

# Budget 2005

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## Investing for our future:

## Fairness and opportunity for Britain's hard-working families

### Economic and Fiscal Strategy Report and Financial Statement and Budget Report

March 2005

Return to an Order of the House of Commons dated 16 March 2005

*Copy of Economic and Fiscal Strategy Report and Financial Statement and Budget Report – March 2005  
as laid before the House of Commons by the Chancellor of the Exchequer when opening the Budget.*

Stephen Timms  
Her Majesty's Treasury  
16 March 2005

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

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# Economic and Fiscal Strategy Report

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# OVERVIEW

The Government's economic objective is to build a strong economy and a fair society, where there is opportunity and security for all. Budget 2005, *Investing for our future: Fairness and opportunity for Britain's hard-working families*, presents updated assessments and forecasts of the economy and public finances, and reports on how the Government's policies are helping to deliver its long-term goals. The Budget:

- shows that the economy is growing strongly and that the Government is meeting its strict fiscal rules for the public finances;
- announces a long-term programme of investment to deliver twenty-first century facilities in primary schools, along with further support for ICT in schools and funding to help schools deliver extended services;
- sets out further measures to help young people develop skills, including improving financial support for 16 to 19 year olds in learning; and piloting a new allowance for 16 to 17 year olds not in education, employment or training;
- sets out radical reforms to reduce the regulatory burden on business, through implementing the recommendations of the Hampton Review of regulatory inspection and enforcement; the recommendations of the Better Regulation Task Force report on controlling the stock and flow of regulations; and applying the principles of better regulation in Europe;
- announces free local bus travel for people over the age of 60 and disabled people from April 2006, and an additional payment guaranteeing that council tax paying households with someone over 65 will receive £200 towards the cost of council tax;
- announces further measures to help families, including a commitment to increase the child element of the Child Tax Credit in line with average earnings up to 2007-08;
- takes further steps to extend employment opportunity for all, through measures which focus help and support on those who face the greatest barriers to work;
- doubles the starting threshold of stamp duty land tax to £120,000 for all residential property transactions;
- provides a further £340 million for the special reserve in 2004-05 and £400 million in 2005-06 for military operations in Iraq and the UK's other international obligations;
- announces a new better targeted Local Enterprise Growth Initiative to drive forward local business-led regeneration, following the end of time-limited relief on commercial property purchases in disadvantaged areas;
- introduces a range of measures to modernise the tax system, and to tackle tax fraud and avoidance; and
- defers the inflation-based increase in main road fuel duties to 1 September 2005, in response to sustained volatility in oil prices.

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

**1.2** The long-term decisions the Government has taken – giving independence to the Bank of England, new fiscal rules and a reduction in debt – have created a strong platform of economic stability. Over the past four years, many industrialised countries have suffered economic downturns, including the US and much of the euro area. More recently, the international economy has been affected by geopolitical uncertainty, rising oil prices, and large current account imbalances and shifting exchange rates between Europe, Asia and the

US. In the UK, with low and stable inflation, interest rates set by the Monetary Policy Committee to meet the Government's symmetric inflation target, and fiscal policy supporting monetary policy over the cycle, the economy has grown continuously throughout this period. The UK economy continues its longest unbroken expansion on record, with GDP now having grown for 50 consecutive quarters.

**1.3** Economic stability provides the platform for building prosperity, achieving social justice with security and opportunity for all, and maintaining investment in public services. Stability allows business, individuals and the Government to plan more effectively for the long term, improving the quantity and quality of investment and helping to raise productivity. The Government is committed to locking in stability and investing in the UK's future, enabling it to meet the challenges and rise to the opportunity of the rapidly evolving global economy.

**Meeting long-term global challenges**

**1.4** The international economy is becoming increasingly integrated through greater cross-border trade and investment, driven in part by rapid advances in technology. Production processes are becoming increasingly flexible, dispersed across continents and with an increasing level of specialisation. Emerging market economies are growing strongly, particularly China and India, and are developing skilled workforces. China and India already each produce around 2 million graduates a year, compared with around 250,000 in the UK. Within the next twenty years, half the world's manufactured exports could come from developing countries.

