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Budget 2007

Building Britain's long-term future: Prosperity and fairness for families

Economic and Fiscal Strategy Report and Financial Statement and Budget Report

March 2007

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as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget.*

John Healey
Her Majesty's Treasury
21 March 2007

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The Economic and Fiscal Strategy Report and the Financial Statement and Budget Report contain the Government's assessment of the medium-term economic and budgetary position. They set out the Government's tax and spending plans, including those for public investment, in the context of its overall approach to social, economic and environmental objectives. After approval for the purposes of Section 5 of the European Communities (Amendment) Act 1993, these reports will form the basis of submissions to the European Commission under Article 99 (ex Article 103) and Article 104 (ex Article 104c) of the Treaty establishing the European Community.

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Economic and Fiscal Strategy Report

OVERVIEW

The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. Budget 2007, *Building Britain's long-term future: Prosperity and fairness for families*, presents updated assessments and forecasts of the economy and public finances, and reports on how the Government's policies are helping to deliver its long-term goals. The Budget:

- shows that the economy is stable and growing and that the Government is meeting its strict fiscal rules for the public finances;
- sets out the next stage in the Government's reforms to simplify the tax system, to provide help for pensioners, support for families and make work pay, including:
 - removing the 10 pence starting rate of tax and cutting the basic rate of income tax from 22 pence to 20 pence from April 2008;
 - increasing the upper earnings limit for national insurance and fully aligning it with the point at which taxpayers start to pay the higher rate of income tax, and raising the aligned upper earnings limit and higher rate threshold by £800 a year above indexation in April 2009;
 - raising the higher personal allowances for those aged 65 or over by £1,180 above indexation in April 2008;
 - increasing further the child element of the Child Tax Credit by £150 per year above earnings indexation in April 2008; and
 - increasing the threshold for Working Tax Credit by £1,200 to £6,420 and raising the withdrawal rate on tax credits by 2 per cent to 39 per cent in April 2008, and increasing the weekly rate of Child Benefit for the eldest child to £20 in April 2010.
- sets out a major package of reforms to the corporate tax system, including reducing the headline corporation tax rate from 30 per cent to 28 per cent from April 2008, simplifying capital allowances, further enhancing research and development tax credits, and increasing the small companies' rate to tackle individuals incorporating to minimise tax;
- increases investment in education and skills in England by 2.5 per cent a year in real terms (5.3 per cent in nominal terms) on average between 2008-09 to 2010-11;
- restricts tax relief available on empty commercial properties, to encourage the supply of office, retail and industrial premises;
- introduces further reforms to modernise the tax system, and a number of measures to tackle tax fraud and avoidance; and
- takes further steps to tackle the global challenges of climate change including an increase in fuel duty rates from 1 October 2007, reforms to Vehicle Excise Duty and measures to improve the energy efficiency of homes.

1.1 The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all.

1.2 The long-term decisions the Government has taken – giving independence to the Bank of England, new fiscal rules and a reduction in debt – have created a strong platform of economic stability. In the UK, with low and stable inflation, interest rates set by the Monetary

Policy Committee to meet the Government's symmetric inflation target, and fiscal policy supporting monetary policy over the cycle, the economy has grown continuously throughout this period. The UK economy is currently experiencing its longest unbroken expansion since quarterly records began, with GDP now having grown for 58 consecutive quarters.

Meeting long-term global challenges

I.3 The global economy is in the midst of radical transformation with far reaching and fundamental changes in technology, production and trading patterns. Rapid technological change continues to impact on how individuals, business and communities interact with each other and how they expect to interact with the state. Global security is being reshaped as the international community responds to the ongoing threat of international terrorism, conflict and the challenges of ending world poverty. The pressures that economic and population growth are placing on the earth's natural resources and climate are increasingly apparent, presenting an urgent need for international cooperation.¹

I.4 This transformation will present both challenges and opportunities for the UK. Individuals, businesses and communities all need to be ready to respond to the changing global environment. Stable, flexible, skilled and innovative economies will prosper. This Budget sets out further reforms to lock in stability and to invest in the UK's future including a major package of reforms to the corporate tax system to enhance international competitiveness, encourage investment and promote innovation, reducing the main rate of corporation tax to 28 percent by April 2008, the lowest in the G7.

I.5 Fairness must go alongside flexibility, providing security and support for those that need it and ensuring that everyone has the opportunity to fulfil their potential. The reforms of the welfare state, introduced since 1997, reflect the Government's aims of eradicating child poverty, supporting families to balance their work and family life, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax system which encourages work and saving, and ensures that everyone pays their fair share of tax. This Budget announces the next stage in modernising the tax and benefit system, to provide support for pensioners, tackle poverty and make work pay. This includes removing the 10 pence starting rate of tax, cutting the basic rate of income tax from 22 pence to 20 pence, increasing the upper earnings limit for national insurance and aligning it with the higher rate threshold for income tax, as well as increases in Child Tax Credit and the threshold for Working Tax Credits.

