



## RAISING TREND GROWTH

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### Increasing the trend rate of growth

PSA target 1 relates to the Treasury aim, it is not linked directly to an objective.

3.1 The ultimate indicator of the Treasury’s performance in meeting this target is the estimate of the current rate of trend output growth. However, this cannot be determined until the completion of the economic cycle which commenced in mid-1999. An alternative is to report progress over the last complete economic cycle, which ran from 1997H1 to mid-1999. However, this was a very short cycle. Therefore, the Treasury uses a longer period comprising one and a half economic cycles (between the on-trend points in 1997H1 to 2001Q3) to estimate trend output growth over the recent past, and, accordingly, reports progress over this period.

#### Performance against target

3.2 The average annual trend output growth over this period was 2.9 per cent per annum, as documented in Budget 2004<sup>1</sup>. This is higher than the average annual trend growth rate of 2.5 per cent estimated over the previous cycle (1986Q2 to 1997H1). The Treasury is therefore on course to meet this target over the current cycle, which is forecast to end in 2006. Table 3.1 presents the latest outturns over the recent past (1997H1 to 2001Q3) and the previous cycle (1986Q2 to 1997H1).

PERIOD	Trend Output per hour Underlying	Trend Output per hour Actual	Average Hours Worked	Employment Rate	Population of Working Age	Trend Output Growth
1986Q2 - 1997H1	2.22%	2.05%	-0.10%	0.33%	0.24%	2.54%
1997H1 - 2001Q3	2.65%	2.44%	-0.47%	0.42%	0.54%	2.94%

The projected rate of trend output growth from 2001Q3 to the end of 2006 is 2¾ per cent.  
DATA: ONS, HMT

#### Delivery

3.3 The new macroeconomic framework has resulted in a less volatile macroeconomic environment that is more conducive to investment and long-term planning in the economy. Growth in output has been very stable since 1997, with the standard deviation less than a third of that over the last 30-year period.

#### Achievements

3.4 In recent years, the UK economy has continued to grow despite the impact of weak global demand and ongoing global uncertainty. GDP growth in the UK has now been unbroken for 46 consecutive quarters. In 2003 GDP grew by 2.2 per cent, significantly higher than in other major European economies.

<sup>1</sup>Page: 221, Table B2, Budget 2004, HC301, HM Treasury

## Future Plans

**3.5** The Treasury will continue to monitor the economic developments and macroeconomic framework closely, taking the necessary steps to ensure that the trend output growth PSA target is met. The policies and initiatives necessary to achieve this cross a number of the Treasury's objectives, and are detailed in Objective IV on productivity and Objective VI on employment, in this report.

## OBJECTIVE IV: Increase the productivity of the economy

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### Performance against target

3.6 There are two targets that relate directly to this objective:

- PSA 5 – Demonstrate progress by 2006 on the Government’s long-term objective of raising the rate of UK productivity growth over the economic cycle, improving competitiveness and narrowing the productivity gap with the US, France and Germany (joint target with the Department for Trade and Industry); and
- PSA 6 – Make sustainable improvements in the economic performance of all English regions and over the long term reduce the persistent gap in growth rates between the regions, defining measures to improve performance and reporting progress against these measures by 2006 (joint target with the Office for the Deputy Prime Minister and the Department for Trade and Industry).

### PSA 5 - RAISING THE RATE OF UK PRODUCTIVITY GROWTH

3.7 Improving UK productivity is a long-term objective. Given the sensitivity of the headline productivity figures to cyclical change, UK performance is assessed between on trend points. For the purposes of making international comparisons of productivity over time, progress is assessed for years when the US, UK, France and Germany are at a similar point in their economic cycles (as judged by OECD data on output gaps).

#### Raising the rate of UK productivity growth over the economic cycle

3.8 Actual trend productivity (output per hour) is estimated to have grown by 2.44 per cent between the two on trend points 1997H1 and 2001Q3, compared to 2.05 per cent between 1986Q2 and 1997H1, the previous economic cycle<sup>2</sup>.

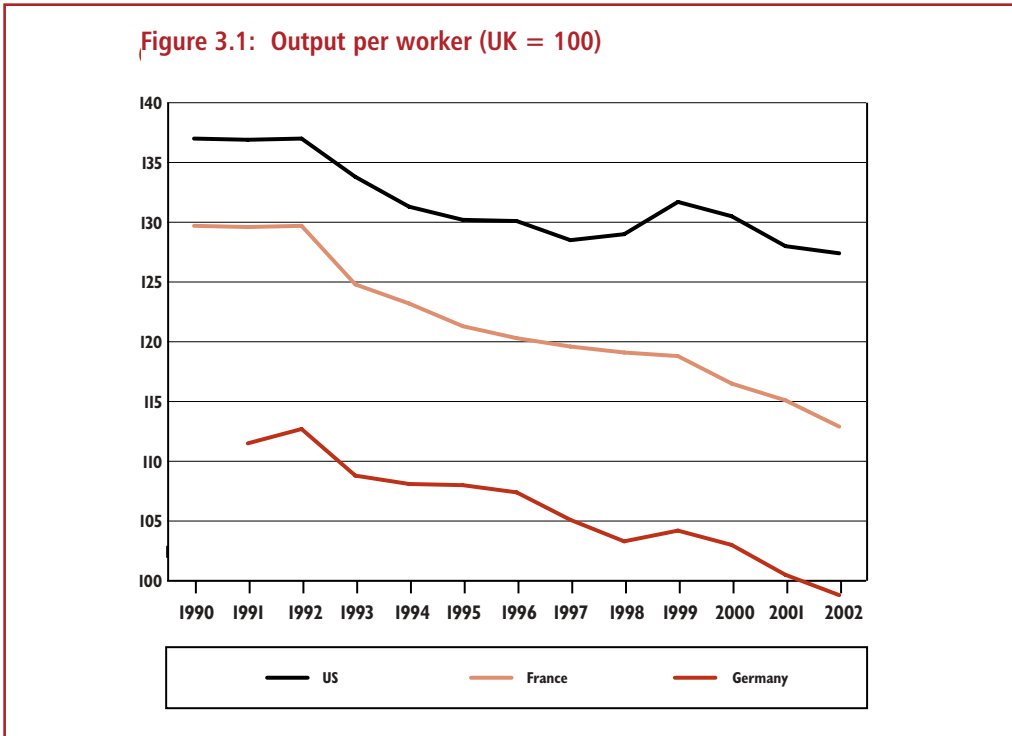
3.9 Underlying trend productivity (output per hour), which takes account of the marginal worker effect, (new workers entering employment, the marginal worker, take time to learn the job-specific skills that are necessary to raise their productivity to the average level) is estimated to have grown by 2.65 per cent between 1997H1 and 2001Q3 compared to 2.22 per cent between 1986Q2 and 1997H1.

