5 BUILDING A FAIRER SOCIETY

The Government is committed to promoting fairness alongside flexibility and enterprise, to ensure that everyone can take advantage of opportunities to fulfil their potential. The Government's reforms of the welfare state reflect its aims of eradicating child poverty, supporting families to balance their work and family lives, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax system that ensures everyone pays their fair share of tax. This Pre-Budget Report sets out the next steps the Government is taking to support these aims, including:

- **an extension of Winter Fuel Payments** paid at £200 for households with someone aged 60 or over, rising to £300 for households with someone aged 80 or over, for the rest of this Parliament;
- **an additional £300 million over three years to enable pensioners on Pension Credit to have central heating systems installed free of charge,** and to provide a £300 discount on central heating systems to all other pensioners who do not already have one in their home;
- **investing £53 million over the next two years to improve support for families and children**, including piloting new Parent Support Advisers in over 600 primary and secondary schools;
- **a tax credits package** to provide more certainty around tax credit awards while maintaining the flexibility to respond to falls in income and changes in circumstances;
- **establishing an implementation body to take forward the Russell Commission recommendations** on youth volunteering, with £3.5 million already committed by seven corporate Founding Partners;
- **action to protect tax revenues and modernise the tax system,** including a number of measures to tackle fraud, avoidance and tax-motivated incorporation;
- **an increase in North Sea oil taxation,** striking the right balance between producers and consumers, to promote investment and ensure fairness for taxpayers; and
- **further steps to promote debt relief and international development,** including the launch of the pilot International Finance Facility for Immunisation.

5.1 The Government's aim is to promote a fair and inclusive society in which everyone shares in rising national prosperity, and no one is held back from achieving their potential by disadvantage or lack of opportunity. The Government is committed to advancing fairness and flexibility together, so that everyone can benefit from the UK's modern and dynamic economy.

5.2 The Government's approach to promoting employment opportunity for all is set out in Chapter 4. Alongside this, the Government is reforming the tax and benefit system to ensure security and opportunity for the most vulnerable in society. This chapter sets out the progress the Government has made in a number of areas, including:

- tackling child poverty and providing financial support for families;
- delivering the objectives set out in the ten year strategy for childcare, to promote choice, availability, quality and affordability in childcare provision;
- promoting saving and asset ownership, enhancing financial capability and tackling financial exclusion, so that everyone has a financial stake in society;
- ensuring that pensioners can share in rising national prosperity and making sure that older people are able to play a full and active role in society;
- providing further financial support for pensioner households and accelerating the progress being made to tackle fuel poverty; and
- creating a supportive environment in which charitable, voluntary and community action can flourish.

5.3 These reforms are underpinned by the Government's commitment to delivering a modern and fair tax system that encourages work and saving, keeps pace with developments in business practices and the global economy, and provides the foundation for the Government's objective of building world-class public services.

5.4 This chapter also sets out how the Government has used the UK Presidencies of the G7/8 and EU to make progress in tackling global poverty, including through securing substantial new aid commitments, agreement on 100 per cent multilateral debt cancellation for Heavily Indebted Poor Countries (HIPCs), and the launch of the pilot International Finance Facility for Immunisation.

SUPPORT FOR FAMILIES AND CHILDREN

5.5 The Government is determined to ensure that every child, irrespective of race, gender, background or circumstances, gets the best start in life and the ongoing support they and their family need to allow them to fulfil their potential.

5.6 *Support for parents: the best start for children,* published alongside this Pre-Budget Report, sets out the Government's strategy for breaking cycles of deprivation and securing improved outcomes:

- *rights and responsibilities,* supporting parents to meet their responsibilities to their children;
- *progressive universalism,* providing support for all and more for those who need it most, while maintaining incentives to work; and
- *prevention,* working to prevent poor outcomes from developing in the first place for children, young people and their parents.

5.7 Securing positive outcomes for all children, young people and families requires action on a number of fronts, reflecting the wide range of factors that influence their lives. The Government's strategy encompasses economic and financial security; support for parents to manage the demands of work and family life; building stronger communities and regenerating deprived neighbourhoods; and improving and reforming public services.

Box 5.1: Support for parents: the best start for children

***Support for parents: the best start for children*, published alongside this Pre-Budget Report, announces that the Government is investing an additional £53 million over the next two years to improve services and support for families and children in the following areas:**

- **piloting a new school-based outreach role – Parent Support Advisers – in over 600 schools, both primary and secondary;**
- **a series of Single Account Holder Pathfinders in six to ten high-achieving local authorities to determine whether a budget-holding lead professional model might be implemented more widely; and**
- **a new pilot project to establish peer-mentoring schemes in 180 secondary schools over two years which will deliver 3,600 matched mentor and mentee pairs.**

In addition, recognising the acute needs of looked after children, this investment will enable:

- **the piloting of a mentoring scheme for 600 young looked after children aged ten to fifteen; and**
- **the evaluation of new practices in local authorities for managing cases of children on the threshold of being taken into care.**

The Government will consult early in 2006 on a more wide-ranging set of proposals for transforming outcomes for looked after children.

Eradicating child poverty

5.8 Every child deserves the best start in life. Disadvantage in childhood diminishes the quality of children's lives, and reduces their prospects for success later in life. It also leads to poorer outcomes for society as a whole, for example hindering the development of a well-skilled workforce.

5.9 One of the key barriers to happiness as a child and to future life chances is growing up in a poor household. Economic well being provides the foundation on which parents, communities and the Government can work together to respond to the new challenges and complexities of modern family life. Yet child poverty rose dramatically in the 1980s and early 1990s, meaning that by the late 1990s the UK had the highest child poverty rate in the EU. This is why the Government is committed to a long-term goal of eradicating child poverty by 2020.

Progress to date

5.10 The Government's welfare reform programme provides financial and employment support for families, and the Government has already halted and reversed the rapid increase in child poverty. As UNICEF noted in their 2005 report, "over the last six years, the UK Government has pioneered an approach to the monitoring and reduction of child poverty that seems to be working". [1]

5.11 The most recent data show that since 1998-99 the number of children living in low-income households before housing costs (BHC) has fallen from 3.1 million to 2.5 million, and the number living in low-income households after housing costs (AHC) has fallen from 4.1 million to 3.5 million.[2] The Government is on track to reduce the numbers of children in relative low-income households by a quarter between 1998-99 and 2004-05; the first milestone towards its long-term goal. Outturn data for 2004-05 will be available early in 2006.

[1] *Child Poverty in Rich Countries 2005: Innocenti Report Card No. 6*, UNICEF, 2005.

[2] *Households below average income: an analysis of the income distribution 1994-95 - 2003-04*, Department for Work and Pensions (DWP), 2005. A revision of the grossing regime used in the 2003-04 publication resulted in a revision to the 1998-99 estimate for the number of children living in low income households on an AHC basis, with the number falling by 100,000 from 4.2 to 4.1 million.

