

Productivity growth underpins strong economic performance and sustained increases in living standards. The Government's long-term goal is for the UK to achieve a faster rate of productivity growth than its main competitors. Recent data show that the UK is making some progress in closing the productivity gap with Germany and France. Budget 2004 sets out the next steps the Government is taking to build on this success and further strengthen the drivers of productivity growth, including:

- the publication of a **consultation document to inform the preparation of a ten-year investment framework for science and innovation**, as part of the 2004 Spending Review, committing to grow public investment in the science base faster than the trend rate of GDP growth over the next Spending Review period;
- a **commitment to increase NHS funding for R&D by £100 million by 2008**, to underpin the creation of a new UK Clinical Research Collaboration for the effective and efficient translation of scientific advances into patient care;
- a **New Deal for skills** to ensure that individuals are helped to develop the skills they need for employment and employers can develop the skilled workforce needed for the success of their business, and extending Employer Training Pilots to six new areas;
- **reforms to reduce the regulatory burden on businesses**, including consulting on the implementation of phasing out payment via employers for Working Tax Credit, strengthened Government scrutiny of regulatory proposals, and changing the structure of the UK's tax administration;
- **devolving delivery of regional and local Business Link services** from the Department of Trade and Industry to the Regional Development Agencies;
- **full details of the Local Authority Business Growth Incentives scheme**, which will boost the role of local authorities in promoting enterprise and economic growth;
- the Barker Review of housing supply, published today, concludes that house building must rise substantially to reduce house price inflation and increase the number of affordable homes. The Government agrees with the need for a significant increase in housing development over time. It intends to **implement a programme of reform to planning and delivery of development as recommended in the Review and consider a package of measures to increase housing supply**, including social housing investment, alongside a Planning-gain Supplement by the end of 2005;
- a **new entitlement for graduates of the world's top 50 business schools to come to the UK** to seek employment; and
- seeking views on how **property investment funds** (a UK version of the successful US Real Estate Investment Trusts) should be structured, to encourage more efficient investment in commercial and residential property.

### RAISING PRODUCTIVITY IN A FAIR ECONOMY

**3.1** Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance and rising living standards. As a result of macroeconomic instability and market failures, the UK has historically experienced low rates of productivity growth compared to other major economies. In recent years, however, the UK's performance

has improved. Box 3.1 explains that the UK now has similar output per worker to Germany and is narrowing the gap with France. However, there remains a sizeable productivity gap with the US and (on an output per hour measure) with France. 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.

**3.2** Productivity growth requires a flexible economy in which individuals and firms can adapt rapidly to changing conditions, allowing them to exploit new opportunities and to deal with potential challenges effectively. Box 3.2 summarises trends and progress in product and capital market flexibility since the time of Budget 2003.

**3.3** This chapter describes the steps the Government is taking to raise productivity across all regions and countries of the UK. It focuses on the five key drivers of productivity performance:

- improving *competition*, which promotes flexible markets and increases business efficiency and consumer choice;
- promoting *enterprise*, by removing barriers to entrepreneurship and developing an enterprise culture;
- supporting *science and innovation*, to promote the development of new technologies and more efficient ways of working;
- raising *skills* levels, to create a more flexible and productive workforce; and
- encouraging *investment*, to increase the stock of physical capital, including through stronger, more efficient capital markets.

**Monitoring the five drivers of productivity**

**3.4** These five drivers provide a framework both for analysis and for organising policies designed to improve productivity. HM Treasury and the Department of Trade and Industry (DTI) recently published a consultation document<sup>1</sup> setting out a potential set of indicators, grouped around the five drivers, to monitor progress and signal areas where further policy action may be needed. The paper also considers using a similar set of productivity indicators to monitor progress towards the Government's regional performance target.

**Productivity and flexibility in the regions**

**3.5** The Government is committed to ensuring that the benefits of improved productivity are spread throughout the country. Its goal is to make sustainable improvements in the economic performance of all UK regions and, over the long run, reduce the persistent gap in growth rates between the regions. The Government believes that the best way to improve the productivity of all the regions and to overcome regional disparities in economic performance is to allow each area of the UK the freedom and flexibility to exploit indigenous sources of growth. Since 1997, it has pursued a number of important developments driving forward devolution. These developments include the establishment of devolved administrations in Scotland, Wales and Northern Ireland and the setting up of nine Regional Development Agencies (RDAs) in the English regions.

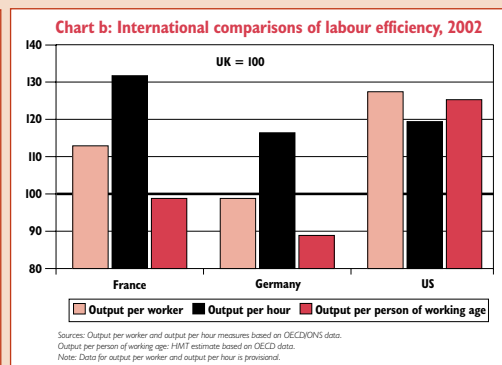
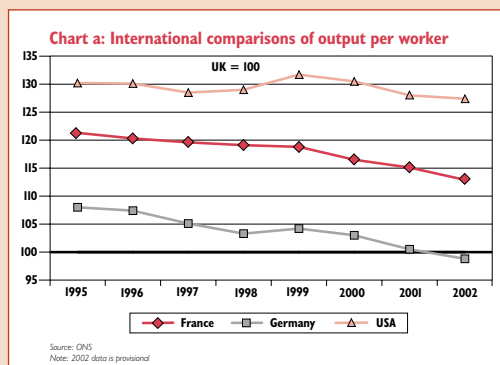
**3.6** The next phase requires an evolution in the relationship between central government, local government, regional organisations and the front line. Central government needs to maintain a strategic role, ensuring national standards are met and maintained, but allowing greater scope locally to determine other priorities and to decide how best to deliver national outcomes. The RDAs, as strategic leaders of economic development in the regions, have a good understanding of the opportunities and restrictions that they and their partner organisations face in their efforts to enhance regional economic performance.

<sup>1</sup> *Productivity in the UK 5: Benchmarking UK productivity performance*, HM Treasury and Department of Trade and Industry, March 2004.

### Box 3.1: UK productivity performance

Historically, UK productivity has been lower than in other major economies. Evidence suggests the UK has been less productive than the US since the early twentieth century and was overtaken by France and Germany in the post-war period.<sup>a</sup>

New data shown in Chart (a) suggest that since 1997, UK productivity has grown faster than its main competitors. As a result, UK workers on average produce as much as German workers, and the productivity gap with France has fallen by seven percentage points. However, workers in the US are still just under 30 per cent more productive than UK workers. Between 1997 and 2001, UK trend productivity (on an output per hour basis) is estimated to have grown by almost two and a half per cent annually, compared to a figure of just over two per cent between 1986 and 1997.<sup>b</sup> This higher rate of productivity growth suggests that the UK has also seen an increase in its trend rate of hourly productivity growth.



This improvement has been achieved despite sustained employment growth in the UK over recent years, which has made the aim of raising productivity growth more challenging because new workers tend to have lower productivity than experienced workers. New workers take time to learn job-specific skills, which may result in lower productivity growth than would otherwise have been the case in a growing economy. A comparison of output per person of working age shows the benefits of the UK's record of strong growth and high employment, as shown in Chart (b). This measure indicates how effectively an economy includes all of its potential workers in productive employment. It shows that UK performance is significantly better than Germany, at a similar level to France, and around 25 per cent behind the US.

It is important to sustain recent improvements and to build on them. The Government will continue to implement a programme of microeconomic reforms with the ambition of raising the productivity of British workers to a level comparable with the best in the world.

<sup>a</sup> *Britain's relative economic performance, 1870-1999*, Nick Crafts, April 2002.

<sup>b</sup> This is shown in Table B2 in Chapter B.

**Box 3.2: UK product and capital market flexibility – report on progress**

The assessment of the five economic tests for UK membership of Economic and Monetary Union (EMU) in June 2003 examined the flexibility of UK product and capital markets. It noted that a decision to join EMU would increase the need for rapid price and factor movements and make it necessary for firms to be able to respond effectively to shocks and adapt to the competitive opportunities that the single currency would bring. It concluded that the UK has a reasonable degree of price flexibility and generally exhibits a competitive business environment, but that the degree of competition and market flexibility falls short of what might be achievable. The assessment also concluded that capital markets play an important role in stabilising the impact of shocks between regions in the US, and greater financial market integration could enhance the scope for risk-sharing across the EU.

Details of trends, measures and progress on the flexibility of product and capital markets are set out in *Flexibility in the UK economy*, published alongside this Budget, and new measures introduced in the Budget are set out in this chapter. Measures include:

**Modernising the corporation tax system:** following consultation the Government has introduced reforms to the corporation tax system, and is committed to further reforms in a number of areas. Detailed legislative proposals will be published later in the year.

**A package of regulatory reforms to ease the burden on small business:** including consulting on implementation of phasing out payments via employers of Working Tax Credit; and any regulatory proposal likely to impose a major new burden on business will require clearance from the Panel for Regulatory Accountability chaired by the Prime Minister, based on a thorough impact assessment of the proposal agreed by the Cabinet Office Regulatory Impact Unit.

**Promoting competition:** through reviews into, and action on, competition in a number of specific markets, including legal services, financial services and energy markets; an Office of Fair Trading (OFT) review into how public sector procurement affects competition; encouragement for the OFT to review Government regulations and consider their impact on competition; and the roll-out from summer 2004 of a consumer help-line, *Consumer Direct*, across four pathfinder regions.

**Planning reform:** through reforms including the first Planning Bill for more than a decade; the creation of Regional Spatial Strategies to guide the pattern of development at regional level; and follow up of the recommendations of the Barker Review of housing supply in the UK, published today.

**Improving access to finance for SMEs and individuals:** through enhanced tax relief for investments in Venture Capital Trusts and incentives to invest under the Enterprise Investment Scheme; the independent Graham Review into the effectiveness of the Small Firms Loan Guarantee scheme; and follow up of the recommendations of the Sandler Review into medium- and long-term savings in the UK.

**Capital market integration:** through initial preparations for implementation in the UK of the wholesale financial services directives most recently passed under the EU's Financial Services Action Plan.