#### Narrowing the productivity gap with the US, France and Germany

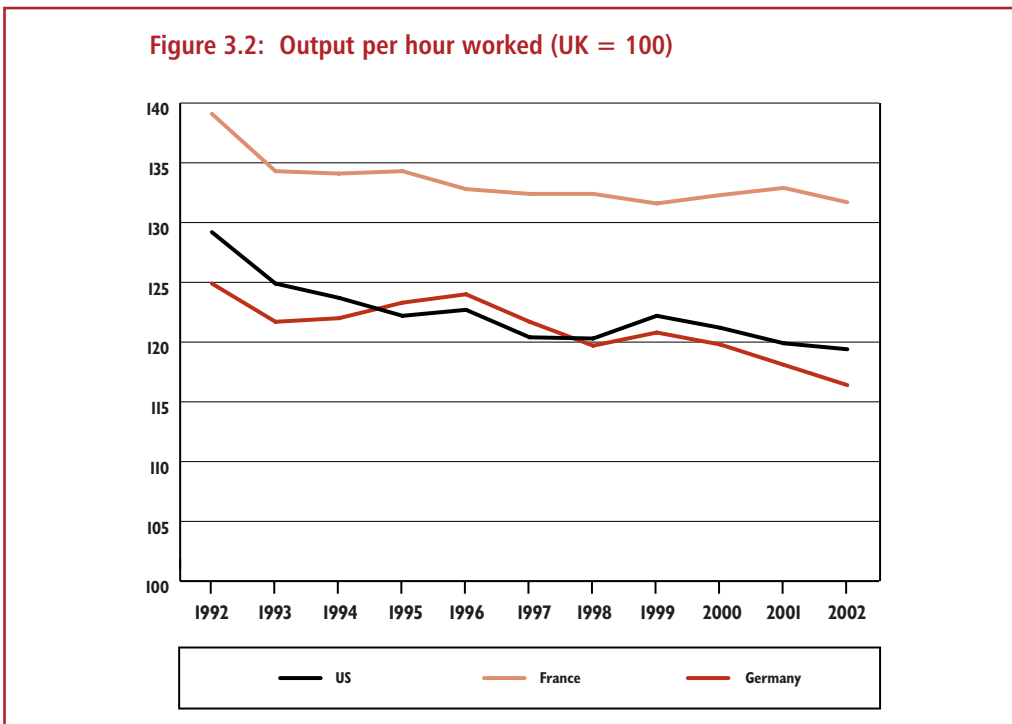
3.10 The most recent International Comparisons of Productivity data (published by the Office of National Statistics on 16 February 2004) incorporated significant revisions to data used in calculating the productivity gap, in particular sizeable revisions to purchasing power parity data. The backward revisions to the data suggest that progress on narrowing the productivity gap in the recent past has been better than previously thought.

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<sup>2</sup>Table B2, Budget 2004, HM Treasury, March 2004



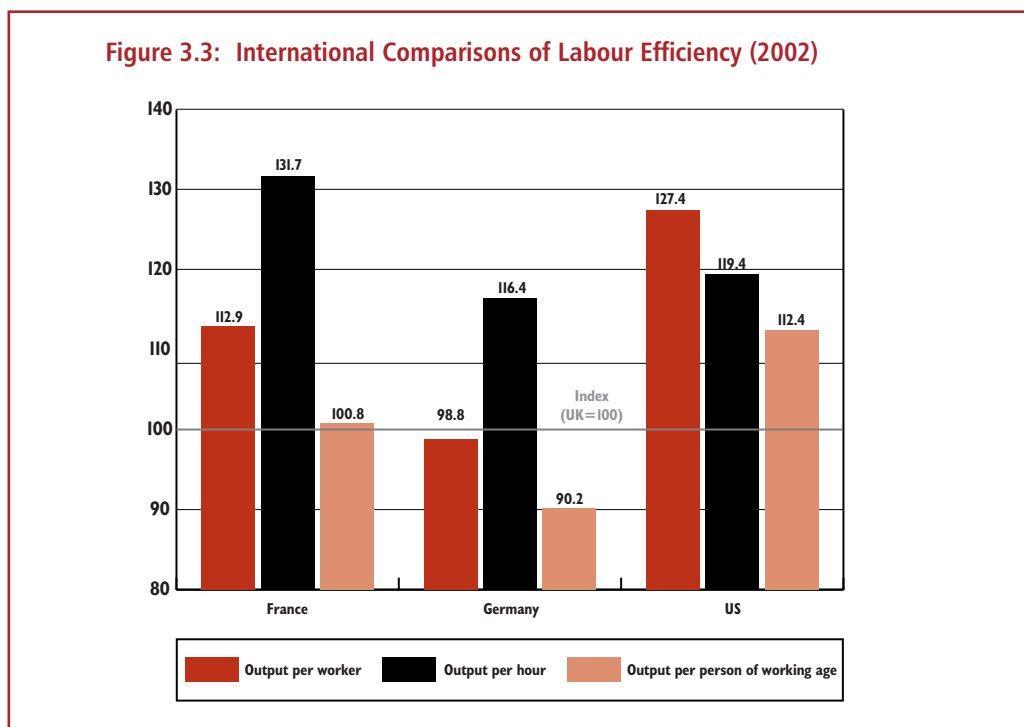
3.11 Fig 3.1 shows that the productivity gap (output per worker) has reduced with France, the US, and Germany since the mid-1990s. This has had the effect of eliminating entirely the gap with Germany.



3.12 Fig 3.2 shows that over the same period, the productivity gap (output per hour) has reduced with the US and Germany, but has remained largely unchanged in relation to France.

