynamic single market in **financial services** should make a major contribution to raising the EU's employment and productivity performance and bring benefits to EU consumers in terms of lower prices and greater choice. Broader and deeper capital markets should reduce the cost of capital and increase the efficiency of allocation of capital across the EU. To achieve these benefits, EU reforms are required, including:

- early delivery of the key measures in the **Financial Services Action Plan**;
- removal of **unnecessary restrictions on where pension funds can invest**;
- building on the approach taken in the e-commerce directive and extending this to all financial services, to develop the **retail financial services sector**; and
- implementation of **the Lamfalussy Committee's recommendations** on the regulation of European Securities Markets, to increase the effectiveness and market-responsiveness of EU regulation by increasing consultation, transparency, flexibility and proportionality in the legislative process.

The service sector

A.12 Progress in liberalising the service sector is essential. Services account for over 60 per cent of GDP across the EU. The European Commission has launched **a strategy for removing barriers in services,** with the aim of introducing a package of new initiatives in 2002. The Government is looking forward to early proposals that will remove barriers to the creation of the single market in services.

Energy markets **A.13** The Feira Council of June 2000 called on the European Commission to present a report by March 2001 on "the evolution of energy markets according to the Lisbon strategy". Evidence from the UK demonstrates the benefits of liberalisation to consumers in lower prices alongside security of supply and universal services. The Government believes that a key reform priority is to **open EU energy markets to effective competition**, and for EU energy markets to be fully liberalised rapidly.

Aviation **A.14** The Government recognises that the EU has made good progress towards completing the single market in aviation. As a result of deregulation air prices have fallen significantly and competition has increased with the entry of new firms. But reforms are still needed to create greater benefits, with two key areas for further action:

- the UK Government is committed to working towards a revised European Regulation that makes progress towards market mechanisms **to allocate scarce take-off and landing spaces** at airports ('slots') that currently inhibit competition at Europe's busiest airports, such as Heathrow; and
- **tackling increasing air transport delays**, reducing air delay and congestion in Europe through a Single European Sky. A 25 per cent reduction in delays could save the European air transport industry and the public around £1.4 billion a year.

Competition policy **A.15** The EU competition regime underpins achievement of the benefits of the single market and delivery of the Lisbon targets. Competition policy can contribute to market liberalisation, especially in utility markets – where independent regulation, unbundling of functions and non-discriminatory third party access have proven important to success. EU competition rules have been used against Member States to enforce action to liberalise utility markets.

A.16 EU state aid policy also has an important role to play in ensuring that governments do not undermine competition and effective markets. However, while state aid should not undermine efficiency, it is important that Government intervention to pursue the Lisbon targets and deliver higher productivity, fairness and enterprise for all is not unnecessarily hindered or prevented by the state aid rules. Moreover, the state aid regime must operate effectively as a system. It should focus its efforts on cases that distort the single market, ensure that cases do not take too long to determine, and that decisions are predictable and transparent. Further reforms include:

- **reform of the state aid regime** – supporting economic modernisation, while bearing down on aids that undermine competition and efficiency; and
- the Government will be pushing for major reforms to the **European cars block exemption** to secure fair prices for consumers.

ADDRESSING THE EU'S R&D AND INNOVATION PERFORMANCE

A.17 As Chapter 2 sets out, greater innovation, and particularly more R&D, is clearly associated with higher growth and productivity. However the EU's record on innovation is poor in some areas:

- the EU as a whole invests considerably less than both the US and Japan in R&D;
- the EU patenting system is slow and expensive when compared with the US; and
- EU venture capital investment per head is only a quarter of that in the US, holding back EU entrepreneurs and limiting their ability to bring their ideas to the market.

A.18 This need to improve R&D performance to match the world's best is increasingly being recognised by EU leaders both in their national policies and at the Lisbon and Stockholm Spring Councils. Action is being taken in a number of areas to close the gap with the US, combining national and EU reforms to create the right climate for R&D and innovation. Key reforms and actions include:

- **the EU R&D and innovation initiative**, an in-depth study to highlight the barriers to R&D and innovation, and examples of best practice to raise performance, for the Barcelona Spring Council 2002;
- action to tackle the EU's poor patenting performance by reaching agreement by 2001 on an affordable and easy to obtain **Community patent**;
- implementation of the Risk Capital Action Plan to tackle market failures in the supply of **venture capital** to support innovation;
- the creation of new guidelines for venture capital state aids, allowing governments to develop initiatives such as the UK's Regional Venture Capital Fund; and
- **reforming the EU's own spending on R&D** to focus on fewer research areas to enable the EU to build a critical research mass in key technologies.

DEVELOPING E-EUROPE

A.19 Liberalisation of Europe's telecommunications systems is key to delivering the information and communication technology infrastructure essential to modern economies. Reforms have clearly benefited consumers through lower prices: for example, the cost of a three minute call between the UK and Italy halved between 1989 and 1999.

A.20 But much remains to be done if the EU is to match world leaders. The EU, on average, has much lower internet penetration and higher access costs than its principal competitors. For example, US internet penetration was 55.8 per cent of the population by November 2000 compared to 33.6 per cent in the UK. And the EU has experienced a slow take-up of electronic commerce by SMEs, with only 6 per cent of SMEs able to carry out e-commerce. The e-Europe 2002 Action Plan sets out an ambitious series of deadlines – from 2000 to 2002 – for effective delivery of this transition. The Government strongly supports the objectives of this plan, which revolve around three core themes:

- a cheaper, faster internet;
- investing in people and skills; and
- stimulating use of the internet.

A.21 However, in the late 1990s, concerns remained that in certain segments of the market the removal of effective monopolies was not happening quickly enough. The Government will press for further reforms to complete the Single Market:

- **adoption of the telecoms package** to provide a new regulatory framework for the telecoms market. This will deliver a fully liberalised market, with the aim of reducing Internet access tariffs to the lowest levels in the world; and
- **in particular, the e-commerce Directive should be adopted by 2002**. This will provide a comprehensive legal framework to govern electronic commerce within the single market, and remove legal obstacles that inhibit the free movement of on-line services within the EU.