**1.5** These developments are both a great opportunity and a great challenge for the UK and the global economy. The Government is committed to taking the long-term decisions to ensure the UK meets these challenges, by entrenching stability and building a flexible, enterprising economy with a highly-skilled, high-productivity workforce and a strong science and innovation sector. This requires investment by the Government and the public and private sectors working together to meet the challenges faced by the UK economy. This Budget includes radical reforms to reduce the regulatory burden on business, ensuring regulation can promote competition and drive up standards, without imposing unnecessary costs on business. It also sets out further plans to boost the UK science and innovation sector.

**1.6** Fairness must go alongside flexibility, providing security and support for those that need it and ensuring that everyone has the opportunity to fulfil their potential. The reforms of the welfare state introduced since 1997 reflect the Government's aims of eradicating child poverty, supporting families to balance their work and family life, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax system which encourages work and saving and ensures that everyone pays their fair share of tax. The Budget announces further measures to help families and pensioners, and to promote employment opportunity for all.

**Investing in education and skills**

**1.7** High levels of education and skills will allow the UK to harness technological improvements and become more productive, and are key to the Government's ambition of creating a flexible, enterprising and innovative economy. For an individual, education and skills provide security and opportunity, enhance personal fulfilment and enable people to contribute to their communities. The Budget sets out a programme of long-term investment in schools and colleges, and further measures to enhance the development of skills, to ensure that everyone has the opportunity to make the most of their talents.

**1.8** The Budget describes the next steps the Government is taking to enhance its long-term goals of:

- **maintaining macroeconomic stability**, ensuring the fiscal rules are met and that inflation remains low;

- **raising the sustainable rate of productivity growth**, through reforms that promote enterprise and competition, enhance flexibility and promote science, innovation and skills;
- **providing employment opportunity for all**, by promoting a flexible labour market which sustains a higher proportion of people in employment than ever before;
- **ensuring fairness**, by providing security for people when they need it, tackling child and pensioner poverty, providing opportunity for all children and young people and delivering security for all in retirement;
- **delivering world-class public services**, with extra investment alongside efficiency, reform and results, including long-term plans for investment in education; and
- **addressing environmental challenges**, such as climate change, poor air quality and environmental degradation in urban and rural areas.

## MAINTAINING MACROECONOMIC STABILITY

**I.9** The Government's long-term economic goal is to maintain macroeconomic stability, ensuring the fiscal rules are met at all times and that inflation remains low. Chapter 2 describes how the Government is working to achieve this goal and summarises prospects for the UK economy and public finances, full details of which are set out in Chapters B and C of the *Financial Statement and Budget Report (FSBR)*.

### The policy framework

**I.10** The Government's macroeconomic framework is based on the principles of transparency, responsibility and accountability, and is designed to ensure lasting stability so that businesses, individuals and the Government can plan effectively for the long term. The Bank of England has operational independence to meet the Government's symmetrical inflation target. Fiscal policy is underpinned by clear objectives and two strict rules which ensure sound public finances over the medium term. The fiscal rules underpin the Government's public spending framework which facilitates long-term planning and provides departments with the flexibility and incentives they need to increase the quality of public services and deliver specified outcomes.

**I.11** The UK economy is currently experiencing its longest unbroken expansion on record, with GDP now having grown for 50 consecutive quarters. With volatility in the UK economy at historically low levels and now the lowest in the G7, the domestic stability delivered by the Government's macroeconomic framework puts the UK in a strong position to respond to the global economic challenges and opportunities of the next decade.

### Economic prospects

**I.12** World growth in 2004 recovered to its strongest rate for nearly three decades and it remains robust. For 2004 as a whole, UK GDP rose by 3.1 per cent, its fastest rate of growth for four years, consistent with the 3 to 3½ per cent forecast range that the Government maintained since the 2002 Pre-Budget Report. Growth has also been more balanced as business investment accelerated in 2004 and private consumption continued to grow at sustainable rates. As world growth retains much of its momentum and with UK business and consumer confidence strong, GDP is expected to grow by 3 to 3½ per cent in 2005 as the remaining slack in the economy is absorbed and the output gap is closed around the end of the year. Growth is then expected to return to between 2½ and 3 per cent in 2006, in line with the economy's trend rate.