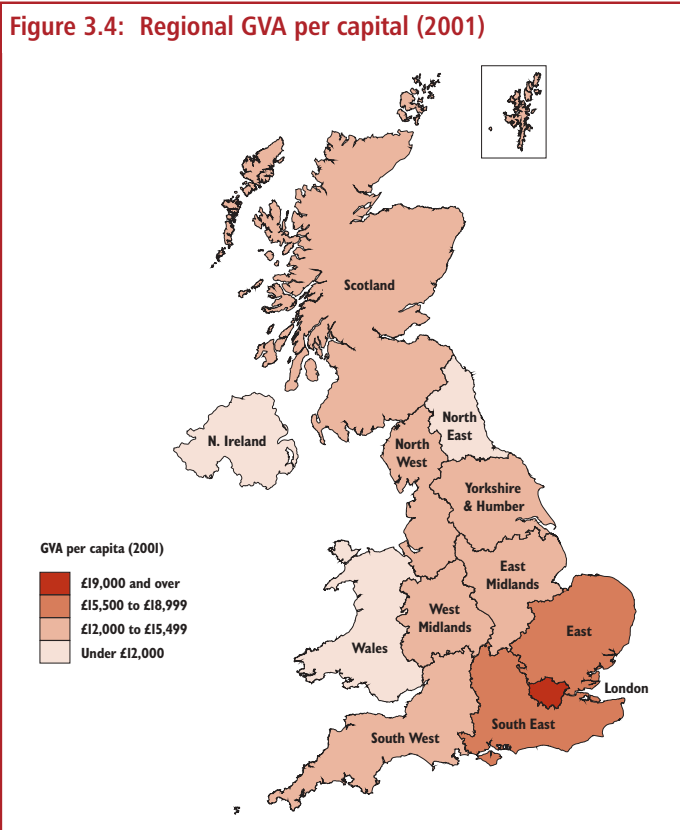
3.13 Relative improvements in output per worker and output per hour over recent years provide encouraging signs that the UK may be starting to make progress on narrowing the productivity gap.

3.14 Fig 3.3 indicates that the UK is significantly closer to its three main competitors on comparisons of output per person of working age, than on other measures of labour efficiency. This measure indicates how effectively an economy includes all of its potential workers in productive employment.



**PSA 6 MAKING SUSTAINABLE IMPROVEMENTS IN THE ECONOMIC PERFORMANCE OF ALL ENGLISH REGIONS AND REDUCING THE PERSISTENT GAP IN GROWTH RATES BETWEEN THE REGIONS**

3.15 An essential element of raising the rate of productivity growth in the UK (as set out in PSA 5) is to improve the economic performance of every part of the UK. Unfulfilled economic potential in every region and nation must be released to increase overall productivity and the long-term growth rate of the UK. Currently, there are considerable regional variations in economic performance. Fig 3.4 shows that the economic performance of the poorest nations and regions – the North East, Northern Ireland and Wales – is around 40 per cent below that of London, the most productive part of the UK.



**3.16** Trends in regional nominal GVA per capita over time show that both the size of the regional economic differentials and the relative rankings of the regions have been persistent over time. This is why the Government has committed itself to a target of “making sustainable improvements in the economic performance of all English Regions” and, over the long term, “reducing the persistent gap in growth rates” between the regions. Following devolution in 1999, substantial power has been devolved to Scotland, Wales and Northern Ireland. Each devolved administration is wholly accountable to its own democratically elected representatives for use of its resources to improve economic performance.

**3.17** The trend rate of growth in Gross Value Added (GVA) per head in each English region will be estimated for the period 2003-2008 to measure performance against the regional economic performance target. The gap in growth rates will be measured by comparing the average growth rate of regions that currently have above average GVA per head, with the average growth rate of regions that currently have below average GVA per head. Annual GVA per head data for each region is only available after a 12-month lag, so performance against this target will be reported in 2010.

**3.18** Christopher Allsopp was commissioned by the Chancellor, as well as the Governor of the Bank of England and the National Statistician, to carry out an independent review of the regional information and statistical framework needed to support the regional economic performance target. The final Allsopp review, published in March 2004, made a number of institutional and technical recommendations to ensure that regional data meets the requirements of policy makers and the wider user community.

### Meeting the English Regional Economic Performance Target

**3.19** Significant progress has been made in reviewing the regional policy instruments of the Treasury, the Office of the Deputy Prime Minister, the Department for Trade and Industry, as well as other Government Departments. The regional Government Offices, Regional Development Agencies (RDAs) and regional chambers have consulted other regional stakeholders on evidence of the drivers of performance in their region and for explanations of economic disparities. They have been invited by the Treasury to submit Regional Emphasis Documents to inform the development process for the 2004 Spending Review.

**3.20** In addition, a programme of research is being conducted to improve the evidence base on the key drivers of regional economic performance – skills, investment, innovation, enterprise and competition, and also employment. Conclusions from the research are being discussed with all appropriate Government departments, as well as regional stakeholders, and are feeding into the 2004 Spending Review.

**3.21** In March 2004, the Treasury, along with the Office of the Deputy Prime Minister and the Department of Trade and Industry, published an updated analysis of the historic and recent trends in regional economic performance in *Devolving decision making: 2 – Meeting the regional economic challenge: Increasing regional and local flexibility*. This document also looked at the delivery challenges facing institutions and policy makers at the regional and local level and set out the next steps necessary to ensure that the regional and local institutional framework is focused on delivering enhanced economic outcomes in the English regions.

### Delivery

**3.22** The Government has identified five drivers of productivity:

- competition;
- enterprise;
- science and innovation;
- skills; and
- investment.

**3.23** In March 2004, the Treasury and the Department for Trade and Industry, issued a consultation document<sup>3</sup> on identifying a possible set of productivity indicators. The consultation aims to identify a short set of indicators that are clearly linked to productivity performance and will be able to provide a clearer picture of progress towards the productivity PSA targets. The indicators will be based around the five drivers of productivity. This should allow changes to be identified and provide an early warning of where policy action may be needed.