I.6 This Budget describes the next steps the Government is taking to enhance its long term goals of:

- **maintaining macroeconomic stability, ensuring the fiscal rules are met and that inflation remains low;**
- **raising the sustainable rate of productivity growth**, through reforms that promote enterprise and competition, enhance flexibility and promote science, innovation and skills;
- **providing employment opportunity for all**, by promoting a flexible labour market which sustains a higher proportion of people in employment than ever before;
- **ensuring fairness**, by providing security for people when they need it, tackling child and pensioner poverty, providing opportunity for all children and young people and delivering security for all in retirement;

¹ Detailed analysis of these issues is set out in: *Long-term opportunities and challenges for the UK: analysis for the 2007 Comprehensive Spending Review*, HM Treasury, November 2006.

- **delivering world-class public services**, with extra investment alongside efficiency, reform and results; and
- **addressing environmental challenges**, such as climate change and the need for energy efficiency in response to rising oil prices.

MAINTAINING MACROECONOMIC STABILITY

I.7 The Government's long-term economic goal is to maintain macroeconomic stability, ensuring the fiscal rules are met at all times and that inflation remains low. Chapter 2 describes how the Government is working to achieve this goal and summarises prospects for the UK economy and public finances, full details of which are set out in Chapters B and C of the *Financial Statement and Budget Report (FSBR)*.

The policy framework **I.8** The Government's macroeconomic framework is based on the principles of transparency, responsibility and accountability, and is designed to ensure lasting stability so that businesses, individuals and the Government can plan effectively for the long term. The Bank of England has operational independence to meet the Government's symmetrical inflation target. Fiscal policy is underpinned by clear objectives and two strict rules which ensure sound public finances over the medium term. The fiscal rules underpin the Government's public spending framework which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

Economic prospects **I.9** The UK economy is currently experiencing its longest unbroken expansion on record, with GDP now having grown for 58 consecutive quarters. Over the past 10 years, the Government's macroeconomic framework has delivered more stability in terms of GDP growth and inflation rates than in any decade since the war. This historically low volatility puts the UK in a strong position to respond to the global economic challenges of the next decade.

I.10 Overall economic developments are as forecast at the Pre-Budget Report. The UK economy grew by $2\frac{3}{4}$ per cent in 2006, as forecast in the Pre-Budget Report. The rebalancing of domestic demand gathered pace during 2006, with business investment ending the year growing at the fastest rate for eight years. Following five consecutive quarters of above-trend growth, the UK economy is estimated to have ended 2006 operating close to its trend level, although there remains evidence of some slack in the labour market. The Budget 2007 economic forecast is little changed from that of the Pre-Budget Report. GDP is forecast to grow by $2\frac{3}{4}$ to $3\frac{1}{4}$ per cent in 2007, and then at trend rates of $2\frac{1}{2}$ to 3 per cent. CPI inflation is expected to return to target in the second half of 2007.

The public finances **I.11** The Budget 2007 projections for the public finances are broadly in line with the 2006 Pre Budget Report and show that the Government is meeting its strict fiscal rules:

- the current budget shows an average surplus as a percentage of GDP over the current economic cycle, even using cautious assumptions, ensuring the Government is meeting the golden rule. Beyond the end of the current cycle, the current budget moves clearly into surplus including, by the end of the projection period, the cyclically-adjusted current budget in the cautious case; and
- public sector net debt is projected to remain low and stable over the forecast period, stabilising at a level below 39 per cent, below the 40 per cent ceiling set in the sustainable investment rule.

Table I.1: Meeting the fiscal rules

	Per cent of GDP						
	Outturn	Estimate	Projections				
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Golden Rule							
Surplus on current budget	-1.2	-0.7	-0.3	0.2	0.4	0.6	0.8
Average surplus since 1997-1998	0.2	0.1	0.0	0.1	0.1	0.1	0.2
Cyclically-adjusted surplus on current budget	-1.0	-0.5	-0.3	0.2	0.4	0.6	0.8
Sustainable investment rule							
Public sector net debt ¹	36.5	37.2	38.2	38.5	38.8	38.8	38.6

¹ Debt at end March; GDP centred on end March.