Halving child poverty

5.12 As the next milestone towards the eradication of child poverty, the Government is committed to halving the number of children in relative low-income households by 2010-11. Alongside the 2004 Spending Review, the Government published the next steps to reduce child poverty in the *Child Poverty Review*.[3] This has four main strands:

- *work for those who can*. For most families, parental employment is the main source of income. The Government has addressed barriers to employment, particularly parental employment, through policies such as the New Deal for lone parents and childcare support. Since 1997, the number of children living in workless households has fallen by nearly 400,000;
- *financial support for families*. The Government supports parents by providing financial support for all families, and by providing more support for families that need it most, when they need it most. Further details on financial support for families are set out below;
- *tackling material deprivation*. The Government recognises that poverty is about more than income alone. Increasing family income has reduced material deprivation, with more families able to afford key items such as new shoes and winter coats.[4] The Government will set in 2006 a target to halve by 2010-11 the number of families suffering material deprivation, once the data on this measure is available; and
- *breaking cycles of deprivation*. Over the long term, the Government seeks to build on the *Child Poverty Review* and address the underlying causes of poverty, to prevent future generations experiencing disadvantage.

Financial support for families with children

5.13 Since 1997 the Government has radically reformed the way it provides support to families with children, recognising the benefits of a good start in life and that families with children face additional costs.

5.14 This support is delivered through a combination of Child Tax Credit (CTC) and Child Benefit. Tax credits are benefiting over 6.1 million families and 10.3 million children, including those families receiving their child allowances through their benefits. Tax credits are reaching far more low- and moderate-income families than any previous system of income-related financial support.

Increased support for families

5.15 This Pre-Budget Report announces that **from April 2006 the child element of CTC will increase by £75 to £1,765 a year**. This represents a total increase of £320 since its introduction in April 2003, and meets the Government's commitment for increases at least in line with average earnings up to and including 2007-08. A family with two young children and a full-time earner on £15,550, half average male earnings, will receive over £105 per week in CTC and Child Benefit next year, a real terms increase of 75 per cent since 1997-98. Table 5.1 shows the levels of support that CTC and Child Benefit will provide for families from April 2006.

[3] *Child Poverty Review*, HM Treasury, July 2004.

[4] *That's where the money goes*, Gregg, Waldfogel and Washbrook, 2005; *Families and children survey*, DWP.

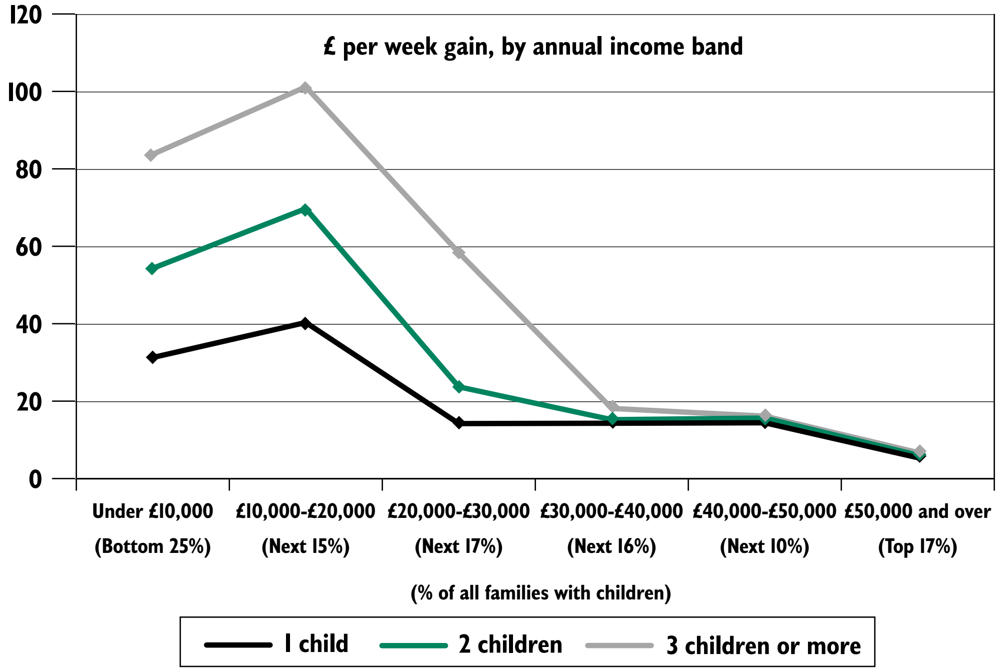
Table 5.1: Minimum annual levels of support for families from April 2006

Annual family income *Per cent of families*	up to £14,155 *30*	up to £50,000 *83*	all families *100*
1 child	£3,220	£1,455	£910
2 children	£5,595	£2,065	£1,520
3 children	£7,970	£2,675	£2,130

Making families better off

5.16 Chart 5.1 shows the impact of the Government's measures to support families since 1997. It shows that all families have benefited, but the greatest benefit has gone to families with low to middle incomes. For example, families with two children and an income in the range £10,000 to £20,000 are on average around £70 a week better off.

Chart 5.1: Gains for families with children from tax credits and other children's measures by 2006



Source: HM Treasury.

5.17 As a result of the Government's reforms to the personal tax and benefit system, by April 2006 and in real terms:

- families with children will be on average £1,500 a year better off, while those in the poorest fifth of the population will be on average £3,350 a year better off;
- a single-earner family on half average male earnings with two children will be £3,750 a year better off; and
- a single-earner family on average male earnings with two children will be £195 a year better off.

Tax credits

5.18 Over the past seven years the Government has reformed Britain's tax and benefit system to achieve three over-arching objectives: to provide adequate financial incentives to work; to reduce child poverty; and to increase financial support for all families. In the past, the tax and benefit system failed adequately to address the challenges of rising worklessness and poverty among families that emerged from the early 1980s. The Government therefore embarked on a programme of tax and benefit integration.

5.19 Central to the Government's programme of tax and benefit reform is the introduction of payable tax credits. This has brought about a step change in the way in which households draw support from the Exchequer. Tax credits follow broadly the same rules and definitions as income tax, are closely aligned with the tax system and are administered and paid by HM Revenue & Customs (HMRC).[5] The high take-up of the Child and Working Tax Credits has demonstrated the advantages of tax and benefit integration:

- there are over 6.1 million families with 10.3 million children benefiting from tax credits; and
- initial estimates of take up suggest that, in its first year of operation, around 80 per cent of families eligible for the Child Tax Credit claimed. This compares to 65 per cent in the first year of Working Families' Tax Credit, and 57 per cent in the first year of Family Credit.

Flexibility and certainty

5.20 The tax credit system responds to changes in circumstances as and when events occur, and to changes in annual income between one tax year and the next. Awards can be revised during the tax year, and are finalised at the end of the tax year, to reflect changes in annual income. The first £2,500 of any annual income rise is disregarded in that year's award. This means that additional support can be provided to people when changes happen, such as when a new child arrives or when there is a fall in a family's income, provided that claimants report changes promptly and keep their records up to date.

5.21 This responsive tax credit system means a family's income and circumstances determining entitlement are only known for certain at the end of the year. Some families, in particular those who have not told HMRC of changes in their income or circumstances, may find when their award is finalised that they received more than they turned out to be entitled to. Others may find they received less than they turned out to be entitled to. The system, and in particular the £2,500 disregard, was designed to minimise such over- or under-payments so far as possible and improve work incentives. The tax credit system therefore strikes a balance between providing the flexibility to respond to changes and maintaining certainty of income for families.

5.22 The measures set out in Box 5.2, once fully implemented, will mean that:

- there will be greater certainty for claimants, particularly for families who see a rise in income;
- the flexibility to respond to falls in income and changes in circumstances will be maintained; and
- in return, claimants will have clear responsibilities to report changes promptly and will be helped to keep their records up to date, including through more proactive contact by HMRC.