**3.7** The RDAs were asked to identify the top ten institutional barriers that hinder effective coordination in the regions, as part of the Devolving Decision-Making Review, which the Chancellor announced in Budget 2003. The Government is publishing two reports resulting from this review alongside this Budget. *Devolving decision-making 1 – Delivering better public services: refining targets and performance management* looks at how refining the approach to targets and performance management can help improve the efficiency and responsiveness of public services. Further detail is provided in Chapter 6. In the second report, *Devolving decision-making: 2 – Meeting the regional economic challenge: increasing regional and local flexibility*, the Government responds to the RDAs' top ten barriers and provides an update on its analysis of the drivers of regional economic growth. The principles emerging from the review are reflected in the devolution of regional and local Business Link services, outlined later in this chapter.

**3.8** Ahead of Budget 2004, HM Treasury also asked the RDAs to provide advice on specific regional productivity challenges. Among the issues raised were proposals to overcome barriers to business start-ups, improve the provision of services to small businesses, enhance access to finance for small and medium-sized enterprises (SMEs) create flexibility at a regional level to meet employers' skills needs, and increase the level of knowledge transfer between businesses and universities. Budget 2004 announces further measures which respond to the RDAs' recommendations.

### Productivity in the EU

**3.9** In March 2000, at the Lisbon European Council, Europe's leaders committed themselves to a ten-year programme of far-reaching economic reform designed to make the EU "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."<sup>2</sup> Structural reform of Europe's labour, product and capital markets, and increased flexibility were seen as the key to economic success in a global economy – success that is vital for ensuring social justice and high standards of environmental protection. Increasing productivity is central to improving Europe's growth potential.

**3.10** Action at the European level since 2000 has included inter-institutional agreement on the need for better regulation and modernisation of EU competition policy. The EU has also adopted a new Action Plan for R&D, with plans on enterprise and innovation forthcoming. Over the past year, action by Member States has included French and Spanish reforms to promote enterprise, German reforms to enhance innovation and research in R&D and the establishment of a new Innovation Council in the Netherlands. Looking ahead, the immediate priorities for reform are strengthening competition in the Single Market, regulatory reform to minimise unintended burdens on business, and advancing enterprise and innovation to increase flexibility.

### International trade and productivity

**3.11** Openness to international trade raises productivity by reallocating resources to the most efficient producers, increasing competition, facilitating technology transfers and raising innovation levels. The Government believes that the goals of more open global markets and domestic structural reform should be pursued vigorously and in tandem. Key to this strategy are success in the current multilateral trade negotiations, discussed further in Chapter 5, and the reduction of barriers to trade and investment between the EU and US. The UK will also take part in a joint productivity forum with the US later in the year.

<sup>2</sup> Presidency conclusions Lisbon European Council, 23-24 March 2000.

## COMPETITION

**3.12** Competition promotes efficiency, puts downward pressure on prices and increases choice for consumers. The Enterprise Act 2002 built on earlier reforms to create a world-class competition regime in the UK. The latest international survey shows that the UK competition regime is joint second in the world behind the US.<sup>3</sup> The DTI has commissioned KPMG to carry out a further peer review of the UK competition framework, which will report in April 2004. The Government also continues to encourage the OFT to review existing Government regulations and to consider their impact on competition and consumers.

### Competition in specific markets

**Legal Services 3.13** David Clementi is leading an independent review into a regulatory framework for legal services, and will make recommendations by the end of 2004. The review published a consultation paper on 8 March 2004, which sets out the key questions on matters such as regulatory models and complaints. It also covers alternative business structures, including legal disciplinary practices (bringing lawyers together from different professional bodies) and multi-disciplinary practices (practices between lawyers and other professionals).

**Payment systems 3.14** The Government welcomes the recent announcement by the OFT on the creation of a Payment Systems Task Force, and the commitment by industry to participate. This Task Force will identify and seek to resolve competition, efficiency and incentive issues relating to payment systems. It will operate initially for a four-year period. The Government will then review competition in the industry and will legislate unless there has been a significant improvement. The Government considers it vital that this important market is efficient and open to real competition, and urges the industry to engage constructively with the Task Force on issues of mutual concern.

**Financial services 3.15** As part of a review of the Financial Services and Markets Act 2000, the OFT is scrutinising the impact of the Act on competition in financial services markets. A report setting out how the OFT will approach the competition scrutiny is available on its website.<sup>4</sup>

**Energy markets 3.16** Liberalisation in energy markets has boosted competition, delivered lower gas and electricity prices, and reduced the need for regulation. The Energy Bill, currently before Parliament, will establish a single framework for electricity transmission and trading arrangements across Great Britain. By April 2005, Scottish consumers will receive the competitive benefits enjoyed by those in England and Wales, while generators will have fair and open access to the market.

### Consumers

**3.17** The Government is committed to putting empowered consumers at the heart of an effective competition regime. Empowered consumers know their consumer rights and demand high quality goods and services, encouraging higher standards and innovation. The DTI is currently reviewing the UK consumer framework, and will publish a consultation paper later this year drawing on the comparative benchmarking report published in October 2003.

**3.18** From summer 2004 a new consumer helpline, *Consumer Direct*, will provide consumers with information on their rights and practical advice on resolving problems and information on their rights. The service will initially launch pathfinders in Yorkshire and the Humber, Wales, Scotland and the South West of England, with national roll-out continuing over the next two years.

<sup>3</sup> *Rating enforcement*, Global Competition Review, 2003.

<sup>4</sup> [www.ofc.gov.uk/Market+studies/Studies/fsma2.htm](http://www.ofc.gov.uk/Market+studies/Studies/fsma2.htm).

**3.19** HM Treasury and the DTI are undertaking a joint project on consumer representation in regulated industries. In spring 2004, the project will publish a report that will make recommendations to improve the operation of the current system in the medium term. This report will draw upon the results of a benchmarking study undertaken by PriceWaterhouseCoopers, jointly commissioned by the DTI and the National Audit Office.

## Competition in the supply of goods and services to Government

**3.20** The Government is committed to achieving greater value for money through better procurement and is considering ways of strengthening the public sector procurement infrastructure – further details are provided in Chapter 6. It is also taking steps to improve competition in the supply of goods and services to the Government:

- the Office of Government Commerce is taking forward the recommendations of a recent report on this issue<sup>5</sup> through discussions with industry and the wider public sector, and is developing a pilot market for testing capacity planning techniques. The pilot market will be launched by September 2004 prior to a wider roll-out in 2005; and
- the OFT has launched a review into how public sector procurement affects competition. This research is expected to be completed by July 2004.

**3.21** Effective competition in public procurement is essential to the proper functioning of the EU, and the Government welcomes the recent revision of European procurement rules. To help ensure that these rules are translated into practice, Alan Wood, Chief Executive of Siemens in the UK, is undertaking a review of UK businesses' experiences of accessing public contracts in the EU. Firms involved in tendering for public contracts in other EU Member States have been invited to report on their experiences through the review's website.<sup>6</sup> The review will report in summer 2004.

## Competition in the EU

**3.22** The UK supports a strong and proactive European competition policy. It believes that investigations of markets and sectors have a key role to play in ensuring that barriers to competition can be tackled flexibly. In January 2004, the UK, France and Germany called for further action to develop this strategic dimension through a clear statement of the European Commission's approach. The Commission has made a number of welcome recent steps in this direction, including investigations of competition in specific markets and sectors.

## ENTERPRISE

**3.23** A modern dynamic economy needs a strong entrepreneurial base. There are 3.75 million SMEs in the UK, accounting for over 55 per cent of business employment and 52 per cent of business turnover. A vibrant small business sector creates wealth and employment, generates competitive pressure that drives innovative activity and improves the range, quality and prices of goods and services for consumers.

<sup>5</sup> *Increasing competition and improving long-term capacity planning in the Government market place*, Office of Government Commerce, December 2003.

<sup>6</sup> [www.woodreview.org](http://www.woodreview.org).

## Enterprise culture

**3.24** The Government believes that a culture of entrepreneurship should be encouraged and valued so that anyone who has the potential to succeed in business has the opportunity and support to do so. Latest data from the Global Entrepreneurship Monitor show that levels of entrepreneurial activity in the UK have risen to 6.4 per cent of the adult population, from 5.4 per cent in 2002.<sup>7</sup> The Government wants the UK to be the best environment in the world for starting and growing a business. In January 2004, the Chancellor hosted a conference in London, *Advancing Enterprise: Britain in a Global Economy*, attended by many business leaders and Government representatives. The conference covered a range of different themes related to enterprise including creating an enterprise culture, technology and innovation, and tackling the skills gap.

### Promoting an enterprise culture

**3.25** The implementation of the Davies Review<sup>8</sup> into economy and enterprise in education is critical to ensuring that young people develop the entrepreneurial skills and attitudes necessary for success in their working lives. The interim report of the Tomlinson Review<sup>9</sup> of the 14-19 curriculum identifies a core set of employability skills, of which enterprise skills are an important subset. Integrating enterprise education fully within the 14-19 curriculum will strengthen the UK's enterprise culture.

**3.26** The Government has also introduced a number of specific measures to promote an enterprise culture, including:

- Enterprise Insight's campaign to create a step change in the enterprise culture of the UK, which will be launched in June 2004, leading to Enterprise Week in November;
- the £1 million Enterprise Promotion Fund, announced in Budget 2003, which has made awards to more than 20 organisations. As part of the UK-US Enterprise Agreement, students from the New Entrepreneur Scholarship programme will study in the US, and the first US-UK forum to share best practice in enterprise education will be held in June 2004;
- the launch of a new competition to identify European Centres of Enterprise – local centres of excellence in enterprise policy; and
- an online summit of experts from the US, UK and Canada to be held in April 2004 on women's entrepreneurship. This is the start of a trilateral alliance, which aims to increase the percentage of businesses owned by women.

### National Council for Graduate Entrepreneurship

**3.27** In the 2003 Pre-Budget Report, the Government announced the establishment of a new National Council for Graduate Entrepreneurship. **Six members of the Council have been appointed with David Frost, British Chambers of Commerce, acting as interim chairman and Karan Bilimoria, founder of Cobra Beer, as the Council's Graduate Champion.**

<sup>7</sup> UK Report, Global Entrepreneurship Monitor, 2003.

<sup>8</sup> A review of enterprise and the economy in education, Howard Davies, February 2002.

<sup>9</sup> 14-19 curriculum and qualifications reform, Interim report of the working group on 14-19 reform, February 2004.