**The public finances** **I.13** The Budget 2005 projections for the public finances are broadly in line with the 2004 Pre-Budget Report and show that the Government is meeting its strict fiscal rules:

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

**Table 1.1: Meeting the fiscal rules**

	Outturn 2003-04	Estimate 2004-05	Per cent of GDP				
			2005-06	2006-07	Projections 2007-08 2008-09 2009-10		
<b>Golden rule</b>							
Surplus on current budget	-1.8	-1.4	-0.5	0.0	0.3	0.6	0.8
Average surplus since 1999-2000	0.5	0.1	0.1	0.1	0.1	0.1	0.2
Cyclically-adjusted surplus on current budget	-1.0	-0.8	-0.3	0.1	0.3	0.6	0.8
<b>Sustainable investment rule</b>							
Public sector net debt	32.8	34.4	35.5	36.2	36.8	37.1	37.1

**Budget policy decisions** **I.14** Against this backdrop, and building on steps already taken, Budget 2005 announces further decisions to lock in stability and invest in the UK's future, including :

- a long-term programme of investment to deliver twenty-first century facilities in primary schools, and new measures to boost the development of skills in young people;
- a commitment to increase the child element of the Child Tax Credit in line with average earnings up to 2007-08;
- free local area bus travel for all people over the age of 60 and disabled people from April 2006, and an additional payment guaranteeing that council tax paying households with someone over 65 will receive £200 towards the cost of council tax;
- a doubling of the stamp duty land tax zero-rate threshold from £60,000 to £120,000 for all residential property transactions;
- a range of measures to tackle tax fraud and avoidance; and modernise the tax system;
- deferral of the inflation-based increase in main road fuel duties to 1 September 2005, in response to sustained volatility in oil prices; and
- a further £340 million for the special reserve in 2004-05 and £400 million in 2005-06 for military operations in Iraq and the UK's other international obligations.

**Long-term fiscal sustainability** **I.15** Consistent with the requirements of the *Code for fiscal stability*, the updated public finance projections in Budget 2005 take into account the fiscal effects of these and all other firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FSBR.

**I.16** An updated analysis of long-term fiscal sustainability was published alongside the 2004 Pre-Budget Report in the *2004 Long-term public finance report*, and is updated in Annex A of the Economic and Fiscal Strategy Report. Using a range of sustainability indicators, this shows that the public finances are sustainable in the longer term, and that the UK is in a strong position relative to many other countries to meet the challenges of an ageing population.

## MEETING THE PRODUCTIVITY CHALLENGE

**I.17** Productivity growth, alongside high and stable levels of employment, is central to long-term economic performance in the global economy. In the increasingly knowledge-driven global economy, science, innovation and creativity are important drivers of productivity growth, backed up by a highly-skilled workforce and a competitive and enterprising economy. The UK has historically experienced comparatively low rates of productivity growth. However, in recent years, UK performance has improved in relation to other major economies. The Government's long-term goal is for the UK to continue to close the productivity gap by achieving a faster rate of growth than its main competitors.

**Action so far I.18** The Government's strategy focuses on five key drivers of productivity performance:

- **improving competition** which promotes flexible markets and increases business efficiency and consumer choice;
- **promoting enterprise**, including through reducing the regulatory burden on business, to ensure that UK firms are well-placed to respond to opportunities in a rapidly changing global market;
- **supporting science and innovation** which is central to success in the international economy, as global restructuring focuses developed economies toward knowledge-based and high value-added sectors;
- **raising UK skills** to create a more flexible and productive workforce, and to meet the long-term challenge of rising skills levels in emerging markets; and
- **encouraging investment** to increase the stock of physical capital supported by stronger, more efficient capital markets. In the global economy, attracting international capital and investment will require macroeconomic stability and a robust and efficient investment environment.

**Next steps I.19** Building on the reforms and initiatives already introduced, Budget 2005 sets out the next steps the Government is taking to strengthen the drivers of productivity growth and meet the long-term challenges of the global economy, including:

- **a package of radical reforms to tackle the burden of regulation on business**, while maintaining standards of protection for the public, consumers and employees, through:
  - building on the success of the Panel for Regulatory Accountability (PRA) by ensuring that regulation is only used where necessary, that it is not 'goldplated' if it originates from EU law, and that all Whitehall departments strengthen their focus on removing outdated and unnecessary regulations as recommended by the Better Regulation Task Force (BRTF) report;
  - adopting a risk-based approach to inspection and enforcement, streamlining regulatory structures and increasing accountability in order to reduce the costs to business of administering regulation, as

recommended by the Hampton Review, and setting new targets to reduce the administrative burden over time;