Budget policy I.12 Against this backdrop, and building on steps already taken, Budget 2007 announces **decisions** further decisions to lock in stability and invest in the UK's future, including:

- reforms to simplify the tax system, to provide help for pensioners, support for families and make work pay, including:
 - removing the 10 pence starting rate of tax and cutting the basic rate of income tax from 22 pence to 20 pence from April 2008;
 - increasing the upper earnings limit for national insurance and fully aligning it with the point at which taxpayers start to pay the higher rate of income tax, and raising the aligned upper earnings limit and higher rate threshold by £800 a year above indexation in April 2009;
 - raising the higher personal allowances for those aged 65 or over by £1,180 above indexation in April 2008;
 - increasing further the child element of the Child Tax Credit by £150 per year above earnings indexation in April 2008; and
 - increasing the threshold for Working Tax Credit by £1,200 to £6,420; raising the withdrawal rate on tax credits by 2 per cent to 39 per cent and increasing the weekly rate of Child Benefit for the eldest child to £20 in April 2010.
- a major package of reforms to the corporate tax system, including reducing the headline corporate tax rate from 30 per cent to 28 per cent from April 2008, simplifying capital allowances, further enhancing research and development tax credits, and increasing the small companies rate to tackle individuals incorporating to minimise tax;
- restricting tax relief available on empty commercial properties, to encourage the supply of office, retail and industrial premises;
- further reforms to modernise the tax system, and a number of measures to tackle tax fraud and avoidance;
- taking further steps to tackle the global challenge of climate change including an increase in fuel duty rates from 1 October 2007, reforms to Vehicle Excise Duty and measures to improve the energy efficiency of homes.

I.13 Budget 2007 also confirms the firm overall spending limits for the 2007 Comprehensive Spending Review years 2008-09, 2009-10 and 2010-11, which ensure that the

Government meets its strict fiscal rules while allowing it to increase total public spending by an average of 2 per cent per year in real terms with:

- current spending increasing by an average of 1.9 per cent per year in real terms;
- net investment rising to 2¼ per cent of GDP compared with ½ per cent of GDP in 1997-98, locking in the step change in investment over the past decade;
- an early CSR07 settlement for the Department for Education and Skills which sees education spending in England rise by 2.5 per cent a year in real terms (5.3 per cent in nominal terms) on average between 2007-08 and 2010-11, increasing UK education spending from 4.7 per cent of GDP in 1996-07 to 5.6 per cent by 2010-11; and
- substantial additional resources to support the Government's vision for personalised education, including funding for one-to-one teacher-led tuition for over 300,000 under-attaining pupils a year in English by 2010-11 and 300,000 in Maths.

I.14 Consistent with the requirements of the Code for Fiscal Stability, the updated public finance projections in Budget 2007 take into account the fiscal effects of these and all other firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FSBR.

I.15 An analysis of long-term fiscal sustainability was published alongside the 2006 Pre-Budget Report in the *2006 Long-term public finance report*, and is updated in Annex A of the Economic and Fiscal Strategy Report. Using a range of sustainability indicators, this shows that the public finances are sustainable in the longer term, and that the UK is well placed relative to many other countries to face the challenges of an ageing population.

MEETING THE PRODUCTIVITY CHALLENGE

I.16 Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance. In the increasingly knowledge-driven global economy, science, innovation and creativity are important drivers of productivity growth, backed up by a highly skilled workforce and a competitive and enterprising economy. The UK has historically experienced comparatively low rates of productivity growth. However, UK performance has improved in relation to other major economies in recent years. The Government's long term goal is for the UK to continue to close the productivity gap by achieving a faster rate of growth than its main competitors.

Action so far I.17 The Government's strategy focuses on five key drivers of productivity performance:

- **improving competition** which promotes flexible markets and increases business efficiency and consumer choice;
- **promoting enterprise**, including through reducing the regulatory burden on business, to ensure that UK firms are well-placed to respond to opportunities in a rapidly changing global market;
- **supporting science and innovation** which is central to success in the international economy, as global restructuring focuses developed economies toward knowledge-based and high value-added sectors;

- **raising UK skills** to create a more flexible and productive workforce, and to meet the long-term challenge of rising skills levels in emerging markets; and
- **encouraging investment** to increase the stock of physical capital supported by stronger, more efficient capital markets. In the global economy, attracting international capital and investment will require macroeconomic stability and a robust and efficient investment environment.