**Training, education and advice** **3.28** Small businesses that access external training and advice are more likely to grow and to succeed. In Budget 2003, the Government asked a working group chaired by Sue Brownson to oversee the development of a training and support package for SMEs. The new online training directory developed by the group, and which will be promoted in partnership with the main high-street banks, has been successfully launched at [www.businesslink.gov.uk/training](http://www.businesslink.gov.uk/training). The site offers a range of online courses and a directory of 750,000 other courses across the UK that can help businesses to succeed. It is just one element of the new [businesslink.gov.uk](http://businesslink.gov.uk) online advisory service to be launched at the end of April. The website will be a one-stop shop where businesses can access advice on starting-up, regulatory requirements, exporting, accessing finance for growth, and other information.

**Business Links** **3.29** The 2002 Spending Review launched a pilot programme of devolved RDA-led Business Link services in the North West, East Midlands and West Midlands. The Government intends to roll out the programme nationwide and devolve delivery of regional and local Business Link services to RDA control. **From April 2005 all RDAs will be granted responsibility for flexibly managing Business Link services in their areas to tailor delivery to the needs of their region.** A national framework will maintain core service standards and will sustain the performance improvements Business Link achieved last year. Further details will be set out in the 2004 Spending Review.

## Promoting enterprise in the regions and in disadvantaged areas

**Local Authority Business Growth Incentives** **3.30** To create a direct financial incentive for local authorities to promote local business growth, the Government is introducing the Local Authority Business Growth Incentives scheme. This will allow local authorities to retain a proportion of increases in local business rate revenues to spend on their own priorities. No business will pay more under the scheme.

**3.31** The 2003 Pre-Budget Report announced the results of a public consultation, and initial decisions on the model to be used for setting local baselines. **The Office of the Deputy Prime Minister (ODPM) is today publishing full details of the baselines for individual local authorities,** alongside further proposals on the method to be used to calculate ceilings on the amount of revenue that each local authority can retain.

**3.32** Details of other technical factors, including local authority floors, scaling factors, and the division of revenues between the different tiers of local government, will be published in the coming months. Following consultation last year, the Government is proposing a medium floor and ceiling factor so that most authorities can benefit from the scheme, and the calculation of ceilings based on a modified Formula Spending Share approach. The ODPM will work with a number of local authorities to test the administration of the scheme, and will publish a further consultation document alongside the draft secondary legislation in summer 2004. The scheme will then begin operating for all authorities in April 2005. In total, the Government expects local authorities across England and Wales to retain around £150 million of revenues in 2005-06, rising to £450 million by 2007-08. To ensure that the scheme is achieving its objectives, and that baselines and incentives remain fair, the Government will commission an evaluation of the scheme, and will review baselines and floors after three years. The Welsh Assembly Government has also finished consultation on a similar scheme.

**Enterprise Areas** **3.33** The Government believes that raising levels of enterprise and economic activity is essential to sustainable regeneration in the UK's most disadvantaged communities. The 2002 Pre-Budget Report designated 2,000 Enterprise Areas in which measures to boost enterprise are being focused. The Government has been working with the RDAs and the Local Government Association and has held a series of Open Space events in partnership with RBS/Natwest and local communities. These are being used to inform policy developments

and are shedding light on how local stakeholders and RDAs can tailor measures in Enterprise Areas to meet specific development challenges.

**3.34** Research by the Social Exclusion Unit in ODPM has found that 75 per cent of the streets with the highest rates of worklessness in England are in Enterprise Areas. The Government is considering measures to tackle barriers to employability in Enterprise Areas.

**Business Premises Renovation Allowance** **3.35** In the 2003 Pre-Budget Report, the Government announced details of a Business Premises Renovation Allowance scheme, providing 100 per cent capital allowances in Enterprise Areas for the costs of renovating business properties that have been vacant for at least a year. **Subject to state aid approval, the scheme will be introduced in 2005, and draft legislation will be published shortly for consultation.**

## Finance for small businesses

**Small Firms Loan Guarantee** **3.36** The 2003 Pre-Budget Report announced that Teresa Graham would conduct a review of the Small Firms Loan Guarantee (SFLG). In February 2004, the Review published a discussion document which asked for submissions from interested parties.<sup>10</sup> The Review intends to publish its initial findings on the state of the market and the trends in SFLG usage in the spring, and to make recommendations in summer 2004 on the appropriateness of the scheme's structure and rules to its effective operation, and whether SFLG is sufficient to tackle the barriers faced by start-ups and small businesses in the current debt finance market.

**Enterprise Capital Funds** **3.37** In the 2003 Pre-Budget Report, the Government announced the introduction of a pathfinder round of Enterprise Capital Funds (ECFs) to explore the scope for a longer term ECF programme. ECFs will be commercially-managed entities investing a mixture of public and private capital in potentially high-growth small businesses affected by the equity gap. The Government is discussing the details of the pathfinder round with interested stakeholders and, subject to satisfactory progress in the state aids clearance process, intends to publish, within the next three months, draft details of what pathfinder ECFs might look like and how the funds will be selected. Full details will be published once EU state aids clearance has been achieved.

**Venture Capital Trusts and Enterprise Investment Schemes** **3.38** The 2003 Pre-Budget Report also announced proposals to target structural factors that have contributed to volatility in fundraising for Venture Capital Trusts (VCTs) and to improve the incentives to invest under the Enterprise Investment Scheme (EIS). The Government now intends to proceed with its proposals, including:

- doubling the annual investment limit for VCTs for both the relief for new shares and shares in issue to £200,000;
- raising, also to £200,000, the annual limit on the size of investment eligible for income tax relief under the EIS;
- withdrawing capital gains tax deferral relief for investments in VCTs in favour, in the long term, of an enhancement of equivalent value to the incentives to invest through income tax relief for new subscriptions to VCT shares; and
- in the short term, to provide a temporary additional stimulus to investment in VCTs for a period of only two years, by increasing the effective rate of income tax relief from 20 per cent to 40 per cent.

<sup>10</sup> [www.hm-treasury.gov.uk/graham](http://www.hm-treasury.gov.uk/graham).

**3.39** Following discussions with industry, and having explored alternative delivery options, the Government has decided to deliver this additional stimulus through a straightforward increase to 40 per cent in the rate of income tax relief paid to investors.

**Financial inter-mediation** **3.40** Budget 2003 announced that Michael Snyder would chair a working group to consider how intermediaries, such as accountants, could do more to advise small firms seeking to raise finance for growth. The Institute of Chartered Accountants in England and Wales and the Association of Chartered Certified Accountants have indicated through the group that, with the help of the Small Business Service (SBS), they will **work to establish a self-accreditation programme for accountants and other business advisers who are able to provide advice to small businesses seeking finance. Business Link will promote accredited advisers to businesses seeking advice.**

**3.41** The Small Business Investment Taskforce (SBIT) has reported its findings on potential barriers in the UK market for intermediation between small firms seeking equity finance and investors, including business angels. Their initial view is that there is no widespread lack of intermediation provision in the UK, although there are problems for SMEs seeking start up and early stage risk capital. **The Government will ask the SBIT to build upon their initial work by focusing on the broader demand issues, and in particular the problems faced by start up and early stage firms.**

**3.42** In January 2004, the Government launched a consultation on potential changes to the regulation of financial promotion to make it easier for small firms to raise finance from business angels.<sup>11</sup> The consultation seeks views by April 2004 on how best to ensure that financial regulation in this area strikes the right balance between allowing small firms to raise capital, and the appropriate level of protection for investors. The Government will continue to examine the appropriate balance in other areas of financial regulation, and will, in implementing the Prospectus Directive, assess whether the costs of issuing equity for small firms can be properly lowered.

**Business transfer** **3.43** Effective transition of business ownership has the potential to drive productivity benefits through improved innovation, investment and skills. However, ensuring a smooth succession of ownership can be especially challenging for smaller businesses who may not know how to get appropriate advice, and who may face barriers in raising finance to fund the transition. The Small Business Council has asked the Government to examine the barriers that might constrain business transfer. Martin Wyn Griffith, the Chief Executive of the Small Business Service, will lead a cross-departmental review of the hurdles that businesses face when their ownership changes, and what more could be done to ease the process.

## Modernising the business tax system

**3.44** The Government proposes a number of steps in this Budget to reform the tax system for business; promoting investment and productivity, while modernising the relationship between business and the tax system. As set out in Chapter 5, the Government today published the report of the Review of the Revenue Departments and has accepted its recommendations. A particular focus of the review was how costs to businesses that currently interact with two separate revenue departments might be reduced. The Review recommends that a new single tax department should be created, integrating HM Customs and Excise and the Inland Revenue. The new department will be able to focus more effectively on its customers, helping to reduce costs for compliant taxpayers. It will also help to create a more coherent approach to tax administration and support policy making.

<sup>11</sup> *Informal capital raising and high net worth and sophisticated investors: a consultation on proposed changes to the Financial Promotion Order*, HM Treasury, January 2004.

**3.45** Chapter 5 also includes a number of measures to protect revenues, including proposals to prevent business competitiveness being undermined by tax avoidance schemes, which distort competition and disadvantage the majority of businesses without access to sophisticated tax planning schemes and arrangements. Following the announcement of the Government's intentions in the 2003 Pre-Budget Report, Chapter 5 also sets out the steps the Government is taking to address a trend to tax-induced incorporation by the self employed, and to ensure low rates of corporation tax are focused on those businesses adopting the corporate legal form in order to invest in, and grow their business, including through a 19 per cent minimum rate of Corporation Tax levied on distributed profits.

**Enhancing  
capital  
allowances**

**3.46** The Government recognises that small businesses make a vital contribution to the productivity of the UK economy and it remains committed to encouraging investment, as a key driver of productivity and growth. In response to representations from a number of bodies, the Government has been considering the case for further expansion of the capital allowances available to small businesses. 40 per cent first year capital allowances for SMEs were made permanent in Budget 2000 and extended in the 2003 Pre-Budget Report to a wider definition of enterprises. Budget 2004 announces an extension to the enhanced capital allowances available to incorporated and unincorporated small businesses investing in plant and machinery. **For expenditure in the year from April 2004, the first year allowance will be set at a new rate of 50 per cent.** This measure will assist small businesses' cashflow and provide enhanced funding for new investment.