- applying the principles of better regulation in Europe through the six presidencies initiative;
- consistent with the Hampton principles, a strategy to meet stretching new targets **to reduce the administrative burden of the tax system for small businesses**, including in the short-term cutting the tax return for 500,000 of the smallest businesses and rolling out new options for paying and managing VAT online;
- **taking forward the ten-year Science and Innovation Investment Framework**, including a UK Stem Cell Initiative, chaired by Sir John Pattison, to formulate a ten-year vision for stem cell research, creating a platform for co-ordinated public and private research funding; a mandatory requirement that at least 2.5 per cent of public sector extra-mural R&D spending will be with Small and Medium Enterprises (SMEs) and engaging with business to ensure that the R&D tax credit better supports UK businesses with high potential to become major innovative firms of the future;
- **to support the Government's major new investment in education and skills**, plans to enhance workforce skills including continued support of £65 million for the Employer Training Pilots and funding to support a new Union Academy;
- **further support for enterprise**, through a new Local Enterprise Growth Initiative worth £150 million per year by 2008-9, to boost enterprise in the most deprived areas of England, following the end of the time-limited commercial stamp duty land tax disadvantaged areas relief in this Budget; and Regional Development Agencies' (RDAs) plans for the development of business coaching focused on businesses with high growth prospects;
- **a package of measures to increase the contribution of creativity to productivity growth**, including: a review led by George Cox, on how best to use the UK's world class creative industries and universities to support and develop the creativity of SMEs; and action by the RDAs to support the integration of design into corporate strategy, product and market development, including through the Design Council's Design Immersion Programme; and £12 million to the Arts Council England to promote better management and leadership within the cultural sector; and
- as a further step in reforming the investment chain, **taking forward the Morris Review recommendations** to promote greater competition in actuarial services and in advice to pension funds on investment issues, including asset allocation and fund manager selection, and to strengthen the regulation of the actuarial profession.

## INCREASING EMPLOYMENT OPPORTUNITY FOR ALL

**1.20** The Government's long-term goal is employment opportunity for all – the modern definition of full employment. It aims to ensure a higher proportion of people in work than ever before by 2010. To achieve this, each individual who wants and is able to work should be provided with the support to enable them to find work and develop skills. The Government is

also determined to build a flexible labour market which allows the economy to respond quickly and efficiently to economic change, driven for example by shifting patterns of international production and trade.

**Action so far 1.21** The Government's strategy for extending employment opportunity to all builds on the strong performance of the UK labour market over recent years. UK unemployment has fallen to 4.7 per cent, the second lowest of the G7 economies, while the working age employment rate has reached 74.9 per cent. Chapter 4 describes the successful action the Government has already taken to increase employment opportunity, through:

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

**Next steps 1.22** Budget 2005 describes the further steps the Government is taking to build on this success and further strengthen the labour market, with a long-term vision for extending support to the inactive and those who face particular barriers to work. The Budget announces:

- **improvements to incapacity benefits linking rules**, including an automatic guarantee of entitlement to the rules on a move into employment; a single, extended linking rules period of 104 weeks; and immediate re-qualification for the rules on a return to benefit;
- following the Low Pay Commission's recommendations, **the adult rate of the National Minimum Wage will rise to £5.05 per hour from October 2005 and £5.35 from October 2006**;
- **examining the scope for improving Jobseeker's Allowance sanctions and the potential for a fixed fines system**, to maintain an effective balance between rights and responsibilities by improving the capacity to respond swiftly and effectively in cases of non-compliance;
- **supporting young people not in education, employment or training**, details are set out in Chapter 5;
- **accepting the recommendations of the National Employment Panel's report on measures to promote employment and small business growth for ethnic and faith minorities**. The Government will develop proposals for implementing these recommendations, including the establishment of **Centres of Vocational Excellence in Entrepreneurship**;
- **a package of measures to help simplify and improve Housing and Council Tax Benefit** by making further improvements in administration; and
- **improving IT links between local authorities and the Department for Work and Pensions** to allow faster and more accurate processing of Housing Benefit claims.