Next steps I.18 Building on the reforms and initiatives already introduced, Budget 2007 sets out the next steps the Government is taking to strengthen the drivers of productivity growth and meet the long-term challenges of the global economy, including:

- **a major package of reforms to the corporate tax system** to promote growth by enhancing international competitiveness, encouraging investment and promoting innovation:
 - a reduction in the main corporation tax rate from 30 per cent to 28 per cent from April 2008, making it the most competitive rate in the G7 and other major economies;
 - modernising and simplifying the capital allowance system;
 - increasing the small companies' rate, to tackle individuals incorporating to minimise tax and national insurance liabilities;
 - the introduction of a new Annual Investment Allowance (AIA) of £50,000 for all businesses who invest to grow; and
 - further enhancements to the SME and large company R&D tax credit schemes.
- **driving forward the risk-based approach to regulation** by implementing the Hampton review's risk-based approach, for example, in relation to employment tribunals; and encouraging regulatory reform in Europe based on risk;
- **maintaining the Government's commitment that private and public sector R&D investment reach 2.5 per cent of GDP**, with the announcement of early CSR settlements for the Department for Trade and Industry's science budget and the Department for Education and Skills, which together will ensure that total investment in the public science base will rise by 2.5 per cent in real terms over the CSR period; and
- **reforming empty property reliefs in business rates** alongside a wider package of land and property incentives to increase competitiveness, encourage investment and deliver sustainable increases in housing supply.

INCREASING EMPLOYMENT OPPORTUNITY FOR ALL

I.19 The Government's long-term objective for the labour market is to realise employment opportunity for all – the modern definition of full employment. There has been considerable progress towards this objective, particularly in those areas and among those groups of people who had previously been most disadvantaged. The Government aims to go further, however, and has set a long-term aspiration for an employment rate equivalent to 80 per cent of the working age population. This will involve reaching out to the hardest to help, moving people

from inactivity to labour market participation and encouraging more individuals to take personal responsibility to move from welfare to work.

Action so far I.20 The Government's strategy for extending employment opportunity to all builds on the strong performance of the UK labour market over recent years. Employment in the UK reached 29 million for the first time in 2006. This is the highest figure since comparable records began in 1971. The working age employment rate is now 74.4 per cent, up from 72.7 per cent in 1997, while unemployment has fallen to 5.5 per cent. Chapter 4 describes the successful action the Government has taken to increase employment opportunity, through:

- **delivering employment opportunity to all**, to provide everyone who is able to work with the support they need to move into work as quickly as possible;
- **extending employment opportunity** to those groups and regions which have faced the greatest barriers to work;
- **enhancing skills and mobility**, to ensure that everyone can fulfil their potential in the labour market and that business has access to the skilled workforce they need to compete in the global economy; and
- **making work pay**, through the National Minimum Wage and tax credits which create a system of support that provides greater rewards from work, improving incentives for individuals to participate in the labour market.

Next steps I.21 Budget 2007 describes the further steps the Government is taking to build on this success and further strengthen the labour market, with a long-term vision for extending support to the inactive and those who face particular barriers to work. The Budget announces:

- **steps to provide further help to lone parents to stay in employment, by continuing to make In-Work Credit available to eligible lone parents in the current pilot areas until June 2008, benefiting over 250,000 lone parents, and offering a higher rate of £60 across the whole of London;**
- **a four-week run-on in entitlement to Working Tax Credit** from the day that a previously eligible claimant ceases to work 16 hours;
- **testing reforms to the education and training offered to participants on New Deal for young people**, and a seamless link from New Deal to in-work training delivered through Train to Gain;
- **local employment partnerships with large retail employers working in partnership with Jobcentre Plus** at a local level, to help the long-term unemployed and economically inactive back to work;
- **trailing short, work-focused approaches for English as a second or other language (ESOL) courses** in the London City Strategy pathfinders for parents on benefits or tax credits;
- **improve further the administration of Housing Benefit, and setting out an intention to reform Housing Benefit subsidy for temporary accommodation;**
- **a package of measures to align further and simplify the benefits system;** and

- following the Low Pay Commission recommendations, **raising the adult rate of the National Minimum Wage to £5.52 per hour**, the youth rate, for workers aged between 18 to 21, to £4.60 and the development rate for 16 and 17- year olds to £3.40; all from October 2007.

BUILDING A FAIRER SOCIETY

I.22 The Government's long-term economic goal is to combine flexibility with fairness. Policies that ensure fairness act to minimise the short-term costs that can be associated with the changes that are needed in flexible outward-looking economies. Fairness provides security and support for those that need it and ensures that everyone has the opportunity to fulfil their potential in the global economy, now and in the future. The Government is also at the forefront of global efforts to achieve the Millennium Development Goals for global poverty, and to reduce debt in the poorest countries.

Action so far I.23 Chapter 5 describes the range of reforms the Government has undertaken to achieve its goals in these areas, including:

- **support for families and children** to lift children out of poverty and so ensure they have the opportunity to fulfil their potential;
- **support for pensioners** to tackle poverty and ensure security in retirement for all pensioners, with extra help for those who need it most and rewards for those who have saved modest amounts;
- **steps to encourage saving**, including through the introduction of the Child Trust Fund, stakeholder pensions and Individual Savings Accounts; and
- **measures and reforms to improve the tax system**, and to ensure that everyone pays their fair share toward extra investment in public services.