**Corporation tax  
reform**

**3.47** The Government is committed to a modern, fair and competitive corporation tax system that reflects the increasingly flexible and global business environment. Box 3.3 sets out further details of the Government's approach. Following the August 2003 consultation on corporation tax reform,<sup>12</sup> two specific issues are being taken forward from 1 April 2004, as announced in the 2003 Pre-Budget Report:

- relief for the expenses of managing investments will be available to companies with investment business, whether or not they qualify as investment companies; and
- transfer pricing will apply to transactions within the UK as well as cross-border. Concerns raised during consultation will be addressed through exemptions for SMEs, with a two-year relaxation of the penalty regime, new guidance on record-keeping and enquiries, **an exemption for existing dormant companies and a number of technical measures designed to accommodate various commercial financing transactions and structures.**

**3.48** The Government is committed to reform in other areas of the corporation tax system, including the schedular system, the capital/income divide, and the tax differences between trading and investment companies. Detailed legislative proposals will be published later this year, focusing on those areas where the system may create unjustified barriers to modern commercial activity. Having considered a range of proposals for reform of the tax treatment of capital investment, the Government has concluded against alignment with accounts depreciation. Respondents to the consultation made it clear that capital allowances were a valuable part of the tax system. The Government will therefore consider further whether the current capital allowances regime can be modernised to reflect more closely the relative economic value of different forms of investment, and will consider possible changes to the way that leasing transactions are taxed in the light of this decision.

**3.49** The Government will also continue the wider-ranging dialogue on international issues that was begun during the August 2003 consultation, with a view to maintaining the competitiveness and fairness of the UK corporation tax regime and ensuring that it remains robust.

<sup>12</sup> *Corporation tax reform: a consultation document*, HM Treasury and Inland Revenue, August 2003.

**Modernising VAT 3.50** The Government has introduced a series of measures designed to help reduce the administrative burden on small businesses and to ease their cash flow. Budget 2004 announces further measures to help small and newly-registered businesses reduce their VAT compliance costs, including from 1 April:

- raising the VAT registration threshold in line with inflation from £56,000 to £58,000, helping to keep a further 5,000 of the smallest businesses out of the VAT system; and
- increasing the turnover ceiling for businesses wishing to use the VAT annual accounting and cash accounting schemes from £600,000 to £660,000.

**3.51** Budget 2004 also announces a consultation to enable VAT to be applied more fairly to land and property used by charities.

### **Box 3.3: Corporation tax, globalisation and the changing nature of business activity**

Two interrelated trends are reshaping corporate activity and pose both opportunities and challenges for corporation tax systems:

- the growth and global integration of multinational companies; and
- new forms of business activity, such as the proliferation of diverse corporate structures and financing arrangements and the growth of intangible inputs and products.

Sovereign governments need the freedom to respond to these challenges, reflecting different choices over the level and types of social provision and the size and nature of their public sector. Inflexible systems, including those that could arise from harmonisation, will increasingly become barriers to growth. A modern corporate tax system must also avoid creating barriers to innovation or commercial activity, while ensuring that businesses contribute their fair share to the provision of public goods and services. Unjustified distortions in the treatment of different types of assets, barriers to entrepreneurship and risk-taking, and outdated distinctions between different forms of commercial activity will therefore continue to be addressed as part of reform and modernisation of UK corporation tax. The Government will therefore continue to ensure that the UK is able to exploit the benefits of economic integration, while embracing fair competition and resisting tax harmonisation at the European level and beyond.

In addition, the Government will continue to support effective international cooperation to ensure that national tax systems help deliver the benefits of global integration. For example:

- the UK's extensive network of bilateral tax treaties removes significant barriers to cross-border investment by alleviating double taxation;
- the UK is an active participant in the Organisation for Economic Co-operation and Development's work to develop international standards for transparency and exchange of information in national tax systems, which help counter cross-border tax evasion and avoidance; and
- the UK has played a lead role in the Code of Conduct on business taxation in the European Union, a voluntary process of peer review to facilitate the removal of harmful tax measures and ensure fair tax competition.

## Reforming and reducing regulation

**3.52** Effective and well-focused regulation can play a vital role in correcting market failures, promoting fairness and competition and driving up standards. However, unnecessary or poorly implemented regulation can be an obstacle to flexibility, restricting employment growth and competitiveness, particularly for smaller firms, without actually improving regulatory outcomes. The Government is committed to delivering targeted deregulatory changes to relieve burdens on business as well as strengthening policy-making processes at UK and EU level to improve the quality of regulation.

### Tax credits: payment via employers

**3.53** Payment via employers has helped reinforce the principle that tax credits are a reward for work, reducing the stigma associated with claiming. Tax credits are now firmly established as the fair approach to providing financial support to working families. Further, at the end of January 2004, six million families were benefiting from the new tax credits exceeding the Government's ambitious expectations. The Government accepts the case, in principle, that the benefits to business justify moving to direct payment of the Working Tax Credit, reducing the cost of payroll administration and addressing a key area of business concern. The reform will be particularly valuable to the 1.2 million small businesses that stand to benefit. The Government will consult with employers on the detail of implementation.

### Better policy- making in the UK

**3.54** Significant and lasting improvements in the regulatory environment for business will only be delivered through the continuous improvement in policy-making at both UK and EU level. The Government has already strengthened its approach to reducing the overall regulatory burden on business, improving the quality of regulations, and enhancing regulatory stability. For the first time, Government departments are this year reporting on their regulatory performance – **and the independent Better Regulation Task Force (BRTF) will publish its own analysis of these reports.** Departments' regulatory performance will be taken into account in the 2004 Spending Review. The Government has also accepted all the recommendations in a recent BRTF report<sup>13</sup> and is now promoting the use of alternatives to regulation across Whitehall and the wider public sector.

**3.55** Building on this, the Government is introducing further changes to ensure that reducing the flow and improving the quality of regulation at UK level is a central part of the policy-making process. **In future, any regulatory proposal likely to impose a major new burden on business will require clearance from the Panel for Regulatory Accountability, chaired by the Prime Minister, based on a thorough impact assessment of the proposal agreed by the Cabinet Office Regulatory Impact Unit, before the proposal is put to wider Ministerial approval.** The Panel will consider all such proposals in the context of Departments' previous regulatory performance and the overall burden of regulation across key business sectors. Where appropriate emergency legislation will be exempt from these new processes, and the new requirements will not change the long-standing arrangements through which tax matters are considered by the Chancellor in the course of normal Budget processes.

### Better policy- making at EU level

**3.56** Around half of all new regulation with a significant impact on UK businesses originates in EU law. Further reform is therefore essential at the European level. In January 2004, the Chancellor and the Finance Ministers of Ireland, the Netherlands and Luxembourg set out proposals for regulatory reform. These proposals include improved tests to ensure that new legislative proposals do not damage the European economy, clear commitments to reduce the burden of existing EU legislation, and greater use of alternatives to regulation. **EU Finance Ministers have supported these proposals and called for a clear programme of action covering the next two years. The Government will press for agreement on this at the Spring European Council.** Further, the Government is submitting to the European Commission a list of priority areas for regulatory simplification, reflecting those suggested by business in the recent BRTF consultation.

<sup>13</sup> *Imaginative thinking for better regulation*, Better Regulation Task Force, September 2003.

**Better regulation** **3.57** The enforcement activity of regulatory bodies is a significant driver of business compliance costs. As the BRTF recognised in their 2003 report *Independent regulators*,<sup>14</sup> well targeted inspection programmes are vital, not only to deliver the outcomes society demands, but also to minimise the costs borne by compliant firms. Regulators understand these challenges and some are making progress. Enforcement strategy is a theme of a document recently published by the Health and Safety Executive,<sup>15</sup> and the Environment Agency's consultation *Delivering for the Environment*.<sup>16</sup> Building on this work, the Government has asked Philip Hampton, former finance director of LloydsTSB, BT and British Gas, to consider, with business, regulators, and in consultation with the BRTF, the scope for promoting more efficient approaches to regulatory inspection and enforcement while continuing to deliver excellent regulatory outcomes.

**Greater regulatory certainty** **3.58** In Budget 2003 the Government committed to making changes to employment regulation on only two dates each year, unless European obligations require otherwise. This approach, providing greater certainty about changes to the regulatory environment, has been welcomed by business. **The Government will consult formally with businesses next month on the feasibility of extending common commencement dates to other areas of regulation and tax. In parallel, the Department for Environment, Food and Rural Affairs will study the feasibility of extending the approach to environmental regulation.**

**Tackling regulations across key sectors** **3.59** Alongside the strengthened central scrutiny of new regulatory proposals outlined above, Government Departments will continue to engage directly with businesses to tackle unnecessary regulations across key sectors. The sectoral reviews announced in Budget 2003 are progressing well:

- **for the construction, chemicals and retail sectors, the Government will establish new industry/cross-government forums on policy and regulatory development**, to give early warning of, and allow industry to express its views on, emerging policy and regulatory proposals; and
- following concerns expressed by the construction industry on unreasonable delays in payment, **the Government will review the operation of the adjudication and payment provisions in the Housing Grants, Construction and Regeneration Act 1996** to identify what improvement can be made.

**3.60** The two-year review of the Financial Services and Markets Act 2000 proposes making it easier for Citizens Advice Bureaux and similar organisations to advise their clients without being subject to Financial Services Authority regulation. Similar steps are proposed in relation to employers advising employees on pensions.

## Enterprise in Europe

**3.61** The Government is also working with its European partners to promote enterprise in Europe. The Finance and Industry Ministers of the UK, France and Germany recently submitted joint proposals to the European Commission and other Member States setting out the priority actions to boost enterprise in Europe.<sup>17</sup> The Government believes these proposals, alongside those to improve the quality of regulation in Europe and a new European Centre of Enterprise competition, provide a concrete framework for further action. This work will be taken forward as part of the Commission's Action Plan on Entrepreneurship.

<sup>14</sup> *Independent regulators*, Better Regulation Task Force, October 2003.

<sup>15</sup> *A strategy for workplace health and safety in Great Britain to 2010 and beyond*, Health and Safety Commission, February 2004.

<sup>16</sup> *Delivering for the environment*, Environment Agency, October 2003.

<sup>17</sup> *Towards an enterprising Europe*, A paper by the French, German and UK Governments, January 2004.

## SCIENCE AND INNOVATION

**3.62** Science and innovation lie at the heart of the UK's prosperity and quality of life. Scientific and technological advances are necessary to help tackle many of the UK's national challenges, particularly in health and environmental protection. In an increasingly knowledge-driven global economy, a high-quality science base and a strong supply of science, engineering and technology skills are also critical for the UK's innovation performance and long-term competitiveness.