[5] *Tax credits: reforming financial support for families,* HM Treasury, March 2005.

Box 5.2: Tax credits: increasing flexibility and certainty

The Government has carefully monitored the operation of the tax credit system during its first two years. On 26 May 2005 the Government announced that HMRC will improve performance in six key areas of the administration and communication of the system. This Pre-Budget Report announces a series of steps to ensure that the system strikes the right balance between providing a stable award and maintaining the ability to respond to changes.

The package includes a number of measures to increase the flexibility of the tax credit system and involves new responsibilities for claimants to tell HMRC about changes in their circumstances promptly:

- **to increase the flexibility of the system, from April 2006 the disregard for increases in income between one tax year and the next will rise from £2,500 to £25,000, ensuring that almost all families with increasing incomes will not have their tax credit entitlement reduced in the first year of the increase, further boosting work incentives;**
- **to provide greater certainty of award for claimants, from November 2006 HMRC will apply automatic limits on recovery of excess amounts paid where awards are adjusted in-year following a reported change. This will reduce the effect of the change on continuing payments. These limits will be the same as the current limits on cross-year overpayment recovery, and will ensure that no low- to middle-income family faces unexpected reductions in their tax credit payments; and**
- **to tackle the problems associated with families overestimating falls in income, from April 2007 when claimants report a fall in income during the year, their tax credit payments will be adjusted for the rest of the year to reflect their new income level, but will not include a one-off payment for the earlier part of the year. At the end of the year, their award will be finalised when their actual income is known. If they have been underpaid, a further payment will then be made in the ordinary way.**

Claimants will also receive clear messages that they need to report changes quickly, and will be helped to keep their records up to date:

- **from April 2007, the time allowed to report a change that reduces tax credit entitlement will be decreased from three months to one month, shortening the time when people are potentially being paid too much. From November 2006, it will also become mandatory to report more changes in circumstances than at present. The new mandatory circumstance changes will be: ceasing to work at least 16 or 30 hours; ceasing to be responsible for a child or young person; and a child or young person ceasing to qualify for support;**
- **from 2006 the deadline for the return of end-of-year information will be moved from the end of September to the end of August. This will reduce the time that recipients are being paid on the basis of information rolled forward from the previous tax year, which is often out-of-date; and**
- **starting in early 2007, HMRC will contact key groups of tax credit recipients to collect up-to-date income information before the start of the new tax year. This will allow provisional payments up to the time of renewal to be set more accurately, helping to reduce overpayments.**

5.23 A case has been made for a system of fixed awards, which within the framework of the annual tax credits system would need to be based on last year's income. The Government will continue to listen to the case, but believes on balance that it is preferable to maintain the current system that flexibly responds to changing circumstances. Any move to a fixed system would take time to implement as it would require primary legislation, and would mean that awards could not reflect falls in a family's income promptly, which would make tax credits less well targeted on tackling poverty.

Childcare and work-life balance

5.24 The Government's vision is for every child to have the best start in life, and for parents to have more choice and control over how they balance work and family life. The Government is committed to promoting a supply of high-quality, flexible and affordable childcare and early years education that meets parents' needs. Box 5.3 summarises progress against the objectives set out in *Choice for parents, the best start for children: a ten year strategy for childcare,* which was published alongside the 2004 Pre-Budget Report.

5.25 The ten year strategy included a commitment to consider the case for direct payment of Statutory Maternity Pay by HMRC. Following consultation with business, the Government has concluded that the costs of a direct payment scheme (up to £75 million in set up costs, £50 million in annual running costs and very significant numbers of additional HMRC staff) would be disproportionate to the benefits, and poor value for money for the taxpayer.[6] The net benefit to business would be around £1 million a year, of which only around £400,000 would accrue to small employers. This is because payment by HMRC on behalf of businesses would only be possible by requiring businesses to provide detailed, real-time information to HMRC.

[6] The analysis underpinning this assessment of the costs and benefits of direct payment is published as a technical note on the HMRC website.

Box 5.3: Ten year strategy for childcare

Choice for parents, the best start for children: a ten year strategy for childcare, published alongside the 2004 Pre-Budget Report, set out the Government's long-term vision for childcare. Good progress is being made to deliver the objectives set out in the strategy.

Choice and flexibility: The Government is committed to ensuring parents have greater choice and flexibility in balancing work and family life. Legislation is now being considered by Parliament to extend paid maternity leave from six to nine months from April 2007, with the aim of 12 months paid maternity leave by the end of the Parliament; to introduce a right for an additional period of paternity leave, some of which can be paid if the mother returns to work; and to extend the right to request flexible working to carers of the sick and disabled. The Government will continue to examine the case for extending it to parents of older children in the future. In addition, from April 2006 the flat rate of Statutory Maternity, Paternity and Adoption Pay and Maternity Allowance will be increased to £108.85 a week.

The Government is also developing a national network of 3,500 Children's Centres by 2010. These centres will offer a new integrated service for families and children, and 420 are already in place. They will build on lessons from Sure Start Local Programmes and on international best practice, to ensure a consistent approach and a clear focus on improving child outcomes.

Availability: The Government's vision is that all families with children aged up to 14 who need childcare can find an affordable, flexible, and high-quality place that suits their circumstances. Legislation is now being considered by Parliament introducing a new duty on local authorities to secure a sufficient supply of childcare places to meet working families' needs. A growing number of schools are offering childcare from 8am to 6pm each weekday for children aged 3-14, supported by the National Remodelling Team.

Quality: The Government is committed to achieving high-quality early years provision, including radical improvements in the capacity and quality of the childcare workforce, with an objective that all full daycare settings have a graduate-level early years professional by 2015. The Government is now working with the Children's Workforce Development Council and the Training and Development Agency to plan the development of a new early years professional degree course and to secure a sufficient supply of graduates in future years. The Government's commitments on the childcare workforce will from April 2006 be supported by investment via a new Transformation Fund, worth £125 million each year.

Affordability: The Government wants families to be able to afford flexible, high-quality childcare that is appropriate for their needs. To help improve affordability, from April 2005 the eligible cost limits of the childcare element of the Working Tax Credit increased to £300 a week (£175 for one child), and from April 2006 the maximum proportion of costs that can be claimed will be increased from 70 to 80 per cent. The Government is also working with the Greater London Authority on a pilot to address childcare affordability issues in London. This programme is on track to deliver 10,000 sustainable childcare places over three years, with support for over 3,000 places being offered to low-income families in the first round, launched on 14 November 2005.

Delivery and next steps: The Department for Education and Skills will publish early next year a delivery plan for the commitments in the ten year strategy for childcare.

SUPPORTING YOUNG PEOPLE

5.26 The Government is committed to ensuring that all young people reach the age of 19 ready for higher education or skilled employment, regardless of their background. Skills are key to increasing individual opportunity, labour market flexibility and productivity, and so the Government aims to raise post-16 participation from 75 per cent to at least 90 per cent at age 17 by 2015. The interim report of Sandy Leitch's Review of Skills, *Skills in the UK: the long-term challenge,* published alongside this Pre-Budget Report and described further in Chapter 3, sets out the evidence on the UK's existing skills profile and projections for progress to 2020.