## BUILDING A FAIRER SOCIETY

**I.23** The Government's long-term economic goal is to combine flexibility with fairness. Policies that ensure fairness minimise the short-term costs that can be associated with the changes that are needed in flexible outward-looking economies. Fairness provides security and support for those that need it and ensures that everyone has the opportunity to fulfil their potential in the global economy, now and in the future. The Government is also at the forefront of global efforts to achieve the Millennium Development Goals for global poverty, and to reduce debt in the poorest countries.

**Action so far I.24** Chapter 5 describes the range of reforms the Government has undertaken to achieve its goals in these areas, including:

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

**Next steps I.25** Building on these reforms, the Government is committed to taking the long-term decisions to promote opportunity and fairness. The Budget announces:

- building on previous increases in financial support for families, **a commitment to increase the child element of the Child Tax Credit at least in line with average earnings up to and including 2007-8**;
- **enhancing the development of young people's skills**, through measures to improve financial support for 16 to 19 year olds in learning, including through extending Child Benefit and Child Tax Credit from April 2006; and piloting a new Activity Agreement and Allowance for 16 to 17 year olds not in education, employment or training from April 2006;
- to support parents and improve children's learning, **an additional £35 million in 2006-07 and 2007-08 for the Parenting Fund and to improve early learning help for families**;
- **free off-peak local area bus travel for all people over the age of 60 and disabled people in England from April 2006**;
- **an additional payment guaranteeing council tax paying households with someone over 65 will receive £200 towards the cost of council tax**;
- **extending the existing higher Individual Savings Accounts limits to April 2010**, to promote further saving;
- **consulting on payments at secondary school age in the Child Trust Fund**;
- **investing up to £100 million over the next three years, to deliver the Government's response to the Russell Commission report on youth volunteering**, including a matched volunteering opportunities fund rising to

£40 million in 2007-08, conditional on private sector support;

- **doubling the zero-rate threshold for stamp duty land tax to £120,000 for residential property transactions**, exempting an extra 300,000 home buyers from stamp duty every year;
- **increasing the threshold for inheritance tax** to £275,000 in 2005-06, £285,000 in 2006-07 and £300,000 in 2007-08; and
- further reforms to **modernise the tax system**, including better aligning North Sea corporation tax payments with payments for petroleum revenue tax, and a number of measures to clamp down on **tax fraud and avoidance**.

## DELIVERING HIGH QUALITY PUBLIC SERVICES

**I.26** The Government's goal is to establish world class public services, with extra investment tied to reform and results. Investment in key public services provides the foundation on which the UK will be able to meet long-term economic challenges. A healthy and skilled workforce, modern and reliable transport networks, and an adequate supply of affordable housing will promote productivity and flexibility, and also help to ensure opportunity and security for all, both now and in future generations. The Government's strategy is to deliver improvements in public services through sustained investment and reform to ensure that taxpayers receive value for money.

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

- **a new framework for managing public spending** that strengthens incentives for departments to plan for the long term;
- **significant extra resources for public services**, consistent with the strict fiscal rules. The 2004 Spending Review set departmental spending plans for the three years to 2007-08, locking in previous increases in investment, while providing for further investment in priority areas of the public services. Current spending will increase by an annual average of 2.5 per cent in real terms over 2006-07 and 2007-08; and
- **challenging efficiency targets for all departments**, delivering over £20 billion of efficiency gains a year by 2007-08 to be recycled to front-line public services.

**Next steps I.28** The Government's long-term goal is to deliver world class public services through investment and reform, while ensuring efficiency and value for money. The Budget announcements include:

- **a further update on the progress departments have made toward meeting the challenging efficiency targets for all departments;**
- **proposals to rationalise the inspection and regulation of public services, building on the approach of the Hampton Review;**
- **a long-term programme of investment to deliver twenty-first century facilities in primary schools**, along with further support for ICT in schools, funding to help schools deliver extended services, and measures to ensure that every 16-18 year old has access to education and training; and

- **an additional £340 million for the special reserve in 2004-05 and £400 million in 2005-06** for military operations in Iraq and the UK's other international obligations.

## PROTECTING THE ENVIRONMENT

**I.29** The Government's goal is to deliver sustainable growth and a better environment, by addressing the challenges of climate change, poor air quality and environmental degradation in urban and rural areas. Sustainable development is vital to ensure a better quality of life for everyone, today and for generations to come. Economic growth is key to rising national prosperity. However, growth must not come at the expense of the environment or social progress. Continued growth in the developed world, combined with the rapidly growing and highly populated economies of China and India, will place increasing demands on the world's resources and environment over the coming decade. Meeting this long-term challenge requires action at a local and national level, but crucially also through international cooperation.