**Ten-year investment framework for science and innovation**

**3.63** The Government will publish a ten-year investment framework for science and innovation alongside the 2004 Spending Review. The framework (detailed in Box 3.4) will set out the Government's ambition for UK science and innovation over the next decade. In drawing up this framework, the Government is consulting key stakeholders including the scientific community, businesses, charities, and regional and devolved bodies. The Government published a consultation document on 16 March 2004.<sup>18</sup>

**3.64** **To maintain the momentum of recent reforms, funding and improved outcomes from the science base, the Government will ensure that the level of public investment here will grow faster than the trend rate of GDP growth over the Spending Review period 2005-06 through to 2007-08.** Further, in order to ensure that this growth in spending is well matched to the needs of the economy as a whole, the Government hopes to see parallel commitment from major business, charity and public sector funders of UK R&D to their own engagement in the future of British science over the next ten years. The strength of this response from others will be a crucial factor in the scale of the Government's commitment and the success of this strategy for the UK.

**Box 3.4: The ten-year investment framework for science and innovation**

In January 2004, the Chancellor announced that the Government would develop, as part of the 2004 Spending Review, a ten-year investment framework for public and private investment in science and innovation to provide a medium-term platform for innovation and productivity growth.

The framework will set out the attributes and funding arrangements of a research system capable of delivering the Government's key aims:

- world-class research at the UK's strongest centres of excellence;
- sustainable and financially robust universities and public laboratories across the UK;
- a continuing step change in the responsiveness of the research base to the needs of the economy and public services;
- increased business investment in R&D, and increased business engagement with the UK science base when seeking ideas and talent;
- a supply of science, technology, engineering and mathematics skills more responsive to the needs of the economy, and greater flexibility within schools and universities to attract the skills they need; and
- confidence across UK society in scientific research and innovative applications.

The consultation document sets out the Government's considerations and key questions in these areas.

<sup>18</sup> *Science and innovation: working towards a ten-year investment framework*, Department for Education and Skills, Department of Trade and Industry and HM Treasury, March 2004.

**3.65** A key focus of the investment framework will be the contribution of science and innovation to the Government's public service priorities, particularly in supporting the Government's health modernisation agenda, and delivering better, more personalised healthcare services to patients. Following reports by the Bioscience Innovation and Growth Team and the Academy of Medical Sciences, the Government will work with the NHS, industry and the medical charities to strengthen clinical research in the UK. The ten-year investment framework will also consider what more could be done to ensure that clinical research plays its full role in generating health and economic benefits in the UK. To support this work, **the Department of Health will increase the NHS funding for R&D by £100 million by 2008**. This will provide a stronger platform for growth in Government investment in medical research, including through the Medical Research Council, and will complement business and charity-funded clinical research efforts. This should allow the combined budget for medical research and for R&D within the NHS to rise to around £1.2 billion a year by 2007-08.

**Box 3.5: Partnerships in medical research: the UK Clinical Research Collaboration**

Four years ago, the Government recognised the advantages of developing research partnerships to help tackle major diseases. As a first step it set up the National Cancer Research Institute (NCRI). This has been a great success, and works closely with the National Cancer Institute in the US. The Government now wishes to extend partnership working to cover a much wider range of medicine, and has therefore decided to create a new UK Clinical Research Collaboration (UKCRC) involving the Medical Research Council, the Wellcome Trust and other medical charities, the NHS, industry and patients themselves. Its purpose will be to achieve effective and efficient translation of scientific advances into patient care, thereby improving national health and contributing to national wealth.

The first major initiative of the NCRI was to create cancer research networks, which succeeded in doubling the number of patients involved in clinical trials of new anti-cancer drugs within two years, such that overall numbers are now similar to those in the USA. This idea will now be extended to other disease areas covered by the UKCRC, with funding and research efforts targeted on diseases that place a high burden on the nation.

**DTI Innovation Report 3.66** The DTI Innovation Report, published in December 2003,<sup>19</sup> highlights the UK's excellent science base and record of accomplishment in invention, but explains that more needs to be done, including in the service sector, to ensure the successful exploitation of new ideas and secure our future prosperity in an increasingly global world. Proposals in the Report now being implemented include:

- a £150 million National Technology Strategy to provide a framework for policy priorities and focus support on innovation;
- new procurement guidelines to make government a more intelligent customer and encourage innovation through its supply chain; and
- an increased role for the Small Business Service in promoting innovation and knowledge transfer.

<sup>19</sup> *Competing in the global economy: the innovation challenge*, Department for Trade and Industry, December 2003.

**3.67** The Secretary of State for Trade and Industry is chairing a Ministerial team to lead the innovation agenda across the whole of government and to drive forward the action plan of the Report.

**Lambert Review  
of business-  
university  
collaboration**

**3.68** The final report of the Lambert Review, an independent review of business-university collaboration, was published in December 2003 and made a series of recommendations aimed at improving the links between the UK's strong science base and the business community.<sup>20</sup> The Government recognises the importance of this policy agenda and is strongly supportive of the analysis in the report.

**3.69** The Government's ten-year investment framework on science and innovation requires linkage at national, regional and international levels. Within this framework of national-regional partnership, the Government intends to develop the main strands of policy reform put forward by the Lambert Review, including:

- **building the Higher Education Innovation Fund as a permanent third stream of funding** for universities in England to further build the university sector's capacity for knowledge transfer;
- **working with universities and businesses to develop a set of model collaboration contracts and to undertake further work on the development of an intellectual property protocol;**
- **enhancing the role of the English RDAs in strengthening business-university links.** The Government believes that the RDAs are well placed to promote business-university collaboration, but recognises that they need the capacity and links to national innovation programmes to do this most effectively. The Government will continue to explore with the RDAs and other stakeholders the best mechanisms for fostering business-university collaboration;<sup>21</sup> and
- **working with the Funding Councils and other agencies to explore further whether a workable lighter-touch approach to risk-based regulation of the university sector can be developed.**

**3.70** Full details are set out in the Government's science and innovation consultation document and comments on the Government's initial proposed response to the Lambert Review are invited. The Government's final response will be published this summer as part of the ten-year investment framework.

**R&D tax credits**

**3.71** Improvements to the R&D tax credits scheme were announced in the 2003 Pre-Budget Report. The new definition of R&D published by the DTI has been welcomed by business as easy to use and clear, and will come into effect from 1 April 2004. An extension to the range of qualifying costs was also announced at the 2003 Pre Budget Report. Expenditure on software, power, water and fuel will all qualify for the tax credit, providing £35 million of additional support. The definition of materials consumed during the R&D process will also be revised.

**3.72** With these further extensions and clarifications the tax credit will provide an even greater incentive for companies to invest in R&D. **The Inland Revenue will produce new guidance in support of the R&D tax credit in advance of the 2004 Pre-Budget Report. It will also embark upon a programme to improve delivery of the credit so that companies get the most benefit from the reliefs and funds available.**

<sup>20</sup> *Lambert review of business-university collaboration: final report*, Richard Lambert, December 2003.

<sup>21</sup> The devolved administrations have primary responsibility for working with their own development agencies to improve business innovation and economic performance in their respective countries, including through strengthening business-university collaboration.

**Science Research Organisations 3.73** The 2003 Pre-Budget Report announced that proposals would be brought forward in Budget 2004 to refine the treatment of Scientific Research Organisations (SROs). The Government proposes:

- updating the tax exemption for SROs and bringing it in line with the new definition of R&D used for tax credits purposes; and
- reducing compliance costs by replacing the current DTI-administered clearance system with a new monitoring procedure operated by the Inland Revenue.

**3.74** The Government will work with SROs and their representatives to ensure that the new legislation puts the original aims of the tax exemption in a modern context, while deregulating the sector wherever possible. To enable a managed transition, the required legislative changes will be brought forward in Finance Bill 2005.

**Innovation in Europe 3.75** The innovation performance of the EU remains poor relative to some of its major international competitors'. In April 2003, EU leaders endorsed an Action Plan to try and raise public and private expenditure on R&D to approaching 3 per cent of GDP by 2010. The Government welcomes this initiative, but believes that additional investment must be backed by wider action to tackle the structural barriers to innovation itself. To address this challenge, the Finance and Industry Ministers of the UK, France and Germany recently submitted joint proposals<sup>22</sup> to the European Commission and other Member States setting out a range of priority actions to strengthen innovation in Europe. The Government hopes that these proposals will be fully reflected in the Commission's forthcoming Action Plan on Innovation.

## SKILLS

**3.76** A dynamic and flexible economy needs skilled workers, better equipped to adapt effectively to change. *Flexibility in the UK economy*, published alongside this Budget, sets out the need for a flexible economy, and the role that workforce skills have to play in that. Chapter 4 describes the next steps in the Government's strategy for promoting employment opportunity for all.

**3.77** UK unemployment is now the lowest of the G7 economies and employment is at a record high. However, while the proportion of people in the UK with high skills compares well internationally, the share of the workforce with intermediate skills is relatively low and, despite improvements over the last few years, there is still a large stock of low-skilled workers.

**3.78** Tackling the number of people with no or low skills is therefore a key priority for the Government. More than one-third of the workforce has qualifications below level 2 (equivalent to five GCSE passes at grade C or above). Seven million have basic skills needs in literacy or numeracy.<sup>23</sup> The case for helping individuals acquire level 2 skills is strong. They are important in their own right and provide an essential platform for improving employability and progression to higher skills. However, it is at these lower skill levels that market failures appear to be most significant – those with lower level qualifications, or none at all, are much less likely to receive training. This is where the challenge is greatest.

<sup>22</sup> *Towards an innovative Europe*, A paper by the French, German and UK Governments, February 2004.

<sup>23</sup> *The Skills for Life Survey: A national needs and impact survey of literacy, numeracy and ICT skills*, Department for Education and Skills, October 2003.

**3.79** The White Paper *21st century skills*<sup>24</sup> sets out a national skills strategy to ensure employers have the right skills to support the success of their business, and individuals have the skills they need to be employable and personally fulfilled. The Government is determined to build on this foundation, by tackling the barriers to skills acquisition and training for the low skilled, to help them gain qualifications to move into sustainable and productive work and, through work, progress to higher skills levels and better paid jobs. This is a challenging goal which cannot be achieved by the Government alone. Building on the Skills Strategy, and in following the National Employment Panel's report,<sup>25</sup> the next stage in tackling the low skills problem is to set out clear rights and responsibilities of individuals and employers with respect to skills, and the steps which the Government must take to ensure appropriate support, extend choice, secure an efficient consumer driven system, and provide an informed and effective lead. This compact is the Government's New Deal for skills.