Next steps I.24 Building on these reforms this Budget announces the next stage in modernising the tax and benefit system, as part of a rebalancing of the tax system to offer more support for work, families and pensioners:

- **removing the 10 pence starting rate and cutting the basic rate of income tax from 22 pence to 20 pence in April 2008**, creating a simpler structure of two rates: a 20 pence basic rate and a 40 pence higher rate;
- **increasing the upper earnings limit for national insurance by £75 a week above indexation in April 2008 and, from April 2009, fully aligning it with the higher rate threshold** – the point at which taxpayers start to pay the higher rate of income tax, simplifying the system;
- **raising the aligned higher rate threshold and upper earnings limit by £800 a year above indexation in April 2009;**
- **increasing the higher personal allowances for those aged 65 or over by £1,180 above indexation in April 2008**, removing 580,000 pensioners from paying tax. **By April 2011, no pensioner aged 75 or over will pay any tax until their income reaches £10,000;**
- **increasing the child element of the Child Tax Credit by £150 a year above earnings indexation in April 2008**, raising the child element to £2,080 a year;

- **increasing the threshold for Working Tax Credit by £1,200 to £6,420 in April 2008**, further strengthening the incentives to work for families with children and low-income working households;
- **raising the withdrawal rate on tax credits by 2 per cent to 39 per cent in April 2008**, helping to retain the current focus of tax credits; and
- **increasing the weekly rate of Child Benefit for the eldest child to £20 in April 2010**, providing support to all families in line with the principle of progressive universalism.

I.25 This Budget also announces:

- **an increase in the annual Individual Savings Accounts investment limit from April 2008 to £7,200, with an increase in the cash limit to £3,600**, in order to encourage savings;
- **that the inheritance tax allowance will rise to £350,000 in 2010-11**, to continue to provide a fair and targeted system;
- **measures to support the third sector, including £80 million in small grants for community organisations, a campaign to drive up giving gift aid, and gift aid changes to facilitate relationship building with donors**; and
- **further reforms to modernise the tax system and protect tax revenues, including measures to tackle avoidance.**

DELIVERING HIGH QUALITY SERVICES

I.26 The Government's aim is to deliver world-class public services through sustained investment and far-reaching reform. High quality education and training, a modern health service, a fair and effective criminal justice system and a fast and reliable transport network provide the essential foundations for a flexible economy and a fair society, which is well placed to prosper in the increasingly competitive global environment.

Action so far I.27 Chapter 6 sets out the steps the Government has taken to deliver lasting improvements in the delivery of public services, including:

- **a new framework for managing public spending** that strengthens incentives for departments to plan for the long term;
- **significant extra resources for public services**, consistent with the fiscal rules. The 2004 Spending Review set departmental spending plans for the three years to 2007-08, locking in the increased resources delivered in previous spending reviews while providing for further investment in priority areas of the public services; and
- **challenging efficiency targets** for all departments, delivering over £21 billion of efficiency gains a year by 2007-08 to be recycled to front-line public services.

² Stern Review on the Economics of Climate Change, October 2006, Cambridge University Press.

Next steps I.28 The 2007 CSR will set departmental spending plans for the years 2008-09, 2009-10 and 2010-11. A central element of preparations for the 2007 CSR is a comprehensive value for money programme which will embed efficiency into departmental planning and release the resources needed to meet new priorities. This Budget announces further details of that programme, including:

- having established the baseline savings ambition for the 2007 CSR period of 3 per cent savings per year across central and local government, **this Budget confirms that all of these savings will be net and cash-releasing, thereby maximising resources available to improve frontline services and fund new priorities;** and
- an early 2007 CSR settlement for the Attorney General's Departments, which sees their budgets fall by 3.5 per cent per year in real terms and provides the early certainty needed to take forward an ambitious programme of reform and improvement across the criminal justice system.

I.29 Budget 2007 confirms the firm overall spending limits for the 2007 CSR years, 2008-09, 2009-10 and 2010-11, which ensure that the Government meets its strict rules while allowing it to increase total public spending by an average of 2 per cent per year in real terms with:

- **current spending increasing by an average of 1.9 per cent per year in real terms;** and
- **net investment rising to 2¹/₄ per cent of GDP compared with 1¹/₂ per cent of GDP in 1997-98, locking in the step change in investment over the past decade.**

I.30 To ensure that the UK has the skills and science base it needs to prosper in an increasingly competitive global economy, alongside **the early 2007 CSR settlement for the science budget announced in Chapter 3**, Budget 2007 announces:

- **an early 2007 CSR settlement for the Department for Education and Skills which sees education spending in England rise by 2.5 per cent a year in real terms (5.3 per cent in nominal terms) on average over the period, increasing UK education spending from 4.7 per cent of GDP in 1996-97 to 5.6 per cent by 2010-11;** and
- substantial additional resources to support the Government's vision for personalised education, **including funding for one-to-one teacher-led tuition for over 300,000 under-attaining pupils a year in English by 2010-11 and 300,000 in maths.**

I.31 To accelerate the ongoing development of counter-terrorism capabilities, Budget 2007 announces a further £86.4 million for the Security and Intelligence Agencies.