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<sup>3</sup>Productivity in the UK 5: Benchmarking UK productivity performance, HM Treasury and Department of Trade and Industry, March 2004.  
[http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/productivity\\_indicators/](http://www.hm-treasury.gov.uk/consultations_and_legislation/productivity_indicators/)

3.24 Recent key policy measures include:

- **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;
- the preparation of **a ten-year investment framework for science and innovation**;
- **reforms to reduce the regulatory burden on businesses**, including consulting on the implementation of phasing out payment via employers for Working Tax Credit, strengthening Government scrutiny of regulatory proposals, and changing the structure of the UK's tax administration; and
- **the Local Authority Business Growth Incentives scheme**, which will boost the role of local authorities in promoting enterprise and economic growth.

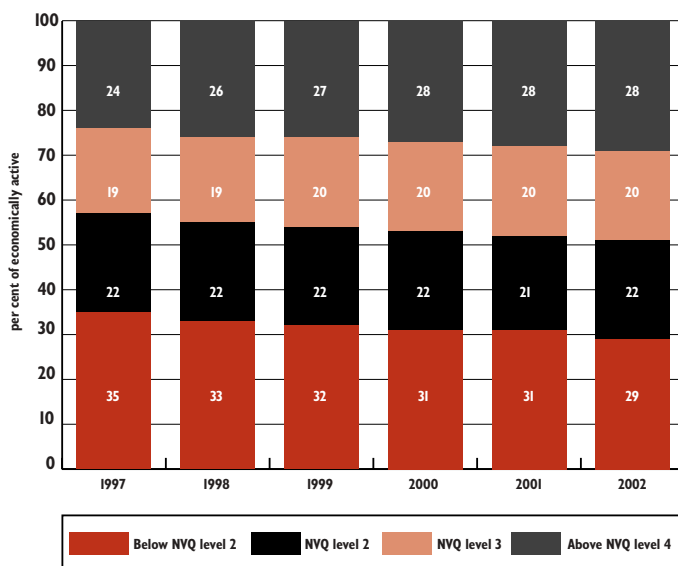
3.25 The Treasury has worked with other Departments including the Office of the Deputy Prime Minister, the Department of Trade and Industry, the Home Office and the Department for Education and Skills on each of these initiatives.

**Achievements**

**Improvements in workforce skills**

3.26 Fig 3.4 shows that there has been a reduction in the proportion of economically active people with only basic skills - from 35 per cent in 1997 to 29 per cent in 2002 - and an increase in the proportion of economically active people with NVQ4 or above, from 24 per cent in 1997 to 28 per cent in 2002.

**Figure 3.4: Highest qualification levels gained by people aged 18-59/64, England**



Source: DfES

### Improvements in the quality of the competition regime

**3.27** Major changes were made in 2003 to the UK competition regime with the entry into force of the Enterprise Act 2002. The main provisions of the Act are in box (a).

#### Box (a) Main competition provisions of Enterprise Act 2002

- *Full independence for the competition authorities, including an appeals tribunal body.*
- *For mergers:*
  - *Introduction of a pure competition test;*
  - *Except for special public interest cases, decisions to be taken by independent competition authorities.*
- *New market investigation powers to investigate markets where the structure of the market or the conduct of suppliers or customers is harming competition.*
- *Introduction of criminal penalties against individuals dishonestly engaging in cartels.*
- *Power for OFT to disqualify directors of companies which have committed a breach of competition law.*
- *Right for consumer associations to bring super-complaints to the OFT where there are market features that harm consumers.*
- *CAT can hear claims for representative damages brought by named consumers harmed by a breach of competition law.*

### Increases in the stock of Foreign Direct Investment (FDI) in the UK

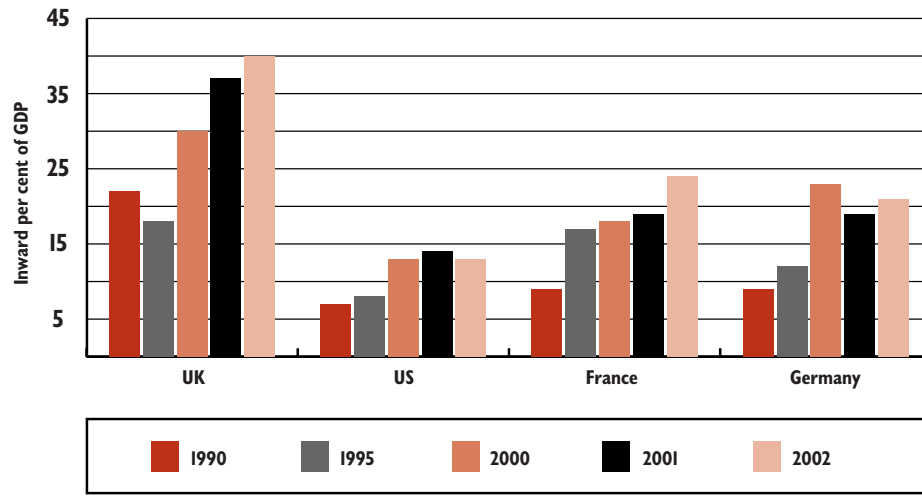
**3.28** Fig 3.5 shows that FDI into the UK has more than doubled as a proportion of GDP since 1995. It is now more than 15 percentage points ahead of France, the UK's nearest major competitor. Along with macroeconomic stability, this may be contributing to better productivity performance.

#### Future Plans

**3.29** The Treasury will take forward and implement policies announced in Budget 2004. For example, the Government will implement a programme of reform to planning and delivery of development in response to the Barker Review of Housing Supply. In addition, it will extend Employer Training Pilots to cover over one third of the country and, as part of the 2004 Spending Review, it will increase public investment in the science base faster than the trend rate of GDP growth over the next Spending Review period.

**3.30** A number of new policies will be rolled out alongside the 2004 Spending Review and in future Pre-Budget Reports and Budgets, which will take the Government's productivity agenda forward.

Figure 3.5: Foreign Direct Investment



Source: UN

## OBJECTIVE V: Secure an innovative, fair dealing, competitive and efficient market in financial services, while striking the right balance with regulation in the public interest

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### Performance against target

**3.31** There is not a PSA target for Objective V. The Treasury is assessed against SDA Targets 5.1-5.5. Annex A2 sets out performance against these SDA targets.