### New Deal for skills

**3.80** Building on the Skills Strategy, the New Deal for skills will be a major step forward in ensuring that each individual is helped to develop the skills he or she needs to be employable and each employer - whether in the private, public or voluntary sector - can develop the skilled workforce needed for the success of his or her business. To realise this aim, high quality training must be accessible for every individual and employer requiring additional skills, to improve their employment prospects and the success of their business. Box 3.6 summarises the New Deal for skills.

**3.81** To deliver these aspirations the Government will ensure that its skills and employment services:

- are restructured around the consumer rather than the producer, giving a stronger voice for employers, particularly through the work of Sector Skills Councils;
- clearly set out rights and responsibilities for individuals and employers in return for government help; and
- support clear pathways for progression beyond subsidised training towards higher skill levels.

### Welfare, work and learning

**3.82** There is good evidence that the longer someone spends on benefits, the harder it is to move into work. The Government's primary aim is therefore to get people into work as early as possible. In most cases, entering work provides the best foundation for remaining and progressing in work. However, accessing appropriate training can be difficult for some while in work, and for others appropriate training may be a prerequisite to getting sustainable and productive work in the first place. Benefit claimants currently have access to a wide range of skills assistance:

- work-based learning for adults provides occupational training, basic skills, and employability training;
- the New Deals provide several training options, from full time education to short, job-focused occupational training;
- the Employment Retention and Advancement pilots offer a package of support to help low wage workers advance in the workplace, including an in-work training bonus; and
- large numbers of benefit claimants also take up Learning and Skills Council (LSC) funded education or training part-time.

<sup>24</sup> *21st century skills: Realising our potential*, Department for Education and Skills, July 2003.

<sup>25</sup> *Welfare to workforce development*, National Employment Panel, February 2004.

**Box 3.6: New Deal for skills**

It is in the common interest of individuals, employers and the wider economy that every adult has the NVQ level 2 skills, which are the platform for further training and future job prospects in a modern economy. The Government's aim, through the New Deal for skills, will be to offer:

- all individuals the opportunity to check the benefits they could receive from further training; to understand how they can get that training might be obtained and what support they can expect from the Government or their employer; and a clear and straightforward access point to comprehensive consumer-focused skills advice;
- all individuals with low skills – employed or unemployed – a local skills advice point, through which they can get access to free comprehensive information and advice;
- for all those in work, free high-quality and flexible training leading to a first full level 2 qualification, focused on the skills they need for employment;
- for those without work, improved access to high-quality advice and training; and
- for all employers better advice and more flexible support to meet the skills needs of their business and the training needs of their workforce, including free and flexibly-delivered training for their low-skilled workers.

The New Deal for skills will build on the New Deal for work and the policies already in place, or that are planned under the Skills Strategy, including:

- free training in basic literacy, numeracy and ICT skills including help in English, where needed, for speakers of other languages;
- free training to a first full NVQ level 2 qualification (focused on work-based learning providing occupational training, basic skills and employability training) with piloting of this entitlement due to commence later this year;
- improved adult information, advice and guidance services;
- a redesigned, more flexible qualification and curriculum structure; and
- a higher quality and more flexible service from training providers.

To help the Government achieve its aims the New Deal for skills introduces more measures to help people move from low to higher skilled work. They include:

- measures and pilots to improve the incentives and help available to those out of work to gain new skills, move into work and then get on at work. These are set out in more detail in Chapter 4;
- better joint working between Jobcentre Plus offices and Information Advice and Guidance (IAG) partnerships to offer a more integrated skills service in Jobcentre Plus offices;
- development of a 'skills passport' to help individuals to make the move from welfare into sustainable work, to build a record of skills and competences gained and to transfer skills between jobs; and
- a further extension of Employer Training Pilots (ETPs) to cover over one third of England.

**3.83** As part of its employment strategy, set out in Chapter 4, the Government is increasing the support and training people can access to develop their skills while claiming benefits, as a basis for helping them move into sustainable and productive work. With the New Deal for skills, when people move into employment, the Government will expect and encourage their training to continue.

**Information, Advice and Guidance 3.84** As part of the New Deal for skills, Jobcentre Plus will work with IAG Partnerships to ensure skills counselling is available in Jobcentres. Better joint working will help focus training on qualifications that best support employability. These skills counsellors will be located in and integrated with the work of Jobcentre Plus offices, as well as linking closely to local colleges and training providers. Jobcentre Plus will ensure that its customers are able to access *Learndirect* and other relevant websites. Further detail is provided in Box 3.7.

**Box 3.7: Information, Advice and Guidance services**

There is clear evidence that access to IAG services increases the likelihood that individuals will enter learning, and that they will achieve a qualification from their study.

The Government wants to ensure that individuals have the advice and support they need to make decisions about training based on a full understanding of how it is likely to enhance their employability. To this end some IAG local services are working together with Jobcentre Plus to ensure advice is available in Jobcentre Plus offices. The Government's aim is to build on this approach, so that skills counsellors can make personal assessments of the skills people need to progress into sustainable and productive work, and to improve their earnings and career prospects. Counsellors will also be able to explain their entitlements to learning and support and to guide them towards the training and qualifications that will best develop their skills. This will make services easier to access, more personalised and clearly linked to enhancing employability

The Skills Strategy recognised that there is currently a lack of consistency in the range of IAG services being delivered, depending on geographical location. As a step towards better coherence, the Strategy committed to the integration of *Learndirect*, which provides a national information and advice service, with the work of local IAG services. The new National Policy Framework for IAG has set out a minimum standard for access to core services including:

- 24 hour access to the website to submit e-mail requests;
- freephone access to the integrated IAG service through a national Entry Point;
- centres for information available at least five days a week;
- appointments for advice available outside normal working hours; and
- outreach provision.

This core service is to be launched in August 2004. It will be accompanied by a strategy to raise awareness and visibility of IAG services.

Provision of comprehensive advice, guidance and support direct to employers particularly for SMEs is also important. The new on-line training directory, described earlier, will help ensure SMEs have access to a range of online courses and a directory of other available courses that can help these businesses to succeed.

**Skills passports 3.85** As part of the New Deal for skills, the Department for Education and Skills will look into developing the concept of 'skills passports' informed by similar schemes such as the e-Skills UK passport and the Small Firms Development Account. Such a scheme could help make the move from welfare into sustainable employment easier, enable participants to build a record of skills and competences and help them transfer skills between jobs. This could link to the sector-based passports that have been developed through Sector Skills Agreements. These passports already allow learners to compile records of training and skills gained, structured according to the employers' needs for skills and accumulating over time to secure recognition through qualifications. Further detail is provided in Box 3.8.

**Box 3.8: Skills passport**

The Skills Strategy sets out how the principles of Individual Learning Accounts have been integrated into a broader strategy, based around a series of entitlements to free training. As part of the Government's ambition to engage those with low or no skills in learning, and take forward principles from the ILA scheme, evidence is emerging from sector pilots of the benefits of using skills passports.

The Construction Skills Certification Scheme (CSCS)<sup>a</sup> aims to register every competent construction operative within the UK not currently on a skills registration scheme. Operatives will get an individual registration card which lasts for three or five years. The CSCS card also provides evidence that the holder has undergone health and safety awareness training or testing.

CSCS is owned and managed by CSCS Limited, controlled by a management board whose members are from The Construction Confederation, Federation of Master Builders, GMB Trade Union, National Specialist Contractors Council, Transport and General Workers Union and Union of Construction Allied Trades and Technicians.

Observer members include the Department for Education and Skills, the Department for Environment, Food and Rural Affairs, the Department for Transport, the Health and Safety Executive and the Confederation of Construction Clients.

<sup>a</sup>More information is available at [www.cscs.uk.com](http://www.cscs.uk.com).

## Developing the skills of young people

### Improving post-16 participation

**3.86** Raising the participation rate of young people in education and training is central to meeting the demand for skills in a dynamic, modern economy. The Government is committed to ensuring that all young people reach the age of 19 ready for higher education or skilled employment. To deliver this, the Government is:

- reforming the financial support system for this age group to support choice and progress, with the right to support conditional on a responsibility to engage in learning. The report on the review of financial support for 16 to 19 year olds, published alongside this Budget and summarised in Chapter 5, sets out a short-term programme of improvements to the current system and a longer-term vision for a radically simplified financial support system for 16 to 19 year olds;
- reforming the curriculum to improve vocational pathways and more flexible programmes of learning for all young people. To inform the Government's thinking on long-term strategy, the Working Group on 14 to 19 Reform, led by Mike Tomlinson, published its interim report in February 2004 proposing a flexible multi-level diploma system.<sup>26</sup> The group will present its final recommendations in the Autumn;
- expanding the quality and quantity of training supplied through stronger accountability and incentives for further education providers and through the expansion of the Modern Apprenticeship (MA) programme. With 255,000 young people now engaged in MAs, the Government is on track to meet its 2004 PSA that 28 per cent of young people start an MA; and

<sup>26</sup> *14 - 19 curriculum and qualifications reform*, Interim Report of the Working Group on 14 - 19 Reform, February 2004.

- reforming the advice, guidance and support structures better to fit need. This will include both the role of schools and colleges and the personal adviser model developed by Connexions. It will also look to ensure that parents have access to relevant advice and information, which will inform the support they offer their children when they make their learning decision.

## Improving workforce learning

**Raising skills through professional bodies** **3.87** *Delivering an incentive to membership bodies to provide workforce development,*<sup>27</sup> published alongside the 2003 Pre-Budget Report, outlined the principles that the Government believes should underpin any reform of the current tax relief for fees and subscriptions to membership-based organisations. The paper has prompted a range of responses, which the Government is evaluating. The Government will continue to discuss with interested parties how the relief can be better targeted, in order to promote training and skills opportunities across the workforce and will bring forward proposals.

**Employer Training Pilots** **3.88** The Government is currently testing ETPs to help employers stimulate demand and train their low skilled staff. As announced in the 2003 Pre-Budget Report, the Government is extending ETPs for a third year to cover over a third of England. **New pilots will operate from September 2004 in the North East region, Lancashire, the Black Country, West Yorkshire, Cambridgeshire, and Devon and Cornwall,** helping to strengthen evaluation of the scheme.