Review of financial suport for 16-19s

5.27 The review of financial support for 16-19 year olds aims to remove financial barriers so that all young people, including the most vulnerable, have genuine choice in selecting the learning route most appropriate to their needs and aspirations. As an important step toward this, Budget 2005 announced that **from April 2006 entitlement to Child Benefit, Child Tax Credit and Income Support will be extended to 19 year olds** completing a course of non-advanced education or unwaged training which they started before their 19th birthday, up to a limit of age 20. Budget 2005 also announced that **from April 2006 entitlement to Child Benefit and Child Tax Credit will be extended to unwaged trainees** on work-based learning programmes arranged by the Government. These reforms will improve the financial support available to learners and, with the extension of Education Maintenance Allowance in England, deliver parity in financial support for education and unwaged training. Under the Child Benefit Act 2005 the Government has the flexibility to further extend support to other groups of young people in the future. For example, the Government has committed to consider extending the same entitlements to full-time volunteers aged 16-19 as it already does to those in education and training.

Engaging the most disadvantaged young people

5.28 At any one time in the UK, around 150,000 16-17 year olds are not in education, employment or training. While for many young people this is only for a short spell, about 40 per cent remain disengaged after 20 weeks. The evidence suggests that spending prolonged periods unemployed or inactive at this age has a negative impact on employment prospects and life chances. Budget 2005 announced that the Government will **from April 2006 allocate £60 million over two years to pilot Activity Agreements and Allowances targeted on the most disadvantaged 16-17 year olds**. The pilots will be located in eight Learning and Skills Council areas with the highest numbers of 16-17 year olds not in education, employment or training: Greater Manchester, Greater Merseyside, West Yorkshire, Central London, East London, Kent & Medway, Cornwall & Devon and Tyne & Wear.

FAIRNESS FOR DISABLED PEOPLE

5.29 Since 1997 the Government has taken important steps to improve the rights of, and opportunities for, disabled people, including the establishment of the Disability Rights Commission and through innovative programmes such as Pathways to Work. In October 2004 protection against discrimination was extended to a further 600,000 disabled workers, with 1 million smaller employers and 7 million jobs brought within the employment provisions of the Disability Discrimination Act 1995.

5.30 The Disability Discrimination Act 2005 provides protection for more people diagnosed with the progressive conditions of HIV, MS and cancer, and ensures that all functions of public authorities, not just services, are covered. It also introduces a new positive duty on public bodies to promote equality of opportunity for disabled people, requiring Government departments to create meaningful Disability Equality Schemes.

Improving the life chances of disabled people **5.31** In January 2005 the Government published *Improving the Life Chances of Disabled People,* a 20-year strategy for supporting disabled people. The Government is now working closely with key stakeholders including disabled people, organisations and advocates, to take forward the report's recommendations. A new Office for Disability Issues was launched on 1 December 2005 to oversee implementation, and will publish an annual report charting progress in this area.

Individual Budgets **5.32** Individual Budget pilots were announced on 21 November 2005 and will be run in 13 local authority areas, commencing this month in West Sussex. The pilots will increase the choice and control that disabled people and older people have over the support they need and how it is delivered. Individuals will be able to take the budget in the form of cash, provided services, or a combination of the two. The pilots bring together a range of funding streams overseen by the Department of Health, the Department for Work and Pensions and the Office of the Deputy Prime Minister.

PROMOTING SAVING, ASSET OWNERSHIP AND INCLUSION

5.33 The Government's vision is for the UK to be a home-owning, share-owning, asset-owning and wealth-owning democracy, not just for some but for all. The Government therefore seeks to support saving and asset ownership for all from childhood, through working life and into retirement, using the right combination of education, support through the tax and benefit system and the effective use of public spending. Household sector net wealth is now higher than ever before, having grown by 50 per cent in real terms since 1997.

Promoting saving and asset ownership for all

Child Trust Fund **5.34** The Child Trust Fund became operational in April 2005. The scheme promotes saving and financial education and will ensure that in future all children have a financial asset at age 18, regardless of family background. There are now over 110 official providers and distributors of Child Trust Funds and over 1.1 million accounts open, over half of which are Stakeholder accounts. The scheme is already transforming the way the nation saves, with more families indicating that they intend to save for their children, and a range of new children's savings accounts coming onto the market. The Government welcomes these developments and innovative ideas for leveraging funds into accounts.

5.35 Under the scheme, all children born from September 2002 receive £250 to invest in a long-term savings and investment account, and children from lower-income families receive £500. Family and friends can add up to £1,200 a year to each account and there is no tax for them to pay on any interest or gains made on this money.

5.36 As announced in the 2004 Pre-Budget Report, the Government is consulting on a further universal payment of £250 at age seven, with children in lower-income families receiving £500. The Government now **invites further comments on the eligibility criteria for and timing of these payments.**[7] As announced in Budget 2005, the Government also invites views on what further payments should be made into Child Trust Fund accounts at secondary school age. The Child Trust Fund and age-related further payments will bring financial education in schools to life. The Government is working with financial education bodies and the devolved administrations to identify appropriate opportunities for learning.

[7] *Child Trust Fund consultation on age 7 top-up payments – further issues*, HM Treasury, December 2005.

Individual Savings Accounts

5.37 Over 16 million people have an Individual Savings Account (ISA), with over £180 billion subscribed since the launch of ISAs in 1999. The Government remains committed to ISAs. ISA and Personal Equity Plan (PEP) savings are supported by an estimated £1.8 billion a year in tax relief. As announced in Budget 2005, the Government will **from April 2006 extend the existing ISA annual investment limits of £7,000, with a maximum £3,000 in cash, until at least April 2010**.

5.38 The Government is keen to promote saving among those who do not usually save, and to play its part in facilitating the transferability of savings between different vehicles in order to give savers greater flexibility over their lifetimes. To extend the range of products, providers and people who can engage with ISAs, as announced in Budget 2005 the Government will **extend the list of qualifying investments for ISAs to include all FSA-authorised retail investment schemes and alternative financial arrangements such as Shari'a accounts.** The Government will also **enable credit unions to provide cash ISAs**.

Matching and the Saving Gateway

5.39 The Government continues to explore matching through the Saving Gateway, and launched a second pilot in March 2005. This is testing the effects of alternative match rates and contribution limits, initial endowments and the support of a range of financial education bodies. Around 22,000 accounts are now open; emerging findings suggest that participants are very positive about the scheme and are saving into their accounts in all pilot areas, with many obtaining the full match each month. Evidence from the pilot will inform the development of matching as a central pillar of the Government's strategy on saving and asset ownership for all.

Stakeholder savings and investment products

5.40 Legislation to create a new range of Stakeholder savings and investment products came into effect in April 2005. There are two new products designed to meet short- and medium-term saving needs, and to meet long-term saving needs there is a Child Trust Fund account and a revised Stakeholder pension. A £4 million campaign to raise awareness of the features and benefits of these products was launched in September 2005.[8] Industry support has increased since the campaign, with most providers now offering one or other of the long-term products, and a number offering all four Stakeholder products. The Government looks forward to more providers coming on stream in 2006.

Capital limits in benefits

5.41 The Government is committed to ensuring that the benefit system encourages households to save appropriately, particularly those on lower incomes. As announced in Budget 2004 and Budget 2005, **from April 2006 the lower and upper capital limits for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit will be raised to £6,000 and £16,000 respectively**.