### Delivery

**3.32** To meet Objective V the Treasury has in 2003-04 put in place policies aimed at:

- refining the new legislative and regulatory framework established under the Financial Services and Markets Act 2000;
- maintaining the framework for safeguarding financial stability;
- improving the transparency, accessibility and responsiveness of retail financial markets, particularly in response to reviews such as the Sandler Review into the savings market;
- working towards the EU targets for a single market in financial services, and progressing in the WTO round towards more global open trade; and
- improving national and international systems for fighting crime, especially money laundering and terrorist financing.

### Achievements

**3.33** In November 2003 the Treasury announced a two-year **review of the Financial Services and Markets Act 2000 (FSMA)** to refine further the legislative and regulatory framework. In the first quarter of 2004 the Treasury issued consultation documents on reducing the regulation of promotions to high net worth and sophisticated investors, and on clarifying the boundaries of Financial Services Authority (FSA) regulation.

**3.34** The task force on **Major Operational Disruption in the Financial System** chaired by Sir Andrew Large reviewed the framework on safeguarding financial stability and concluded that it would not be appropriate for the Government to take further statutory powers in connection with a major operational disruption in the financial markets. The Treasury has been working with the Bank of England and the FSA to improve their capabilities to react to a crisis.

**3.35** Following the **Sandler Review**<sup>4</sup>, and the Treasury's consultation on product specification, the FSA have piloted a new sales regime and are now undertaking follow-up work.

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<sup>4</sup>The Sandler Review: Medium and Long-Term Retail Savings in the UK is available on the HM Treasury website at [http://www.hm-treasury.gov.uk/Documents/Financial\\_Services/Savings/fin\\_sav\\_sand.cfm](http://www.hm-treasury.gov.uk/Documents/Financial_Services/Savings/fin_sav_sand.cfm)

**3.36** Following the collapse of the WTO round, the Treasury has been working on bilateral discussions to increase **global financial services liberalisation** and, in particular, has pushed for broadening and deepening the EU/US regulatory dialogue, with the Financial Secretary hosting a high level round table discussion with interested stakeholders in September 2003.

**3.37** The Treasury has successfully negotiated outcomes to a number of EU directives of the **Financial Services Action Plan** (FSAP). For example negotiating a successful conclusion of the EU Occupational Pensions directive in May 2003; final agreement to the EU Prospectus directive, making it easier to raise capital across Europe on the basis of a single prospectus, and negotiating the Investment Services Directive, a significant improvement on the existing 1993 directive, which should contribute to greater integration of EU financial services markets. The Treasury secured London as the location for the Lamfalussy level 3 banking committee in January 2004, and also launched a consultation in December 2003 on the forthcoming European Union (EU) proposals for new **prudential capital rules** for banks and investment firms.

**3.38** The Treasury is continuing to improve national and international systems for fighting **financial crime**. Specifically, it has successfully negotiated on the revised recommendations on money laundering and terrorist financing of the Financial Action Task Force (FATF); introduced new Money Laundering regulations to implement the 2nd EU Money Laundering Directive; and frozen the assets of known terrorist individuals and organisations.

**3.39** On 1 July 2003 Parliament passed secondary legislation to bring **general insurance intermediation and mortgages** within the scope of FSA regulation with effect from January 2005 and October 2004 respectively. The Treasury also made progress on financial exclusion by successfully ensuring the inclusion of measures to increase the transparency of credit products and measures to tackle over-indebtedness in the Department of Trade and Industry's Consumer Credit White Paper<sup>5</sup> (published in December 2003).

### Future Plans

**3.40** In addition to the above, on 8 March 2004, the Treasury published the Penrose Report of the Equitable Life Inquiry. In response to Lord Penrose's findings, it has commissioned two independent reviews: one on the **governance of mutual life offices** headed by Paul Myners, and one on the **actuarial profession** headed by Sir Derek Morris. The Treasury has also asked the Accounting Standards Board to set up an urgent study of **accounting for with-profits business** within the published accounts of life insurance companies.

<sup>5</sup><http://www.dti.gov.uk/ccp/topics1/pdf1/creditwp.pdf>

**3.41** Budget 2004 announced that the Government will work with the financial services industry to bring forward specific proposals in Summer 2004 on reducing the problem of **financial exclusion** (particularly, households without basic bank accounts; the lack of affordable credit for those on the lowest incomes and insufficient free debt advice). The Government will assess and report on progress on reinvesting **unclaimed assets** back into society at the time of the 2004 Pre-Budget Report. The Government endorsed the conclusion of the **Miles Review**<sup>6</sup> (published on 12 March 2004), that urgent reform is desirable to make the UK mortgage market work better. Both the Government and FSA will consider and report on the recommendations set out in his report.

**3.42** On **European financial services**, the Treasury's priorities will be; first, to implement a number of FSAP measures (including market abuse and prospectus directives); second, to help define a new strategy for financial services in Europe, based on principles of 'better regulation'; and, third, to take forward negotiations on new legislation, including prudential capital rules for banks.

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<sup>6</sup>The UK Mortgage Market: Taking a Longer-Term View, David Miles, March 2004, is available on the Treasury website at: [http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/miles\\_review/consult\\_miles\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/miles_review/consult_miles_index.cfm)

## BETTER REGULATION

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**3.43** The Treasury has two roles relating to the better regulation agenda: promoting better regulation within the Treasury, and promoting better regulation across Government, taking forward the Chancellor's commitment to improve the regulatory environment for business and public services.

### Regulatory Reform Action Plan (RRAP)

**3.44** The RRAP lists over 650 deregulatory measures identified since February 2002 by all regulating Departments. The Chancellor highlighted the progress of this regulatory reform programme in both Budget 2003 and the 2003 Pre-Budget Report.

**3.45** Much of Treasury regulation is EU-led and relates to Financial Services. Two measures were included in the RRAP during 2003-04: one relating to restrictions on credit unions, the other changing statutory communication requirements between building societies and their members. Both of these measures have now been completed, one by Regulatory Reform Order – a fast-track way of removing outdated legislation.

### Compliance with RIA Process

**3.46** The Treasury produced 10 Regulatory Impact Assessments (RIAs) between 01 April 2003 and 31 January 2004, all of which can be found on the Treasury website<sup>7</sup>.

### Better Regulation Initiatives

#### Working with the private sector as a possible alternative to regulation/ legislation

**3.47** With the Budget 2004 announcements on **financial exclusion** and **unclaimed assets** (see Objective V for details), the financial services industry has the opportunity to find solutions before the Treasury introduces legislation.