PROTECTING THE ENVIRONMENT

I.32 The Government is committed to delivering a strong economy based not just on high and stable levels of growth and employment but also on high standards of environmental stewardship. Growth in the developed world, accompanied with the rapidly growing and highly populated economies of China and India, will place increasing demands on the world's resources and environment over the coming decade. Meeting this long-term challenge requires action at a local and national level, but crucially also through international cooperation. Climate change is a very significant challenge, and the recently published *Stern*

*Review on the Economics of Climate Change*² has highlighted how long-term global prosperity will be undermined if early and coordinated international action is not taken.

Action so far I.33 Chapter 7 describes the steps the Government has taken to deliver its environmental objectives, including:

- **tackling climate change** and reducing emissions of greenhouse gases in line with domestic as well as international targets – in particular through the EU Emissions Trading Scheme and Climate Change Levy;
- **improving air quality** to ensure that air pollutants are maintained below levels that could pose a risk to human health – including through support for cleaner fuels and vehicles;
- **improving waste management**, so that resources are used more efficiently and waste is re-used or recycled to deliver economic value – for example through increases in the landfill tax; and
- **protecting the UK's countryside and natural resources**, to ensure that they are sustainable economically, socially and physically – in particular by increasing the aggregates levy.

Next steps I.34 The Government is committed to delivering sustainable growth, and a better environment and to tackling the global challenges of climate change. It is using a range of economic instruments to address the challenges posed by sustainable development, whilst taking into account other social and economic factors. This Budget sets out the next stage in the Government's strategy for tackling the global challenge of climate change including:

- **that the Government will launch this year a competition to develop the UK's first full-scale demonstration of the carbon capture and storage, the result of which will be announced next year;**
- **an increase in fuel duty rates of 2 pence per litre (ppl) from 1 October 2007, and increasing in the next two years of 2 ppl and 1.84 ppl respectively;**
- **announcing car vehicle excise duty rates for the next three years**, including rates for the most polluting cars rising to £400 and rates for clean cars in band B falling to £35;
- **a review to examine the vehicle and fuel technologies which could achieve over the next 25 years low and zero carbon cars;**
- **a package of measures to support biofuels including extending the 20 pence per litre biofuels duty differential to 2009-10;**
- **a rise in climate change levy rates from 1 April 2008** in line with current inflation;
- **that from 1 October 2007 all new zero-carbon homes costing up to £500,000 will pay no stamp duty, with zero-carbon homes costing in excess of £500,000 receiving a reduction in their stamp duty bill of £15,000;**
- **an intention that, by the end of the next decade, all householders will have been offered help to introduce energy efficient measures with the aim that, where practically possible, all homes will have achieved their cost effective energy efficiency potential;**

² *Stern Review on the Economics of Climate Change*, October 2006, Cambridge University Press

- **increasing funds available through the Low Carbon Buildings Programme to a total of over £18 million to help meet demand for microgeneration technologies; and**
- **a £800 million international window for the Environmental Transformation Fund to finance overseas development projects that deliver both poverty reduction and environmental benefits in developing countries.**

I.35 The Budget also reports on the Government's strategy for tackling other environmental challenges including:

- **an increase from 1 April 2008 in the standard rate of the landfill tax by £8 per tonne per year, until at least 2010-11; and an increase in the lower rate of the landfill tax from £2 per tonne to £2.50 per tonne from 1 April 2008; and**
- **an increase in the aggregates levy rate to £1.95 per tonne from 1 April 2008.**

BUDGET MEASURES AND THEIR IMPACT ON HOUSEHOLDS

I.36 The measures introduced in this and previous Budgets support the Government's objectives of promoting enterprise, skills and science, creating employment opportunity, tackling child and pensioner poverty, and protecting the environment. Consistent with the requirements of the *Code for fiscal stability*, the updated public finance projections in Budget 2007 take into account the fiscal effects of all firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FFSR.