Promoting financial capability and inclusion

Financial capability

5.42 Financial capability is vital to enable people to participate in a modern economy and to manage their finances effectively. People need access to information, the knowledge and skills to interpret it, and the confidence to take action. The Financial Services Authority (FSA), working in partnership with the Government, the financial services industry and other stakeholders, has developed a national strategy for financial capability.[9] A baseline survey of financial capability will be completed early in 2006, and to help maintain momentum **the FSA will report annually on progress towards meeting the objectives of the national strategy**. The Government attaches great importance to improving financial capability, and wants to play a full part in the delivery of this agenda.

[8] The campaign included two national television commercials, the 16-page leaflet *A guide to help you make sense of savings, investments and pensions*, and a new cross-government website at www.stakeholdersaving.gov.uk

[9] *Building financial capability in the UK*, Financial Services Authority, May 2004.

5.43 The *14-19 Education and Skills* White Paper emphasised the importance of financial education from an early age. The Government will now **address financial capability more explicitly in the curriculum** by including it in the new functional mathematics component of GCSE mathematics.

5.44 The Government will also take steps to strengthen adult financial capability, especially for groups with particular needs. Building on the work of Skills for Life, the Government will **embed financial capability in functional mathematics aimed at adults** and will **encourage local authorities to provide more financial education to parents** through Sure Start Children's Centres and locally delivered family numeracy programmes. In addition, the Government will **provide information on opportunities for financial education to applicants for Social Fund Budgeting Loans**.

Financial inclusion

5.45 Access to mainstream financial services can be restricted for many people on low incomes. *Promoting financial inclusion* outlined the Government's strategy to tackle this exclusion, including the establishment of a Financial Inclusion Taskforce to oversee progress and a Financial Inclusion Fund of £120 million.[10]

Access to banking

5.46 Despite recent progress, lack of access to banking remains a problem for millions of households. In December 2004, the banks and the Government agreed to work together towards a goal of halving the number of adults in households without a bank account, and making significant progress within two years. The Taskforce will monitor progress and report back to the Government and the banks.

5.47 In addition, to support the most vulnerable young people and prevent them becoming the unbanked adults of the future, the Government will **look to incorporate access to banking into training for the mentors of looked after children**.

Access to affordable credit

5.48 Many low-income households rely on credit products with Annual Percentage Rates of over 100 per cent. The Financial Inclusion Fund is being used to establish a 'growth fund' of £36 million to support third sector lenders providing affordable credit. Distribution of the fund will be informed by maps published today showing the coverage of third sector lenders in areas of high deprivation.[11] To give flexibility to better serve low-income groups, and following consultation, **the maximum rate of interest that credit unions can charge on loans will be increased from 1 per cent a month to 2 per cent a month**. The Government has also consulted on extending Community Investment Tax Relief to the personal lending activities of community development finance institutions. This indicated support for an extension and highlighted a range of practical issues that need addressing. The Government will continue to consider the case for, and practicalities of, this extension. In addition, £10 million of the Financial Inclusion Fund will be used in 2005-06 to support the administration of a scheme where, under certain circumstances, lenders can apply for repayment of arrears through deduction from benefits.

5.49 The Social Fund provides a safety net of grants and loans for the most vulnerable in times of need. The reforms announced in the 2004 Pre-Budget Report will now also mean that **from April 2006 the capital limits for Budgeting Loans, Crisis Loans and Community Care Grants will be doubled** to £1,000 for people of working age and to £2,000 for pensioners. This will ensure recipients are not penalised for having small amounts of savings.

[10] *Promoting financial inclusion*, HM Treasury, December 2004.

[11] Available on the HM Treasury website.

Access to money advice

5.50 Credit is a useful tool for managing expenditure for most people, but some have difficulty managing their borrowing and become over-indebted. The Government recognises that face-to-face money advice is an effective mechanism for tackling problem debt and is providing £45 million from the Financial Inclusion Fund to support increased provision, and a further £6 million to pilot money advice outreach.

FAIRNESS FOR PENSIONERS

5.51 A fair society guarantees security in old age and ensures that pensioners can share in rising national prosperity, while making sure that older people are able to play a full and active role in society. The Government is committed to tackling pensioner poverty and rewarding saving, and to addressing the challenge of enabling people to meet their retirement income aspirations in an ageing society.

Fairness for today's pensioners

Security for the poorest pensioners

5.52 The Government's strategy for pensioners is based on progressive universalism, providing support for all and more for those who need it most. To achieve this, the Government has first had to tackle pensioner poverty. Between 1997 and 2003-04, 2 million pensioner households were lifted out of absolute low incomes, and Pension Credit has been a key factor in achieving this. Since its launch in October 2003 over 2.7 million pensioner households have benefited from Pension Credit's guaranteed minimum income and/or reward for savings. This includes 2.1 million pensioner households who are receiving the guarantee element of Pension Credit, a take up level achieved a year ahead of target. The savings reward in Pension Credit has ended the unfair penalty of the 100 per cent marginal deduction rate that many savers faced, rewarding for the first time 1.9 million pensioner households who saved for their retirement. Around 80 per cent of the poorest pensioners who are entitled are currently benefiting from Pension Credit. The Government will continue to tackle pensioner poverty by:

- increasing the guarantee element of Pension Credit in line with earnings until 2008, as announced at the 2004 Pre-Budget Report. From April 2006 the guarantee element will rise to £114.05 for single pensioners and £174.05 for couples; and
- increasing the savings reward in Pension Credit. From April 2006 the savings reward will rise to a maximum of £17.88 a week for single pensioners and £23.58 for couples.

5.53 Pension Credit has been particularly successful in providing support for women pensioners, who sometimes find that they have not been able to build up as much pension as they might have hoped because of broken work records or low pay during their working lives. 2.1 million of those who benefit from the increased income provided by Pension Credit are women, and an estimated 90 per cent of single women eligible for Pension Credit are thought to be claiming it already.

Support for all pensioners

5.54 The Government has continued to build on the foundation of support for retirement incomes provided by the basic and additional state pensions. The steps taken to provide support for all pensioners include:

- guaranteeing that the April increase in the basic state pension will be in line with the Retail Prices Index for the previous September or 2.5 per cent (whichever is higher), meaning that from April 2006 the basic state pension will rise to £84.25 for single pensioners and £134.75 for couples;

- free television licences for those aged over 75, and free prescriptions and eye tests for those aged 60 and over;
- as announced in Budget 2005, from April 2006 free off-peak local area bus travel for those aged over 60 and disabled people in England; and
- additional payments to help with council tax and other living expenses, as announced in the 2004 Pre-Budget Report and Budget 2005.

Winter Fuel Payments

5.55 In addition, the Government will **extend Winter Fuel Payments at the level of £200 for households with someone aged 60 or over, rising to £300 for households with someone aged 80 or over, for the duration of this Parliament**.

Warm Front

5.56 Improving the energy efficiency of homes also plays an important role in helping pensioners keep warm and reduce their energy bills. The Warm Front programme aims to help the most vulnerable keep warm at the lowest possible cost, by providing them with effective central heating and insulation measures. Warm Front has already helped over 1 million households, and last year the Government announced that resources for Warm Front would increase so that by 2007-08 the total funds available will be £252 million. To further assist pensioners with their heating costs, the Government will **set aside an additional £300 million to enable pensioners on Pension Credit to have central heating systems installed free of charge, and provide a £300 discount on central heating systems to all other pensioners who do not already have one in their home.** Funding will be available for similar schemes in the devolved administrations.