**3.48** Also announced in Budget 2004, the Treasury has asked Philip Hampton, former finance director of Lloyds TSB, BT and British Gas, to consider, with business, regulators, and in consultation with the Better Regulation Task Force, the scope for promoting **more efficient approaches to regulatory inspection and enforcement**.

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<sup>7</sup>[http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/ria/consult\\_ria\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/ria/consult_ria_index.cfm)

### Alternatives to immediate legislation

**3.48** Following Don Cruickshank's report on Competition in UK banking in 2000, the Treasury announced it would legislate to regulate payment systems. However, progress has been made by the payments industry since then, and the 2003 Pre-Budget Report announced that the Office of Fair Trading (OFT) could address its remaining concerns about competition in advance of any legislation. The Treasury will review the situation in four years and will legislate unless competition has significantly improved.

**3.49** The independent Better Regulation Task Force congratulated the Treasury after it concluded that it would not be appropriate for the Government to take further statutory powers to maintain financial systems following major operational disruption (see Objective V for further details).

### Effective Use of RIAs

**3.50** The Treasury has used the Regulatory Impact Assessment process effectively throughout 2003-04 to improve the quality of regulatory proposals. The process was particularly valuable when considering options to regulate **travel insurance sold as part of a holiday package**. The Treasury considered whether regulating would distort the market and reduce competition, and whether there was sufficient consumer detriment to warrant FSA regulation and its consequent compliance costs. The Department found a lack of evidence of consumer detriment, and concluded that the proposed regulation could have a disproportionate impact on small firms' profit margins. It was therefore agreed that Government would not intervene and regulate.

**3.51** The negotiation of the **Capital Adequacy Directive** marks the first time that the Treasury has launched a public consultation at the pre-proposal stage of a financial services policy. The public consultation has helped to develop a much better understanding of extremely complex issues. The Treasury worked with the Financial Services Authority on the RIA to improve analysis of the Directive's likely impact.

### New RRAP Commitments

**3.52** The two-year review of the Financial Services and Markets Act will form a new RRAP entry in the coming year (see Objective V).

### Better Regulation in Europe

**3.53** The Chancellor, with the Finance Ministers of Ireland, the Netherlands and Luxembourg, wrote a joint letter to ECOFIN on 26 January 2004 setting out their plans for regulatory reform across their Presidencies. The Treasury has been working closely with the Regulatory Impact Unit and the DTI to drive forward this initiative.



PROMOTING FAIRNESS AND  
OPPORTUNITY FOR ALL

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## OBJECTIVE VI: Expanding economic and employment opportunities for all

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### Performance against target

4.1 The target for this objective is PSA target 7:

'Demonstrate progress by Spring 2006 on increasing the employment rate and reducing the unemployment rate over the economic cycle,' (joint target with the Department for Work and Pensions).

4.2 The baseline for this target is spring 2003, when the employment rate stood at 74.8 per cent and the unemployment rate at 5.0 per cent. The latest available data, covering December 2003 to February 2004, show that the employment rate is up by 0.3 percentage points on spring 2003 levels, at 75.1 per cent, and the unemployment rate has decreased by 0.2 percentage points to 4.8 per cent.

### Delivery

4.3 The New Deal is central to the Welfare to Work strategy. Specific initiatives for increasing opportunities for employment for young people, those over 25, those with health conditions or disabilities, and lone parents have been launched in recent years. Once in work, the childcare element of the Working Tax Credit assists with the cost of good quality childcare. More information on these initiatives can be found on the Department for Work and Pensions<sup>1</sup> website.

4.4 Although there has been success in raising the overall employment rate, it is recognised that in some areas concentrations of worklessness still exist. To tackle this, Action Teams for Jobs and Employment Zones have been introduced to disadvantaged areas of the UK, to overcome specific local problems using resources with more flexibility.

### Achievements

4.5 Over the past year:

- 65,000 long-term unemployed 18-24 year olds have found work through the New Deal for Young People (NDYP);
- 35,000 older people have been helped into work through the New Deal for those aged 25 and over (ND25+); and
- 215,000 lone parents have voluntarily participated in the New Deal for Lone Parents (NDLP) and 72,000 have been helped into employment through it.

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<sup>1</sup>[www.dwp.gov.uk](http://www.dwp.gov.uk)

**4.6** Overall, New Deal programmes have helped to reduce long-term youth and adult unemployment by over three-quarters since 1997. 1.8 million new jobs have been created since 1997, the highest level of employment for a generation.

**4.7** The New Deal for Disabled People (NDDP) has proved successful in helping those with health conditions or disabilities to move into work. Over the past year, 16,800 people have found work through the programme. In July 2003, it was announced that the NDDP is to be improved and extended to 2006. The Government launched Pathways to Work pilots in October 2003 in three areas. The pilots aim to reshape the culture and expectations of being on an incapacity benefit, in particular, by placing a stronger emphasis on returning to work in the early stages of a claim.

**4.8** In October 2003, the National Minimum Wage was raised to £4.50 an hour (adult rate), or £3.80 (youth and development rate). Budget 2004 announced a further increase, taking effect from October 2004, to £4.85 and £4.10 respectively. A National Minimum Wage for 16 and 17 will also be introduced from October 2004, at a rate of £3.00 an hour, to prevent exploitation of young people through low wages.

**4.9** The Department for Work and Pensions have made good progress developing the network of Jobcentre Plus offices across the country in the past year. To date, over 390 offices have been rolled out, with completion expected in 2006.

### Future Plans

**4.10** The Treasury will continue to support the Department for Work and Pensions to achieve full roll-out of Jobcentre Plus offices in 2006.

**4.11** For lone parents, the Treasury and the Department for Work and Pensions began to implement recommendations made in the Work Works report<sup>2</sup> in Budget 2003, in six cities with high lone parent populations. New measures to build on this work were announced in Budget 2004, and will be introduced from October 2004 in the six cities, including:

- access to NVQ level 3 training in sectors where local employers identify a demand for skills,
- and in childcare;
- improved information for both lone parents and employers; and
  - enhanced support for lone parents in the first two months of work.