**Action so far I.30** Chapter 7 describes the steps the Government has taken to deliver its environmental objectives, including:

- **tackling climate change**, and reducing emissions of greenhouse gases in line with domestic as well as international targets;
- **improving air quality** to ensure that air pollutants are maintained below levels that could pose a risk to human health;
- **improving waste management**, so that resources are used more efficiently and waste is re-used or recycled to deliver economic value; and
- **protecting the UK's countryside and natural resources**, to ensure they are sustainable economically, socially and physically.

**Next steps I.31** The Government is using a range of economic instruments to address the challenges posed by sustainable development, while taking into account other social and economic factors. This Budget describes the next steps in the Government's strategy, including:

- in support of the UK's leadership role in tackling climate change, including through its EU and G8 Presidencies, **a package of new measures to support further action on the abatement of greenhouse gas emissions, including new fiscal incentives, an energy services summit, and a new energy efficiency theme as part of the Government's Invest to Save Budget**;
- **the publication of an independent evaluation of the climate change levy**, which concludes that this measure will deliver annual savings of over 3.5 million tonnes of carbon in 2010, well above the originally forecast savings;
- **two new reduced rates of VAT for the installation of low carbon technologies, and an extension of the Landlord's Energy Savings Allowance** to cover solid wall insulation;
- **the deferral to 1 September 2005, of the inflation-only increase of main road fuel duties, reflecting sustained volatility in oil prices, and of a 1.22 pence per litre increase in duty on rebated fuels**, which will support the strategy to tackle oils fraud;
- **a freeze in the threshold for the minimum percentage charge rate of company car tax** at 140g per kilometre for 2007-08, and simplifications to the company car tax system;

- a freeze of the vehicle excise duty (VED) rates for the lowest four bands of graduated VED for cars, and the standard increase of £5 for the two most polluting bands and for the over 1549cc band for pre-March 2001 vehicles;
- progress on work to assess the feasibility of a biofuels obligation as part of a package of measures to support the development of biofuels;
- a freeze in the rate of the aggregates levy, and the rates of climate change levy and air passenger duty; and
- an increase in line with inflation of the landfill tax credit scheme.

## BUDGET MEASURES AND THEIR IMPACT ON HOUSEHOLDS

**I.32** The measures introduced in this and previous Budgets support the Government's objectives of promoting enterprise, skills and science, creating employment opportunity, tackling child and pensioner poverty, and protecting the environment. Consistent with the requirements of the *Code for fiscal stability*, the updated public finance projections in Budget 2005 take into account the fiscal effects of all firm decisions announced in the Budget. The fiscal impact of Budget policy decisions is set out in Table 1.2. Full details are provided in Chapter A of the FSR.

**I.33** As a result of personal tax and benefit measures coming into effect in 2005-06, by October 2005, in real terms:<sup>1</sup>

- families with children will be, on average, £20 a year better off, while those in the poorest fifth of the population will be, on average, £45 a year better off;
- a single earner couple with 2 children, with earnings up to the median for full time workers – £23,400 per year – will be at least £150 a week better off; and
- a lone parent with 2 children, working 16 hours a week at the National Minimum Wage,<sup>2</sup> will be at least £150 per year better off.

**I.34** As a result of personal tax and benefit measures introduced since 1997, by October 2005, in real terms:<sup>3</sup>

- households will be, on average, £900 a year better off;
- families with children will be, on average, £1,400 a year better off; and
- families with children in the poorest fifth of the population will be, on average, £3,200 a year better off.

**I.35** As a result of personal tax and benefit measures introduced since 1997, in 2005-06:<sup>3</sup>

- pensioner households will be £1,500 a year better off in real terms; and
- the poorest third of pensioner households will have gained £2,000 a year in real terms.

<sup>1</sup> Compared to the 2004-05 system of taxes and benefits, indexed to 2005-06 prices.

<sup>2</sup> The National Minimum Wage will be £5.05 for adults from October 2005.

<sup>3</sup> Compared to the 1997-98 system of taxes and benefits, indexed to 2005-06 prices.