5.57 Energy suppliers are actively involved in promoting energy efficiency measures through the Energy Efficiency Commitment. The first phase of the commitment finished last year and energy suppliers exceeded their targets. The second phase began this year and runs through to 2008. Energy suppliers have agreed to **install loft and cavity wall insulation free of charge to households on Pension Credit if they need it.** This complements the Government's commitment to provide central heating and will ensure that these households will be able to heat their homes efficiently and effectively. This is in addition to discounted insulation offered to all other pensioner households by energy suppliers.

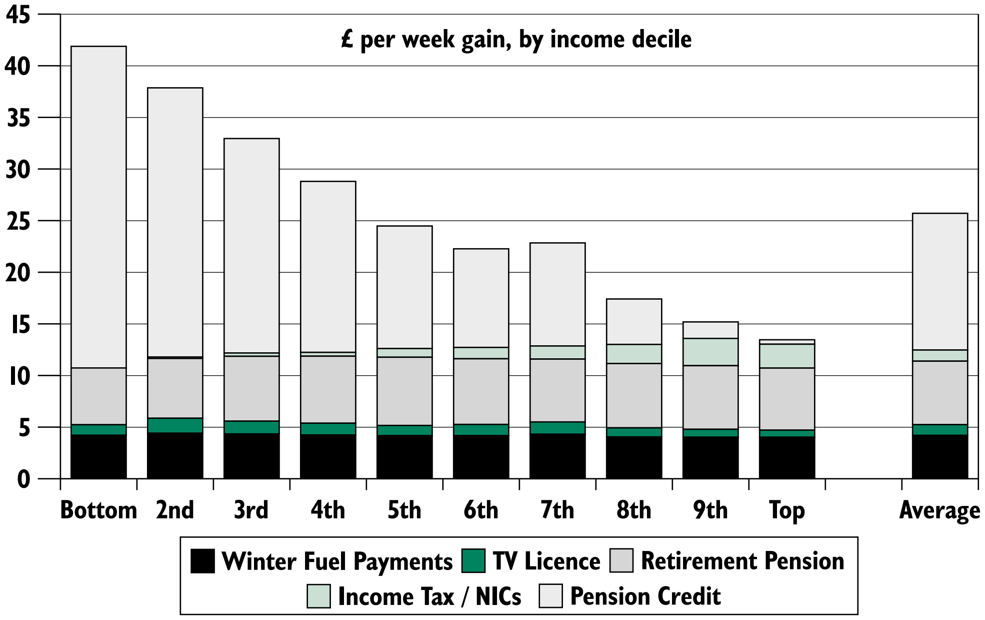
Support for all pensioners who pay tax

5.58 The Government is committed to supporting pensioners who pay income tax. Increases in the age-related tax allowances will mean that in 2006-07 no one aged 65 or over need pay tax on an income of up to £140 a week. This will mean that around half of all pensioners pay no tax on their income.

Effects of measures to support pensioners

5.59 As a result of measures implemented since 1997, the Government is spending around £10 billion a year more in real terms on pensioners. This is around £7 billion a year more than if the basic state pension had simply been linked to earnings over the same period. This approach has focused support on those who need it most. As a result of the tax and benefit measures the Government has introduced, the poorest 10 per cent of pensioner households will be on average £2,175 a year, or around £42 a week, better off. Overall, pensioner households will be on average £1,350 a year, or around £26 a week, better off. Chart 5.2 shows the distributional impact of the Government's measures to support pensioners.

Chart 5.2: Gains for pensioner families from pensioner tax and benefit policies by 2006



Source: Department for Work and Pensions.

Fairness for tomorrow's pensioners

Security **5.60** Retirement saving should be safe and secure. The establishment of the Pension Protection Fund in April 2005 ensures that, for the first time in the UK, individuals in defined benefit pension schemes will receive a meaningful proportion of their expected pension income if their sponsoring employer becomes insolvent. The establishment of a proactive Pension Regulator further improves the security of occupational schemes.

Choices for working **5.61** Enabling people to extend their working lives by providing greater choice and flexibility for those who wish to do so is a critical element of any pensions policy, and the Government has further improved employment opportunities for older workers. In addition, changes that took effect from April 2005 mean that those choosing to defer taking their state pension will be better rewarded with a higher pension or a taxable lump sum. From April 2006 it will be possible to draw an occupational pension while remaining with the same employer. The Government will also implement the age discrimination strand of the European Employment Directive in late 2006.

Pensions tax simplification **5.62** Pensions tax simplification sweeps away the numerous existing tax regimes and replaces them from 6 April 2006 ('A-day') with a single universal regime for tax-privileged pensions saving. The new regime will provide individuals with greater flexibility and choice over their retirement savings, and will benefit both employers and pension providers through increased flexibility and reduced administration costs.

5.63 A small part of the proposed simplification would allow all registered pension schemes to invest directly in residential property. To prevent the potential abuse of the simplification rules, where people could claim tax relief in relation to pension contributions into Self Invested Personal Pensions (SIPPs) for the purpose of funding purchases of holiday and second homes for their or their family's personal use, **from 6 April 2006 SIPPs and all other forms of self-directed pensions will be prohibited from obtaining tax advantages when investing in residential property, and certain other assets such as fine wines**. This action will ensure that tax relief is only given to those whose purpose in making the contribution is to provide themselves with a secure retirement income. However, the Government remains committed to encouraging investment in a range of assets as part of pensions saving and is therefore minded to allow SIPPs to invest in genuinely diverse commercial vehicles that hold residential property, such as the proposed Real Estate Investment Trust model (detailed further in Chapter 3). The Government will not hesitate to take action if it becomes clear that people are trying to use collective vehicles to get around the rules for prohibited assets.

5.64 In addition, the Government will take action to **prevent abuse of the rules for tax-free lump sums from 6 April 2006**, by removing tax advantages when lump sums are recycled back into funds in order to generate artificial levels of tax relief. The Government will also introduce **a small package of supplementary measures to ensure the pension tax rules operate as intended**.

5.65 Following the statement made by the Paymaster General in March 2005, the Government will bring forward legislation in the Finance Bill to **clarify how inheritance tax will apply to choices under the new pension scheme rules**, with effect from 6 April 2006. Further details will be announced in the New Year.

Pensions Commission

5.66 Alongside the Pensions Green Paper in 2002, the Government established the Pensions Commission to examine the regime for private pensions and long-term saving, and consider whether the level of compulsion within the UK pensions and retirement system is appropriate. The Commission's interim report was published in October 2004,[12] and a final report was published on 30 November 2005.[13]

5.67 The Government has welcomed the broad framework of the Commission's report, and has set out the five principles on which its response will be based: the pension system must promote personal responsibility; it must be fair; it must be affordable; it must be simple; and it must be sustainable. The Government has said that the principle of affordability will be central. There will be no relaxation in fiscal discipline, and it will not put the long-term sustainability of the public finances at risk. The Government has announced a major consultation exercise, and it intends to work towards the publication of a White Paper in spring 2006.