**4.12** Fifteen extra Discovery Weeks will be introduced in London, to boost soft skills, such as the confidence of lone parents. A further four areas will be chosen for extended school pilots from October 2004, following the announcement in the 2003 Pre-Budget Report of the creation of extended school pilots in three areas.

<sup>2</sup>See Work Works – final report of the National Employment Panel's steering group on lone parents, National Employment Panel and BT, April 2003.

4.13 The Pathways to Work pilots were launched in October 2003, and aim to help more people with health conditions or disabilities move into work. In the seven Pathways to Work pilot areas, a mandatory work-focused interview regime will be piloted for some existing claimants of incapacity-related benefits. The regime will require relevant claimants to take part in three work-focused interviews. This will be piloted alongside a job preparation premium worth £20 per week, payable for a maximum of 26 weeks, to existing claimants who undertake relevant activity that supports a return to work.

4.14 Housing Benefit can be too complex, and can act as a disincentive for people to move house in order to find or take up work. A package of measures was announced in Budget 2004 to simplify the Housing Benefit system, particularly the rules around entitlement and take up of Housing Benefit, and the way in which the rules align with those for other support. To build on the nine Local Housing Allowance Pathfinders which have already been introduced in the private rented sector, a second round of Pathfinders will be introduced from April 2005.

4.15 'Fair Cities' initiatives will be established in three areas later this year, to work with employers and other local stakeholders, in order to develop strategies to improve employment outcomes for people from disadvantaged ethnic minority groups.

4.16 To support the Government's commitment to individual choice and encourage age positive employment practices, a new high profile national guidance campaign will be launched, to raise employers' awareness of, and ability to adopt, flexible employment and recruitment opportunities.

## OBJECTIVE VII: Promote a fair and efficient tax and benefit system with incentives to work, save and invest

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### Performance against target

4.17 The specific target related to this objective is PSA 8 to

reduce the number of children in low-income households by at least a quarter by 2004-05, as a contribution towards the broader target of halving child poverty by 2010 and eradicating it by 2020 (joint target with the Department for Work and Pensions).

The wider objective is pursued in partnership with the Inland Revenue and HM Customs & Excise.

### Delivery

4.18 The Government's strategy to tackle child poverty is multi-faceted and focuses on addressing the causes as well as the symptoms of child poverty. The strategy involves:

- work for those who can, helping parents participate in the labour market (see objective VI);
- financial support for families, with more support for those who need it most, when they need it most;
- breaking the cycle of deprivation through early years services and education to enable children who start life in poor families to prosper as adults;
- high quality public services that deliver for disadvantaged children; and
- support for parents, so that they can provide better support for their children.

4.19 The Child and Working Tax Credits introduced in April 2003 will make a substantial contribution to the child poverty target.

4.20 For older members of society, the Pension Credit introduced in October 2003 will help to tackle pensioner poverty and reward savings. The Pensions Green Paper, published in December 2002, has set out the strategy for simplifying the pensions system, including replacing the eight current pensions tax regimes with a single lifetime allowance on the amount of tax-privileged pension saving.

4.21 The wider agenda, to enable all members of society to benefit from the security, opportunity and independence that assets provide, is being taken forward through policies such as the Child Trust Fund, Individual Savings Accounts (ISAs) and reform of the treatment of capital in the benefits system.

4.22 To ensure that everyone pays their fair share of tax, a number of measures were introduced in the 2003 Pre Budget Report and 2004 Budget to tackle tax avoidance and evasion. These include:

- new compliance packages for VAT, direct taxes and NICs, involving additional resources for the Revenue Departments to improve their tax compliance activities;
- new disclosure requirements to enable earlier detection of tax avoidance schemes;
- measures to tackle tax avoidance using trusts, and to close other specific loopholes being exploited to avoid tax;
- the introduction of a 19 per cent minimum rate of corporation tax on the retained profits of small companies, allowing lower rates of corporation tax to be targeted on companies investing to grow their businesses; and
- the introduction, from 2006-07, of tax stamps on spirit bottles to support the Government's strategy to tackle alcohol fraud.

**4.23** The 2003 Pre Budget Report and 2004 Budget continued a series of reforms to improve the fairness and efficiency of the tax system. These have included:

- the modernisation of stamp duty;
- a consultation on the introduction of Property Investment Funds - a UK version of the successful US Real Estate Investment Trusts;
- a review of the Residence and Domicile rules as they affect the taxation of individuals;
- on-going reforms to the taxation of gambling;
- extensions of the tax reliefs available to support investment in British films;
- measures to support investment in the North Sea; and
- further tax reductions for Community Amateur Sports Clubs, and measures to enhance the support for small firms implementing Payroll Giving schemes.

### Achievements

**4.24** By the end of January 2004, 6 million families and low-income working households were benefiting from the Child and Working Tax Credits. This means that after just 10 months, tax credits were reaching 100 per cent of those expected to receive them by the end of the first year. Over 20 million people, including 10.7 million children, are already benefiting from the new tax credits.

**4.25** Personal tax and benefit changes mean that by October 2004, in real terms and compared to 1997:

- families with children will be, on average, **£1,350 a year better off**; and
- families with children in the poorest fifth of the population will be, on average, **£3,000 a year better off**.

**4.26** The most recent data show that between 1998-99 and 2002-03 there was a fall of 0.6 million in the number of children in low-income households, measured on an after housing costs (AHC) basis, and a fall of 0.5 million on a before housing costs (BHC) basis from 4.2 million and 3.1 million respectively. The Government is making steady progress towards the target. This progress has been made during a period of high growth in incomes, making the target harder to achieve. In contrast, between 1979 and 1987, median income grew strongly and the proportion of children in relative low-income households almost doubled.

**4.27** The latest data do not reflect the effect of tax credits introduced in April 2003, nor the increase to the child element of the Child Tax Credit to be implemented in April 2004. As a result of these changes, the Government is on course to meet or exceed the target on a BHC basis. Achieving the target is less certain on an AHC basis. Analysis by the Institute of Fiscal Studies suggests that the policies in place will enable the Government to make substantial progress on an AHC basis by 2004-05.