Table I.2: Budget 2005 policy decisions

	(+ve is an Exchequer yield)			£ million
	2005-06 indexed	2006-07 indexed	2007-08 indexed	2005-06 non-indexed
<b>MEETING THE PRODUCTIVITY CHALLENGE</b>				
1 Tonnage tax: adjustments	*	-5	-5	*
2 VAT: revalorise registration and deregistration thresholds	0	0	0	-5
3 Film tax reform	*	-50	*	*
4 Local Enterprise Growth Initiative	-15	-65	-125	-15
5 Stamp duty land tax: ending commercial disadvantaged areas relief	+340	+350	+370	+340
6 Enterprise and creativity	0	-5	-10	0
<b>INCREASING EMPLOYMENT OPPORTUNITY FOR ALL</b>				
7 Housing benefit and council tax benefit: simplification	-5	-5	-5	-5
8 Incapacity benefit: linking rules	0	-10	-20	0
<b>BUILDING A FAIRER SOCIETY</b>				
<b>Supporting families and communities</b>				
9 Income tax: indexation of starting and basic rate limits	0	0	0	-700
10 Child Tax Credit: uprating child element in line with earnings until 2007-08	0	-260	-480	0
11 Stamp duty land tax: increase threshold to £120,000	-250	-240	-220	-250
12 ISAs: extension of higher investment limits until April 2010	0	-35	-100	0
13 Free local off-peak bus travel for pensioners and disabled people	0	-420	-440	0
14 Abolition of hospital downrating	0	-65	-65	0
15 Payment for the over 65s	-800	0	0	-800
16 Supporting youth volunteering	-10	-30	-80	-10
17 Increasing capital limits for IS/JSA from £8,000 to £16,000	0	-5	-5	0
<b>Protecting tax revenues</b>				
18 Preventing avoidance of tax on capital gains	*	+70	+105	*
19 Stamp duty land tax: avoidance	+20	+20	+15	+20
20 Financial products avoidance	+280	+430	+430	+280
21 Double tax relief: anti-avoidance rule	+130	+200	+200	+130
22 Intangible assets: closing loopholes	+15	+25	+25	+15
23 Counteracting avoidance through arbitrage	+130	+200	+200	+130
24 Red diesel: supporting the UK oils fraud strategy	+40	+70	+70	+45
25 VAT: partial exemption loopholes	+25	+30	+25	+25
26 VAT: warehousing avoidance	+20	+25	+25	+20
<b>Duties and other tax changes</b>				
27 Inheritance tax: increase of threshold	-20	-60	-130	-90
28 Alcohol duties: revalorise beer and wine duties and freeze other rates	-10	-10	-10	+150
29 Tobacco: revalorise rates	0	0	0	+20
30 North Sea corporation tax: aligning payments with PRT	+1,100	+210	+170	+1,100
31 VAT: supplies promoting the welfare of vulnerable people	-5	-5	-5	-5
32 VAT: extension of listed places of worship scheme	0	-10	-10	0
33 VAT: construction and repair of memorials by charities	-5	-5	-5	-5
<b>PROTECTING THE ENVIRONMENT</b>				
<b>Environment</b>				
34 Climate change levy: freeze	-20	-20	-20	0
35 Aggregates levy: freeze	-10	-10	-10	0
36 VAT: reduced rate on micro-CHP boilers	*	-5	-5	*

**Table I.2: Budget 2005 policy decisions**

	(+ve is an Exchequer yield)			£ million
	2005-06 indexed	2006-07 indexed	2007-08 indexed	2005-06 non-indexed
<b>PROTECTING THE ENVIRONMENT</b>				
<b>Transport</b>				
37 VAT: revalorise fuel scale charges	0	0	0	+10
38 Fuel duties: revalorise rates from 1 September 2005	-235	0	0	+330
39 Fuel duties: narrowing the differential of road fuel gases until 2007	*	0	+5	*
40 Fuel duties: differentials for biodiesel and bioethanol until 2007	*	0	+5	*
41 Incentivising the use of biomass	0	-5	-5	0
42 Air passenger duty: freeze rates	-10	-25	-30	0
43 Changes to Vehicle Excise Duty	-40	-45	-50	+85
<b>OTHER POLICY DECISIONS</b>				
44 Education and skills measures	0	-300	-400	0
45 Special reserve allocation <sup>1</sup>	-400	0	0	-400
<b>TOTAL POLICY DECISIONS</b>	<b>+265</b>	<b>-65</b>	<b>-590</b>	<b>+415</b>
*negligible				
<b>MEMO ITEMS</b>				
Resetting of the AME margin	+1,880	+370	-260	
Direct taxes compliance package <sup>2</sup>	0	+25	+355	

<sup>1</sup>This is in addition to the Budget 2005 decision to allocate £340 million to the special reserve for 2004-05.