**3.89** The pilots offer a package of support to help low-skilled people in work gain basic skills or their first level two qualification, and provide an option for those out of work to move into supported employment. Employers who offer their low-skilled staff paid time off to train are provided with compensation for wage costs (varying by firm size and pilot area). Training is free or heavily subsidised. A key element of the scheme is that employers are offered skills audits to ensure that the training meets their business needs and the needs of their staff. Training is flexibly provided to ensure minimum disruption to the business and their employees. The training package is developed with the support of brokers who can help design and source the training to ensure that it is delivered in a way that meets the employer's needs. Early evidence suggests that the pilots are proving successful at engaging low-skilled employees in training. By March 2004, over 7,000 employers had signed up to the pilots and approximately 39,000 employees had committed to improving basic skills or gaining a first NVQ level 2. Over 70 per cent of employers involved have less than 50 employees and 40 per cent have not had any previous contact with Government agencies.

**Regional Skills Partnerships** **3.90** Following the Skills Strategy White Paper, the RDAs have been working in partnership with the SBS, local LSCs, Jobcentre Plus, the Sector Skills Development Agency and other regional stakeholders to develop Regional Skills Partnerships. The first of these will be in place by April 2004. The Government is committed to tackling any institutional barriers identified by the Regional Skills Partnerships to creating an effective and integrated approach to regional skills delivery, taking into account the balance with national policy. Further details are provided in *Devolving decision-making: 2 – Meeting the regional economic challenge*, published alongside this Budget.

<sup>27</sup> *Delivering an incentive for membership bodies to provide workforce development: a discussion paper*, HM Treasury and Inland Revenue, December 2003.

## Migration

**3.91** Migration helps to raise productivity and boost economic growth by increasing labour supply and reducing domestic skills shortages. The UK benefits from free movement of labour within the EU, and to maximise these benefits, the Home Secretary has recently announced that workers from accession states will be allowed to access the UK labour market from 1 May 2004, subject to a worker registration scheme.

**3.92** The Government is also committed to promoting schemes to attract unique talent to the UK, recognising in particular the potential of international students, and will therefore:

- introduce over the coming months **a new entitlement for graduates of the world's top 50 business schools to work in the UK for up to 12 months on completing MBAs;** and
- build on pilot measures announced last month by the Scottish Executive to establish a new Relocation Advisory Service streamlining the services involved in migration, and allow graduates from Scottish universities to remain in Scotland for up to two years to live and seek work. If successful, an extended scheme could provide greater freedom for other parts of the UK to attract migrants. This will benefit regional economies and communities.

## INVESTMENT

**3.93** Alongside a skilled labour force, greater investment in physical capital, both public and private, is essential to support a productive economy. The Government is taking steps to improve the environment for private investment and investment decision-making by providing a platform of macroeconomic stability, promoting flexibility in capital markets, and addressing specific market failures in planning and the housing market.

## Non-residential planning

**3.94** A simpler, more flexible and transparent planning system is an important element in raising productivity and delivering the Government's economic, social and environmental objectives. Reforms to the system are being delivered through new legislation, with the first Planning Bill for more than a decade currently before Parliament. Investment in the Planning Delivery Grant has been increased; and the Government is undertaking wide-ranging revision to national planning guidance. It has recently completed the public consultation process for its revised planning policy statement on town centres in England, which aims plan for growth in town centres, expand the boundaries of town centres where this will facilitate further development, promote consumer choice and promote social inclusion.

**3.95** The Planning Bill introduces significant reform to planning system. Its measures include:

- the creation of Regional Spatial Strategies, which will link closely with economic, housing and transport strategies;
- the introduction of a more flexible system based on local development plans;
- statutory timetables for ministerial casework;
- reform to the compulsory purchase system;
- the introduction of Business Planning Zones; and
- reform to Planning Obligations.

## Delivering stability: securing our future housing needs

**3.96** The Government welcomes Kate Barker's review of housing supply *Delivering stability: securing our future housing needs*, published today. A summary of the Review's recommendations is set out in Box 3.9. The Review has fulfilled its remit to consider the weak responsiveness of new housing supply to rising house prices in the UK and the consequences this has in terms of macroeconomic volatility and the diminishing affordability of housing to individuals.

### Box 3.9: The Barker Review of housing supply

The Barker Review's final report states that the UK has experienced a long-term upward trend in real house prices, 2.4 per cent per annum over the last 30 years. To improve macroeconomic stability and deliver greater affordability for individuals a lower trend in house prices is desirable:

- in order to deliver a trend in real house prices of 1.8 per cent an additional 70,000 houses in England might be required;
- to bring the real price trend in line with the EU average of 1.1 per cent an extra 120,000 houses might be required; and
- the Review's scenarios also call for additional social housing new build of between 17,000 and 23,000 units a year.

The Review sets out a number of recommendations for improving the functioning of the housing market:

- a long-term goal for improved market affordability should be set;
- investment in social housing should be increased over time building up to an additional £1.2 to £1.6 billion per annum;
- Regional Planning Bodies and Regional Housing Boards should be merged to create a single body responsible for managing regional housing markets supported by independent advice on the steps required to achieve affordability goals;
- the introduction of a Planning-gain Supplement to capture some of the development gains that landowners benefit from, and as a fair means of releasing resources to increase housing supply;
- the establishment of a Community Infrastructure Fund to help to unlock some of the barriers to development; and
- that local authorities should be allowed to 'keep' the council tax receipts from new housing developments for a period of time to provide incentives for growth and to meet transitional costs associated with development.

**Housing supply 3.97** The Government's objectives for the housing market are to promote stability, sustainability, flexibility and fairness. Locking in economic stability means being more vigilant in matching supply and demand. The Barker Review shows that in order to deliver long-term stability, the current level of housebuilding will not suffice and a substantial increase in housing supply is required. A failure to increase supply risks increasing excess demand for housing and the threat of further volatility in the wider economy. A failure to increase supply also means diminishing affordability of housing in the private sector. The Barker Review also shows how house price inflation has made home ownership in the private sector increasingly unaffordable for many groups in the population, particularly for first-time buyers, with knock-on impacts on rent levels in the private sector and on demand for social housing, which already outstrips supply. The Government is concerned about the impact of this diminishing 'market affordability' on social exclusion and on the opportunities available to young people and others.

**3.98** The Review sets out a challenging analysis of future housing needs. The scenarios it presents suggests that current levels of house building – 160,000 homes a year in England plus a total of 200,000 in the four Growth Areas by 2016 – are insufficient and would need to increase by between 70,000 and 120,000 units per annum to improve affordability trends and to as much as 200,000 units per annum to deliver stable house prices in real terms.

**3.99** The Government needs to balance the economic and social case for development against its environmental and wider implications, and ensure that development is sustainable and protects valuable countryside. The Review recognises the steps the Government has taken through the Sustainable Communities Plan to increase housing supply in a sustainable way in the wider South East, by requiring the efficient use of land through density targets, and to avoid exacerbating problems of low demand and abandonment in parts of the North and Midlands. However, the Review argues that the Government needs to build on that momentum and increase housing supply levels further if it is to meet its economic and social aims. As the Review itself points out, increasing development by 200,000 units a year might put at risk this sustainability and endanger our environmental objectives. Equally, however, the Review states that current supply levels are not sufficient. The Review recommends that to deliver improved affordability, levels of house building would need to rise by over 70,000 units and towards 120,000 units per annum.

**3.100** The Government agrees that to deliver its commitment to stability and affordability a significant increase in development over time is needed. The Government will need to consider the scale of such development and how it can be delivered both in high demand areas and in areas suffering problems of low demand. **The Government will establish a long-term goal for affordability in the housing market incorporated within the PSA process as recommended by the Barker Review.** This goal will need to be reflected at a regional level through regional targets as part of the process of setting regional housing numbers. The Government will consult on the consequences of such development and how this should be reflected at the regional level over the course of the next 18 months.

**Planning 3.101** The Barker Review sets out challenging reform proposals to deliver increased supply to central, regional and local government, and the development industry. **The Government accepts the need for reform and intends to implement a programme of change as recommended in the Review.** The Government will therefore consult with stakeholders to:

- consider how Regional Planning Bodies and Regional Housing Boards can be merged to create a single body responsible for managing regional housing markets and making recommendations to the Government on the distribution of the single housing pot in their regions and how they can be supported by stronger independent advice on the steps required to achieve affordability goals. The Government will come forward with proposals by the summer with a view to implementing them in 2005. Such a structure could also provide the model for planning and housing within elected Regional Assemblies, though this will be for the Assemblies to decide;
- improve the delivery and responsiveness of the planning system by allocating land in a way that provides developers with sufficient land to ensure the delivery of agreed housing numbers and more choice as to which sites to develop. This incorporates market-based triggers to ensure additional land is released where this is needed to balance local housing markets. Government will issue guidance on how these proposals should be reflected in Local Development Frameworks;

- revise planning policy and guidance and consult on it this year, including guidance on determining the scale and allocation of housing at the regional level and the application of market information and signals, a presumption in favour of brownfield development, and the scope for taking account of the relative value society places on different land uses;
- issue planning guidance on the interpretation of the presumption in favour of granting planning permissions which conform to local plans and the realistic availability of sites. The Government will also provide a clearer basis for Regional Spatial Strategies to reflect regional circumstances which justify departure from national policy;
- publish further guidance on the composition of Regional Planning Bodies and the need for a full range of regional stakeholders to be represented on these bodies;
- set out the choice of routes available to housing developers through the planning system, including clarifying the distinction between outline and detailed planning permission and the greater use of design codes backed by Local Development Orders;
- speed-up planning decisions. The Deputy Prime Minister has announced £130 million for 2004-05 in Planning Delivery Grant (PDG) allocations to reward good planning performance, including housing delivery in growth areas and performance on appeals to drive strategic plan making. Allocations of the £170 million PDG for 2005-06 will include a link to housing delivery more generally, to enable and incentivise authorities to deliver improved housing outcomes and to promote progress on e-planning; and
- look to assist local authorities to focus on key development through considering the coverage of Permitted Development Rights and help deliver large-scale sites including through best practice and assistance from the Planning Advisory Service and English Partnerships.

**Delivering 3.102** The Government also accepts the need for reforms to more effectively deliver development housing development, through:

- agreeing to the need to provide incentives to support infrastructure to enable housing development, as suggested in the Community Infrastructure Fund, and will consider how to start to undertake this as part of the 2004 Spending Review;
- building on the Local Authority Business Growth Incentive scheme to consult on ways to give incentives to local authorities to deliver housing growth. The Government can see the case for such an incentive scheme and will come forward with proposals for consultation;
- considering how Government policy and allocation decisions for infrastructure across all relevant departments take account of planned housing, employment and population growth alongside other priorities, including the potential for developer contributions. The Government will also consider how the Highways Agency and utilities are involved in developing regional and local strategies and have clear remits to work to minimise delays to development;
- asking English Partnerships to take a lead role in assembling complex sites for development, including the use of Public Private Partnerships, surplus public sector land, and joint ventures where necessary and within a set of principles defining where and when it should intervene in the market; and

- regularly reviewing the need for special purpose vehicles in consultation with regional and local planners, including where housing undersupply remains a persistent problem.