5.68 The *Long-term public finance report,* published alongside this Pre-Budget Report, sets out projections for long-term public finances including spending projections. Box 5.4 explains the Government's approach to long-term projections for expenditure on state pensions, as used in the report.

[12] *Pensions: challenges and choices,* Pensions Commission, October 2004.

[13] *A new pension settlement for the twenty-first century,* Pensions Commission, November 2005.

Box 5.4: Long-term expenditure on state pensions

The *Long-term public finance report* sets out projections for long-term expenditure on state pensions on the basis that the Guarantee Credit within Pension Credit is indexed in line with earnings. This should not be taken as the Government's policy but as just one possible scenario which leads to an upper estimate of the possible long-term cost of Pension Credit, in order to be prudent and cautious.

It has never been the intention that this scenario should be interpreted as defined Government policy beyond the current commitments. As all previous *Long-term public finance reports* state, the scenarios used in the long-term projections: "...should not be interpreted as meaning that policy will not change over time but is used so that the long-term projections do not prejudge future Government policy".[a]

This was recognised by the independent Pensions Commission in its recent report.[b] When discussing the assumptions that it uses in its projections of state pension spending, the Commission's report states: "[These assumptions] are not however defined government policy for the long-term since for example the Government has only made firm commitments to the Pension Credit indexation regime until 2007-08".[c]

The Government has made clear that decisions relating to the future indexing of Pension Credit will be made on a Budget and Spending Review timetable in the context of resources and priorities. To date the Government has committed to index the Guarantee Credit within Pension Credit by earnings only until the end of the current Spending Review period (2007-08). This commitment forms the basis of the Government's medium-term expenditure plans.[d] If the Government were to decide to index the Guarantee Credit by earnings beyond this period, such a decision would need to be accounted for in the table of Budget policy decisions in the Financial Statement and Budget Report.

The Pensions Commission has set out the additional costs of indexing the Guarantee Credit by earnings in real terms, over and above the Government's medium-term expenditure plans. These costs are reproduced in the table below.

Pension Credit indexation: additional costs of earnings indexation relative to indexation by Rossi (real terms 2005-06 prices)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
£ billion	1.4	2.5	3.3	3.3	3.2	4.3	4.7	5.2	5.2	5.9	6.4

Source: Pensions Commission. See http://www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/media/costs.pdf

The Pensions Commission has also estimated that the total cost of its package would be £7.6 billion in 2020 in real terms, relative to expenditure assuming earnings indexation of the Guarantee Credit. As shown in the table above, the cost of indexing the Guarantee Credit by earnings reaches £6.4 billion by 2020. For public finance purposes this £6.4 billion would be an addition to the medium-term expenditure forecast. As the Pensions Commission has stated, "against this level the cost of the package is £14 billion" in 2020, expressed in real terms.[e]

[a] See for example page 40 of the *2003 Long-term public finance report*, HM Treasury, December 2003.

[b] *A new pension settlement for the twenty-first century*, Pensions Commission, November 2005.

[c] *Ibid*, page 13.

[d] See Annex B of the *2005 Pre-Budget Report*, HM Treasury, December 2005, which sets out the assumptions used to project public sector spending for the years 2008-09 to 2010-11.

[e] *Sanity in the numbers*, Pensions Commission, December 2005.

SUPPORTING COMMUNITIES, CHARITIES AND GIVING

5.69 The third sector plays a vital role in creating a fair and enterprising society, from bringing people together through voluntary action and advocacy, building social capital and strengthening communities, to the delivery of public services. Since 1997, the Government has created a framework within which voluntary and community action can flourish, with support for community programmes and encouragement for increased levels of volunteering and mentoring. The Government also provides support to charities through the tax system, with tax reliefs and special provisions to the sector worth £2.4 billion per year.

Year of the Volunteer

5.70 Recognising the vital role of voluntary action in building cohesive communities and meeting individual, business and third sector goals, 2005 is the Year of the Volunteer.[14] Working with Volunteering England, Community Service Volunteers and other partners in the media, the private and the voluntary and community sectors, the Government has invested over £7 million in the course of the year. This additional investment has supported the volunteering infrastructure and led to a high-profile media and voluntary sector campaign to raise awareness of volunteering. As the year draws to a close, the benefits and the legacy of the year are clear:

- over 1,000 volunteer-focused events held up and down the country, from village halls to Buckingham Palace, celebrating the contribution of volunteers and encouraging more to come forward;
- over 23 million hours (1.4 billion minutes) pledged by volunteers across the country; and
- over 65,000 volunteers registered to help with the 2012 Olympics.

5.71 The Government will work with business and the voluntary and community sector to embed the legacy of the year.

Youth volunteering

5.72 The Russell Commission report published at Budget 2005 set out recommendations to deliver a step change in the diversity, quality and quantity of young people's volunteering, with an ambition of attracting 1 million more young volunteers over five years.[15] These recommendations included the creation of an independent implementation body, to drive forward progress. **After a founding period led by Ian Russell, this body will be chaired by Rod Aldridge,** currently chair of the Capita Group. The Board will be made up of young people and representatives from business and the voluntary and community sector. The Government will also **establish a cross-departmental Ministerial group on youth volunteering**, chaired by the Chancellor, to support the work of the implementation body.

5.73 Budget 2005 announced public investment for this work of up to £100 million over the next three years, including a fund available to match contributions from business. **£3.5 million has already been committed by T-Mobile, ITV, KPMG, MTV, Tesco, Sky and the Hunter Foundation as Founding Partners.** In this financial year, some of the investment will be used to fund a series of projects to build capacity and highlight best practice in delivering youth volunteering. To ensure a greater diversity of new young volunteers, the Government will also **by April 2006 publish a rulebook to set out existing rules on volunteering and the benefit system**.

[14] For more information see www.yearofthevolunteer.org

[15] *A national framework for youth action and engagement*, Russell Commission, March 2005.

Mentors **5.74** Mentoring can benefit both young people being mentored and volunteers acting as mentors. It can also strengthen local communities, by linking people of different cultures, ages and ethnicities. The Mentoring and Befriending Foundation, supported by the Government, is working to promote the growth and development of mentoring, and will continue to develop the evidence base for mentoring. *Support for parents: the best start for children*, published alongside this Pre-Budget Report, announces two new mentoring programmes for young people. Further details on these programmes are set out in Box 5.1.

Promoting charitable giving **5.75** The Government is committed to creating a generous society through support for charitable giving. Gift Aid donations continue to increase in value, and in 2004-05 charities claimed tax repayments of £625 million on Gift Aid. As part of continuing efforts to simplify Gift Aid, the Government recently announced changes to the requirements for Gift Aid declarations. Since 1 November, charities keeping auditable records of oral Gift Aid declarations have no longer needed to send written confirmation to donors. This change will save charities around £1 million a year in administration costs, and make Gift Aid easier to claim. In addition, **legislation will be introduced in 2006 to enable companies owned by more than one charity to donate their profits to parent charities using Gift Aid**.

5.76 In Budget 2005 the Government announced that it would continue to work to identify new ways to promote charitable giving. The Home Office has since set out a number of programmes to encourage a culture of giving.[16] These include training and mentoring for charities to help them benefit from tax-effective giving, and commissioning the creation of a centre of excellence for charitable giving research.