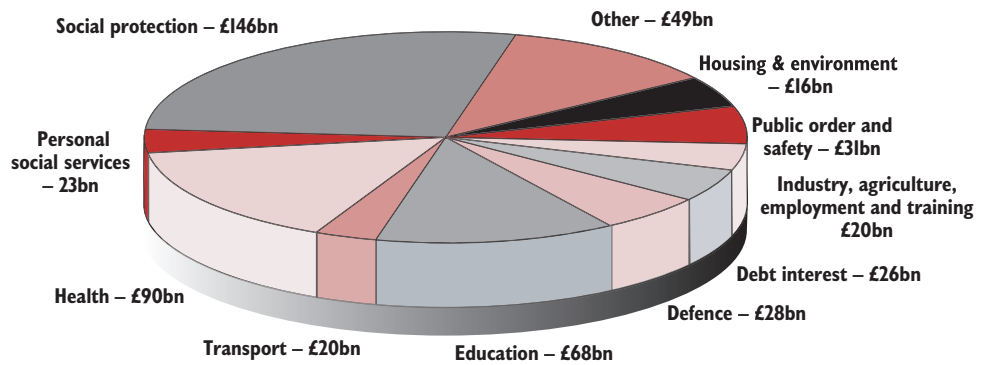
<sup>2</sup>Net of additional resources allocated to Inland Revenue.

## GOVERNMENT SPENDING AND REVENUE

**I.36** Chart 1.1 presents public spending by main function. Total managed expenditure (TME) is expected to be around £519 billion in 2005-06. TME is divided into Departmental Expenditure Limits (DEL), shown in Table C13 of the FSBR, and Annually Managed Expenditure (AME), shown in Table C11 of the FSBR.

### Chart I.1: Government spending by function

Total managed expenditure: £519 billion

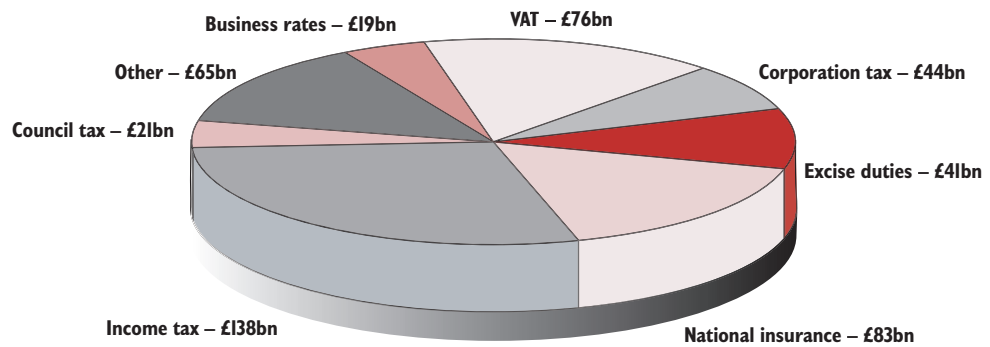


Source: HM Treasury, 2005-06 near-cash projections. Spending re-classified to functions compared to previous presentations and is now using methods specified in international standards. Other expenditure includes spending on general public services; recreation, culture, media and sport; international cooperation and development; public service pensions; plus spending yet to be allocated and some accounting adjustments. Social protection includes tax credit payments in excess of an individual's tax liability, which are now counted in AME, in line with OECD guidelines. Figures may not sum to total due to rounding.

**I.37** Chart 1.2 shows the different sources of government revenue. Public sector current receipts are expected to be around £487 billion in 2005-06. Table C8 of the FSR provides a more detailed breakdown of receipts consistent with this chart.

### Chart I.2: Government receipts

Total receipts: £487 billion



Source: HM Treasury, 2005-06 projections. Other receipts include capital taxes, stamp duties, vehicle excise duties and some other tax and non-tax receipts – for example, interest and dividends. Figures may not sum to total due to rounding.