**Industry 3.103** Delivering increased housing supply requires a housebuilding industry with the capacity and skills to deliver supply in the most cost effective manner and to time. The Government and the industry must work in partnership to deliver this with all sides playing their part. The Barker Review sets out a series of challenging reform proposals to the industry to increase customer satisfaction, tackle skills shortages, increase the flow of new houses onto the market, reduce the time taken to build out new sites, and improve design and use of modern methods of construction. The Review considered the case for an investigation of the industry by the OFT but suggests this is not yet necessary. It is for the industry, in partnership with Government, to respond to these recommendations, together with the recommendations from the forthcoming review of skills by Sir John Egan. **The Government will consider the progress made by summer 2005.**

**Monitoring development 3.104** As recommended by the Barker Review, the Government will establish an independent review of the housing market in no more than three years' time and actively look to improve the evidence base for housing policy and data availability drawing on expertise from the relevant sectors. The Government has also asked Kate Barker to undertake a continued role in monitoring delivery of the whole reform programme.

**Economic incentives 3.105** The Barker Review's analysis has considered the need for incentives and additional resources to facilitate delivery. The Review assesses whether fiscal measures coupled with targeted spending could deliver long-term stability and affordability through an increase in the housing supply. The Review recommends that as housing supply increases the number of social houses needs to rise to meet society's needs. It concludes that investment in social housing must increase and the efficiency of the sector must improve to deliver this supply. The Government accepts that there is a case for increased investment in social housing. It will begin to address this in the 2004 Spending Review. The Government accepts that there are limits to what is achievable within the current fiscal framework and accepts the need for incentives to deliver a long-term solution.

**Taxation of land 3.106** The Barker Review considers the efficient taxation of land and of development on that land. The Review concludes that increased revenues are needed to support greater expenditure on social housing, the infrastructure needed to complement new housing, and to provide the right incentives for local authorities to expand housing provision. These revenues can and should be provided out of the increase in land values associated with new residential development.

**3.107** When agricultural land is sold for development very large gains are often realised that arise mainly because planning permission has been granted. This is known as 'betterment'. The Barker Review has looked at two principal options for a charge based on this increase in land values, in order to provide the resources to fund the Review's other recommendations. These options are:

- *VAT on new housing on greenfield land* – the Review has looked closely at this tax and concluded that VAT on new greenfield housing would have several disadvantages. VAT is a national tax covered by EU legislation, which sets significant constraints on how flexibly it can be levied, and may mean that it is difficult in practice to target VAT at betterment without an adverse impact on incentives to develop new housing; and

- *Planning-gain Supplement* – the Review also looked at the option of supplementary contributions to the Exchequer based on increases in land values and linked to the granting of planning permission. It concluded that this provides a better-targeted and more flexible charge. It could, for example, have lower rates for brownfield development, and thus provide a fair share of the gain in land values to support expansion in housing supply, while incentivising growth in the right areas. The Review concluded that such a charge would have no material effect on either the price paid by householders or on the incentive to develop new housing.

**3.108** The Barker Review concludes that a Planning-gain Supplement is likely to be more effective than VAT in providing an appropriate and efficient source to release resources to help in the expansion of housing supply providing it can be successfully designed and implemented. The Supplement would be levied on the increase in land values at the stage of planning permission, as a fair means of releasing resources. This would be accompanied by the scaling back of section 106 agreements linked with Local Authorities receiving a share of the development gain generated by this measure. As well as expanding housing supply and locking in macroeconomic stability, this package of measures would alter the balance of incentives between greenfield and brownfield development, helping to encourage a more efficient use of land including an added incentive for brownfield land use.

**3.109** There are a range of other measures considered by the Review, including Property Investment Funds (PIFs), a UK version of the successful US Real Estate Investment Trusts, and a Derelict Land Tax Credit. The Government agrees with these suggestions and is consulting on the introduction and structure of PIFs, as discussed below, to improve the efficiency of the property investment market and encourage an expansion of the private rented sector. The Government also aims to introduce, following further evaluation, a Derelict Land Tax Credit that could provide a tax incentive for the development of derelict brownfield land, as discussed in Chapter 7.

### Delivering the Barker package

**3.II0** The Government accepts that, in order to meet the key objectives of stability and improved market affordability, there is a good case for additional social housing investment, incentives to local authorities to deliver housing growth, support for infrastructure to complement new developments, and potentially support to the industry to train their employees to deliver this challenging agenda, all of which would require additional investment. The Government agrees that it is in principle fair to fund this proposed package of measures out of the uplift in land values experienced during the development process.

**3.III** Delivering long-term stability will require the delivery of all the elements within this overall package. The Government will work with stakeholders to ensure that the necessary conditions are in place for the Barker Review's proposals to succeed. Therefore, in considering a package of reforms to follow the Barker Review, the Government will need to be sure that:

- planning reforms are underway and the system is delivering a coherent and efficient service;
- there is a positive impact on supply from the introduction of these incentives;
- the industry is responding to the Review's recommendations and is capable of rising to the challenge;
- the 2004 Spending Review has begun to put in place increased investment for social housing; and
- the design of the proposed Planning-gain Supplement is effective and workable.

**3.II2** The Government will review progress against these objectives by the end of 2005. If the Government is satisfied that they are all on track, it will bring forward this package of measures to deliver economic stability and improved market affordability address housing needs.

**An efficient property investment market** **3.II3** The Government has today launched a consultation document, *Promoting more flexible investment in property*, seeking views on how PIFs should be structured to meet the Government's objectives of further enhancing the liquidity of property investment, providing greater access to retail investors and encouraging expansion in the private rented sector. In addition, **consultation will continue on the introduction of legislation to facilitate the removal of tax barriers to the development of a market in property-based derivatives**. This will complement and encourage more efficient investment in property.

### North Sea oil and gas

**3.II4** The Government is committed to working with industry to maximise economic recovery of UK oil and gas reserves by encouraging new investment to ensure all economically viable reserves are developed. The 2003 Pre-Budget Report announced a new Exploration Expenditure Supplement to help new entrant North Sea companies that do not receive the full benefit of current 100 per cent exploration and appraisal (E&A) capital allowances. The supplement will apply to all expenditure on E&A on or after 1 January 2004.

### Investing in British films

**3.II5** The Government has discussed with the film industry and others extending support to the industry through the tax system beyond 2005, with the aim of simplifying and targeting support more effectively. Budget 2004 announces that **Section 48 relief for low-budget British qualifying films, which is due to expire on 1 July 2005, will be replaced by a new relief for production expenditure**. The relief will go direct to the film-maker and not to any third party. It will typically cover 20 per cent of the production costs of British films, compared with the 15 per cent typically provided by the current Section 48 relief. The Government is currently reviewing the treatment of co-productions with a view to creating a tighter definition of British Qualifying Status. The Government will also consider the scope for the new relief to increase the proportion of British films that get distribution. Full details of the new relief will be published in summer 2004, following further discussions with the industry and others.

### Flexibility in capital markets

**Institutional investment** **3.II6** A key feature of the UK economy is that owners are separated from company management by a complex chain of intermediaries, including pension trustees, insurance companies, investment consultants, fund managers and brokers. Substantial analysis has shown that many elements along the investment chain have poor incentives to act in the interests of owners and that companies are not interacting with shareholders as effectively as they could. The Government has already taken a series of steps to tackle these issues, particularly by promoting greater accountability and transparency in the links between investors and companies. These steps include the Myners review of institutional investment, published in March 2001, and the Higgs review of the role and effectiveness of non-executive directors, published in January 2003. Following on from Myners, in October 2002 the Institutional Shareholders Committee (ISC) issued best practice principles for shareholder engagement with companies, and its members committed to incorporating the principles into fund management mandates.

**3.117** The Pensions Bill introduced in February 2004 implements two of the Myners Review's<sup>28</sup> recommendations: the legal requirement for trustees to have appropriate knowledge of investment matters, and the replacement of the Minimum Funding Requirement with scheme-specific funding standards. The Government is also conducting a review of progress after two years by pension scheme trustees against the set of investment principles recommended by Myners. Qualitative research was published in November 2003 as the first part of this review. It showed that while some progress has been made, particularly by larger schemes, further progress is necessary against many of the Myners principles.

**3.118** The Government will undertake discussions with the industry on the potential for further progress in a number of key areas of Myners. It will consider the need for further actions to improve the functioning of the institutional investment chain in the light of these discussions and the findings of the next part of the review, which is nearing completion.

**3.119** In addition, later in 2004, the Government will examine the extent to which the ISC's principles have delivered change. The Government also welcomes Paul Myners' recent report to the Shareholder Voting Working Group on the obstacles to voting UK shares,<sup>29</sup> which addressed the practical steps which all parties involved in shareholder voting should take to improve the voting process.

**Government  
response to  
Equitable Life  
Inquiry**

**3.120** The Government announced an independent review of the actuarial profession and the Government Actuary's Department (GAD) in response to Lord Penrose's Inquiry into Equitable Life.<sup>30</sup> The review, which will build on the work of the Myners review of institutional investment, will be led by Sir Derek Morris and has a wide-ranging remit to examine the profession and GAD, to consider how to modernise the profession and to promote an open and competitive market in actuarial advice in the UK. The review will report by spring 2005.

**3.121** The Government also announced a review led by Paul Myners into the corporate governance arrangements applicable to mutual life offices. The review will consider the governance framework for mutual life offices in comparison with that for similar companies (and, where relevant, for listed companies). Where appropriate, the review will bring forward recommendations to ensure that boards of mutual life offices are as accountable to their members as boards of comparable companies are to their shareholders. The review will report by the end of 2004.

<sup>28</sup> *Institutional investment in the United Kingdom: a review*, Paul Myners, March 2001.

<sup>29</sup> *Review of the impediments to voting UK shares*, Report by Paul Myners to the Shareholder Voting Working Group, January 2004.

<sup>30</sup> *Report of the Equitable Life Inquiry*, Rt Hon Lord Penrose, March 2004.