**4.28** Budget 2003 announced a **Child Poverty Review** to examine the welfare reform and public service changes needed to advance towards long-term goal to halve, and then eradicate, child poverty. The Review is underway, with a series of seminars having been held during the autumn, covering issues such as ethnic minority groups, educational outcomes, parenting, early years services, health outcomes, supporting families with disabled children and deprived areas. The Review will feed into the 2004 Spending Review.

**4.29** Following an inter-departmental review led by the Treasury, the Government has published a report setting out its long-term vision for financial support for 16-19 year olds, to ensure that all young people have the support and incentives they need to participate in education and training, so they reach the age of 19 equipped for higher education or skilled employment.

**4.30** On pensions and savings, significant progress continues to be made on a number of issues:

- over 2.7 million pensioners now receive the Pension Credit;
- over 15 million people have an ISA and over £130 billion has been subscribed to ISAs since their launch in 1999; and
- the Child Trust Funds Bill was introduced in November 2003 and draft regulations were published in February 2004.

### Future Plans

**4.31** The Treasury will work with the Department for Work and Pensions to take forward a consultation on financial support for 16-19 year olds and a Bill on child benefit changes.

**4.32** The Treasury will implement the Child Trust Fund in April 2005, and the new simplified pensions tax regime in April 2006. Budget 2004 announced that the Treasury will be working with the financial services industry to bring forward specific proposals in summer 2004 to promote financial inclusion, focusing on helping households access affordable banking and credit.

**4.33** The Treasury will continue to develop proposals for further tax reforms in a number of areas, including corporate tax, property investment, the distinctions in the tax system between owner-managers and the self-employed, the taxation of gambling, and residence and domicile rules. It will also continue to take further steps, as necessary, to improve compliance with the tax system.

**4.34** Alongside the 2004 Budget, the Government published a report by Gus O'Donnell, Permanent Secretary to the Treasury, which recommended the integration of the two revenue departments into a new single department. The new department will support improvement in customer service, in the effectiveness of tax-gathering, and in efficiency. The review also recommended that the Treasury assume the leading role over strategic policy development, with a transfer of around 150 posts into the Budget and Public Finances Directorate. The Government accepted the recommendations of Mr O'Donnell's review, and the process of implementation is now underway.

## OBJECTIVE X: Protect and improve the environment by using instruments that will deliver efficient and sustainable outcomes through evidence-based policies

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### Performance against target

4.35 The Government is committed to promoting sustainable development, which is vital to ensure a better quality of life for everyone. To achieve this, strong and stable economic growth and social progress must be balanced with action to protect and improve the environment. This was reflected in the new Objective X introduced from 2003 at the same time as the Treasury's new aim. There is no specific PSA target for Objective X. Progress on sustainable development is already covered through reports on sustainable development from the Department for Environment, Food and Rural Affairs (Defra), who monitors progress on a comprehensive set of sustainable development indicators, and through the Budget and PBR process. There are two specific SDA targets that relate to this objective:

- Objective 10.1: By working with other departments and with EU partners to appraise the sustainable development implications of policy proposals; and
- Objective 10.2: By using fiscal instruments to deliver environmental objectives, in accordance with the Statement of Intent on Environmental Taxation, and other instruments where appropriate.

4.36 The first of these primarily relates to the Treasury's work on the sustainable development implications of other Government departments' policies, particularly in spending reviews, and on international development and poverty. The second relates to the Treasury's work on environmental taxes and other economic instruments, which have an important role to play in securing sustainable development, along with regulation and spending policies. The Treasury's approach to environmental taxation was set out in the Statement of Intent on Environmental Taxation in 1997, and developed further in *Tax and the Environment: using economic instruments*, published alongside the 2002 Pre-Budget Report.

### Delivery

4.37 The Treasury has made considerable progress against its environmental objectives, particularly through the use of fiscal measures where it has a direct lead. A range of measures have been introduced including:

- using fuel duty rates and differentials to encourage the use of less polluting and more efficient fuels and vehicles;
- a graduated system for Vehicle Excise Duty, which provides lower rates for less polluting vehicles and a reformed Company Car Tax system based upon the carbon dioxide emissions of cars;

- the climate change levy (CCL) and the associated Climate Change Agreements and targeted support through the Carbon Trust, which encourage businesses to improve energy efficiency. Budget 2004 announced that eligibility for climate change agreements would be extended;
- further enhanced capital allowances for investments in approved energy saving and sustainable water technologies that were introduced in Budget 2004;
- measures to promote energy efficiency in the home. There is a reduced rate of VAT on the installation of a range of energy saving materials and Budget 2004 announced incentives for private landlords to invest in energy efficient technologies;
- the landfill tax which was originally introduced in October 1996, and increased to £15 per tonne from April 2004. In future years further increases will be made on the way to a rate of £35 per tonne, in order to encourage waste minimisation and alternatives to landfill;
- the Aggregates levy which promotes greater efficiency in the use of virgin aggregate and the development of alternative materials; and
- building upon the UK emissions trading scheme, an EU Emissions Trading Scheme to be introduced in 2005, which will make a major impact on the way that businesses tackle climate change and energy efficiency throughout the EU.

### Achievements

**4.38** The UK has seen good progress on environmental objectives, as a result of the programme of spending measures, regulation and fiscal and other economic instruments. In particular the UK is one of the few countries on course to meet its Kyoto climate change targets, has made good progress in reducing the longer-term trends in air pollution and encouraging the more efficient use of resources. It is recognised nevertheless that important challenges still remain.

### Future Plans

**4.39** The Treasury will continue to work with other Government departments, external stakeholders and EU partners on the appraisal and development of sustainable development policies. It will also continue to explore the use of economic instruments to achieve its environmental and sustainable development objectives and to improve resource productivity, drawing upon the experience of existing taxation and trading measures. The next steps include:

- discussing the use of input taxation for biofuels, the potential role of a biofuels obligation, and the role of enhanced capital allowances to promote the most environmentally friendly biofuels production processes;
- discussion with stakeholders on a package of measures for recycling the increase in landfill tax revenue to boost action to reduce the volume of waste going to landfill;

- consultation on ways of tackling diffuse water pollution, including the potential role of economic instruments;
- working with other Government departments in Spending Review 2004 on the sustainable development implications of their spending plans; and
- working towards the implementation of the Lorry Road-user charge, with extensive testing and piloting in 2006, and the charge being introduced from 2007-08, with a phased introduction.