I.37 As a result of personal tax and benefit measures announced in Budget 2007, by April 2009, in real terms:

- families with children will be, on average, £200 a year better off, while those in the poorest fifth of the population will be, on average, £350 a year better off;
- a single earner couple with 2 children, on median earnings – £27,000 per year – will be around £500 a year better off, and the same family on male mean earnings – £35,900 – will be around £320 a year better off; and
- a lone parent with 2 children, working 16 hours a week at the National Minimum Wage, will be at least £320 per year better off.³

I.38 As a result of personal tax and benefit measures introduced since 1997, by April 2009, in real terms:

- households will be, on average, £1,150 a year better off;
- families with children will be, on average, £1,800 a year better off;
- families with children in the poorest fifth of the population will be, on average, £4,000 a year better off.

I.39 As a result of personal tax and benefit measures introduced since 1997, in 2007-08:

- pensioner households will be £1,500 a year better off in real terms; and
- the poorest third of pensioner households will have gained £2,200 a year in real terms.

³ The National Minimum Wage will be £5.52 for adults from October 2007.

Table 1.2: Budget 2007 policy decisions

	(+ve is an Exchequer yield)			£ million
	2007-08 indexed	2008-09 indexed	2009-10 indexed	2007-08 non-indexed
Corporate tax reform				
1 Main rate of Corporation Tax reduced to 28%	-140	-1,385	-2,230	-140
2 General plant and machinery capital allowances at 20%	0	+1,490	+2,270	0
3 Long-life plant and machinery capital allowances at 10%	0	-210	-380	0
4 Integral fixtures capital allowance at 10%	0	+70	+200	0
5 Industrial Buildings Allowance: phased abolition	0	+75	+225	0
6 Small Companies Rate of Corporation Tax phased to 22%	+10	+370	+820	+10
7 One-year extension of 50% First Year Allowances for small enterprises	-35	-250	+80	-35
8 New Annual Investment Allowance at £50,000	0	-30	-920	0
9 R&D tax credit increase to 130%	0	-40	-90	0
10 SME R&D tax credit increase to 175%	0	-30	-60	0
11 Payable Enhanced Capital Allowances	0	-20	-40	0
12 Reform of Venture Capital Schemes	0	+30	+30	0
13 VAT: revaluation of registration and deregistration thresholds	0	0	0	-5
Personal tax reform				
14 Income Tax: indexation of starting and basic rate limits	0	0	0	-870
15 Remove starting rate of Income Tax on non-savings income	0	+7,320	+8,630	0
16 Increase Age Allowances by £1,180 and raise for 75s and over to £10,000	0	-810	-950	0
17 Increase Child Tax Credit by £150 above indexation	0	-880	-1,020	0
18 Raise the threshold of the Working Tax Credit by £1,200	0	-1,310	-1,310	0
19 Increasing the Tax Credit withdrawal rate by 2 per cent	0	+600	+620	0
20 Income Tax and NICs: phased alignment of higher thresholds	0	+1,110	+1,490	0
21 Income Tax and NICs: raising the higher rate threshold and upper earnings limit	0	0	-250	0
22 Basic rate of Income Tax reduced to 20 pence	0	-8,090	-9,640	0
23 Working Tax Credit continued for 4 weeks after leaving work	-10	-15	-20	-10
Supporting families and communities				
24 Raising the ISA cash limit by £600 and the overall limit by £200	0	-15	-50	0
25 Benefit simplification	0	-5	*	0
26 VAT: reduced rates on products for the elderly	-5	-10	-10	-5
Modernising the tax system				
27 Extension of the dividend tax credit	0	-5	-15	0
28 VAT: reduced rate for smoking cessation products	-10	*	0	-10
29 Energy Products Directive: expiry of derogation	0	+10	+30	0
30 Abolition of Small Consignments' Relief for excise duties	+5	+5	+5	+5
31 Gift aid: increase in benefits	0	-5	-5	0
32 Sale and repurchase agreements: tax treatment	+40	+60	+60	+40
33 VAT: non-business use of assets	+10	+15	+20	+15
34 General insurers' reserves: transitional relief	0	-70	-20	0
Protecting tax revenues				
35 Life insurance companies: financing arrangements	+120	+165	+165	+120
36 Loss-buying	+30	+45	+50	+30
37 VAT: countering missing trader fraud	+50	+45	+35	+50
38 Strengthening the disclosure regime	+15	+30	+30	+15

Table I.2: Budget 2007 policy decisions

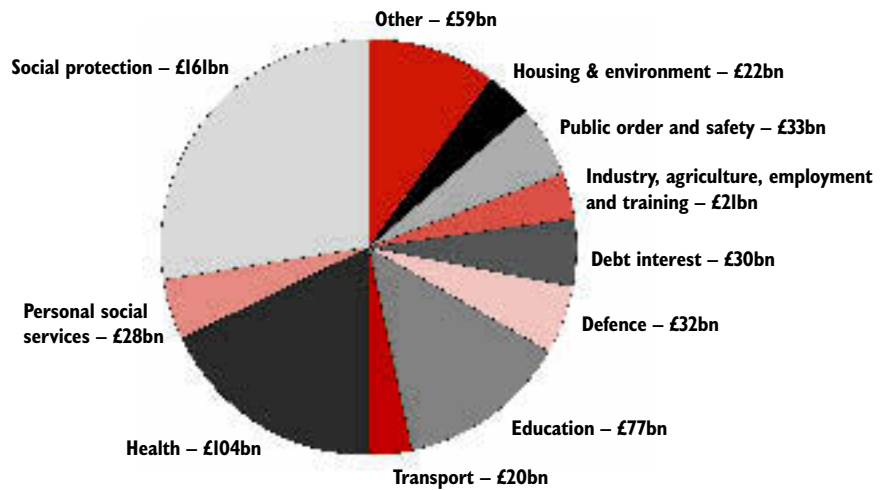
	(+ve is an Exchequer yield)			£ million
	2007-08 indexed	2008-09 indexed	2009-10 indexed	2007-08 non-indexed
Duties changes				
39 Alcohol duties: revalorise beer, wine and sparkling wine, freeze spirits	-20	-15	-10	+210
40 Tobacco duties: revalorise	0	0	0	+40
41 Gaming duties: changes to duty bands and rates	+30	+35	+35	+35
Property				
42 Rationalisation of empty property relief	0	+950	+900	0
Protecting the environment				
43 Expansion of Enhanced Capital Allowances for water-efficient technologies	*	*	-5	*
Supporting a clean and efficient transport system				
44 VED: enhancing environmental incentives	+125	+220	+280	+230
45 Road fuel duties: increases from 1 October 2007	-380	+490	+660	+480
46 Rebated oils duties: increases from 1 October 2007	+50	+125	+135	+65
47 Biofuels: extension of differential to 2009-10	0	0	+10	0
48 Road fuel gas: continuation of differentials to 2009-10	0	0	+5	0
49 Renewal of reduced pollution certificate scheme for lorries	0	0	-5	0
Protecting the UK's natural resources				
50 Aggregates levy: encouraging the sustainable use of resources	-10	+40	+45	0
Improving waste management				
51 Landfill tax: supporting recycling	0	+175	+325	0
Other policy decisions				
52 Special reserve	-400	0	0	-400
TOTAL POLICY DECISIONS	-525	+280	+125	-130
* Negligible				
MEMO ITEM				
Resetting of the AME margin	-1,000			

GOVERNMENT SPENDING AND REVENUE

I.40 Chart 1.1 presents public spending by main function. Total managed expenditure (TME) is expected to be around £587 billion in 2007-08. TME is divided into Departmental Expenditure Limits (DEL), shown in Table C13 of the FSBR, and Annually Managed Expenditure (AME), shown in Table C11 of the FSBR.

Chart I.1: Government spending by function

Total managed expenditure: £587 billion

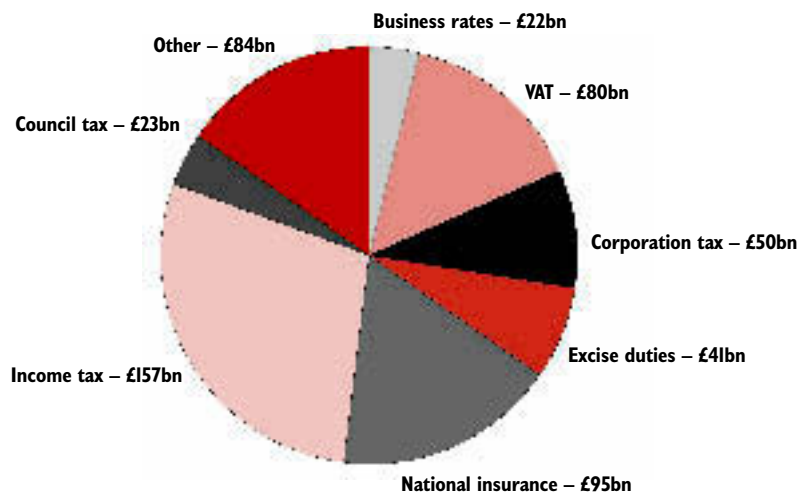


Source: HM Treasury, 2007-08 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services; recreation, culture, media and sport; international cooperation and development; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted in AME, in line with OECD guidelines. Figures may not sum to total due to rounding.

I.41 Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £553 billion in 2007-08. Table C8 of the FSBR provides a more detailed breakdown of receipts consistent with this chart.

Chart I.2: Government receipts

Total receipts: £553 billion



Source: HM Treasury, 2007-08 projections. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts – for example, interest and dividends. Figures may not sum to total due to rounding.