5.77 In January 2005 the Home Office launched a scheme to improve access to Payroll Giving for the 12 million employees in small and medium sized enterprises (SMEs). Since the introduction of the scheme, the number of SMEs offering Payroll Giving schemes has increased by more than 1,200, from around 900 to over 2,100.

Charitable payments in benefits **5.78** All charitable, voluntary and personal injury income payments are already disregarded in Pension Credit and pension-age Housing Benefit and Council Tax Benefit. To further simplify the tax and benefit system, the Government will **from October 2006 disregard in full all charitable, voluntary and personal injury income payments when assessing eligibility for Income Support and Jobseeker's Allowance**. This will enable charities to direct support to individuals without affecting their entitlement to these benefits. The Government will also **from October 2006 provide a 52 week grace period for lump sum personal injury payments** when assessing eligibility for Income Support, Jobseeker's Allowance, and working-age Housing Benefit and Council Tax Benefit.

Unclaimed assets **5.79** It is a feature of modern life that people often lose track of small sums and deposits. Over time these build up as unclaimed assets in the banking system, despite the continuing efforts of the industry – enshrined in the Banking Code for example – to reunite such funds with their owners. In an increasing number of countries in recent years systems have been put in place to enable those funds to be reinvested in society while they remain unclaimed, without removing in any way the rights of owners, if they can be traced, to be reunited with their assets. The Government has taken the view that the time has come to put in place a similar system in the UK, and has been in discussion with the industry about how best to achieve this and about the industry continuing to follow best practice in reuniting assets with their owners.

[16] *A generous society – next steps on charitable giving in England*, Home Office, November 2005.

5.80 The Government has been working with the industry to design a scheme which both preserves the rights of the individual customer and at the same time allows these assets to be reinvested in the community. In this context the Government recognises the need to ensure that the legal and accounting consequences for both the customer and the industry of transferring funds in this way are properly protected, and is in discussion with the industry about effective arrangements needed to achieve this.

5.81 The Government and the industry have agreed that the definition of an unclaimed asset should generally cover accounts where there has been no customer activity for a period of 15 years as that will best identify those accounts that are genuinely unclaimed, and it will consult further on the detail of this. On this basis, initial record searches by the industry suggest that several hundred million pounds may currently lie unclaimed.

5.82 The Government believes that where owners and their assets cannot be reunited, the money should be reinvested in the community, particularly in deprived communities, in a sustainable way, through a coordinated delivery mechanism, with a focus on youth services that are responsive to the needs of young people, and also on financial education and exclusion. There would be an option for small locally-based financial institutions to focus on these needs in their local communities.

5.83 The Government welcomes the commitment from the industry to work to these objectives. The Government and the industry will continue to work together, to develop the best structure to deliver this approach, and will consult with stakeholders such as organisations representing the interests of young people and the Commission on Unclaimed Assets.

Corporate giving by banks

5.84 Separately, the Government recognises that banks are the largest corporate donors, and that the six largest banks have together donated over £500 million over the last five years.

DELIVERING A MODERN AND FAIR TAX SYSTEM

5.85 A modern and fair tax system encourages work and saving, keeps pace with developments in business practices and the global economy, and provides the foundation for the Government's objective of building world-class public services.

5.86 In order to ensure the tax system is effective in meeting these objectives, the Government will continue to develop a modern and customer-focused tax administration; to modernise tax policies to keep pace with a changing world; and to react swiftly and proportionately to protect tax revenues and tax credits from non-compliance.

Modernising tax administration

5.87 The newly integrated HM Revenue & Customs (HMRC) is working to simplify tax administration for its customers. Improved use of information and technology are enabling better risk assessment and targeting of resources and, together with the deregulatory measures described in Chapter 3, are reducing compliance costs. A number of reviews are underway to support these objectives.

Review of HMRC powers

5.88 In March 2005 the Government launched a review of HMRC powers and taxpayer safeguards to provide modern tools for the new organisation. The review, informed by a consultative committee of tax experts, business representatives and others, is making good progress, and further details will be published early next year.

A new Management Act 5.89 HMRC is also reviewing its administrative rules, and will develop and consult on new legislation that will bring together the rules for the main taxes. This will reduce burdens on businesses and facilitate HMRC's provision of a unified service across these taxes.

Carter Review of Online Services 5.90 In July 2005 the Government asked Lord Carter of Coles to review the use of HMRC's key online services, building on his previous review of payroll services. He has completed his work but wishes to assess the progress of HMRC's online services over the next few months, before finalising his conclusions by early spring 2006.

Modernising the tax system

Income Tax and NICs 5.91 The income tax personal allowances will increase in line with inflation in 2006-07. The national insurance contributions (NICs) thresholds and limits will also increase in line with inflation. There will be no change to NICs rates for employers and employees, or to the Class 4 rate paid by the self-employed, and the flat rate of Class 2 NICs paid by the self-employed will be frozen at this year's levels. Annex B provides further details of changes to the rates and allowances in the tax and benefit system.

Taxation of small business 5.92 The zero per cent and minimum rates of corporation tax were introduced to encourage small companies to retain and reinvest their profits for growth. However, many self-employed and employed people are being advised to incorporate simply to reduce their tax and NICs liability. The Government has considered the issue of continuing tax-motivated incorporation in the light of responses to its 2004 discussion paper,[17] where most respondents favoured simplification over options which risked introducing additional complexity. The Government has therefore decided to **replace the non-corporate distribution and zero per cent rates with a new single banding set at the current small companies' rate of 19 per cent**. This will simplify the corporation tax calculations for most small businesses, refocus incentives, and leave the small companies' rate at its lowest since its introduction in 1973.

5.93 To ensure that small businesses are provided with incentives to invest for growth, the Government will **extend their first-year capital allowances to 50 per cent** in the year from April 2006, benefiting 4.2 million small businesses. As outlined in Chapter 3, to assist more small traders with their cashflow, the Government will double the VAT Annual Accounting Scheme turnover threshold to £1,350,000 from April 2006, and has written to the European Commission for derogation to increase the Cash Accounting Scheme turnover threshold to the same level. These measures will benefit both small companies and sole traders, with up to 1 million small businesses able to benefit from a range of more flexible payment options to suit their business needs.

5.94 The Government will continue to keep the structure of tax and NICs under review to ensure an appropriate balance between fairness for individuals and employers, incentives to work, save and invest, and reducing administrative burdens.

Film tax reform 5.95 The Government is committed to supporting the sustainable production of British films, and recognises the cultural and economic benefits that they bring. Following consultation, the Government today announces further details of the new tax incentives available for culturally British films.[18]

[17] *Small companies, the self-employed and the tax system*, HM Treasury, December 2004.

[18] Details of the new cultural test for British films are released today by the Department for Culture, Media and Sport.

5.96 Films costing £20 million or less will be allowed an **enhanced deduction of 100 per cent of qualifying production costs with a payable cash element of 25 per cent,** while films costing more than £20 million will be allowed an **enhanced deduction of 80 per cent with a payable cash element of 20 per cent**. The Government also intends to **allow losses to be utilised in ways that will support more sustainable investment** in the British film industry. The new incentives will replace the existing reliefs from 1 April 2006, subject to state aids clearance, and will provide better-targeted and more effective support direct to film production companies.[19]

Direction of corporation tax reform

5.97 The Government believes that the business tax system should promote productivity and growth by supporting business competitiveness, while ensuring that business contributes a fair share to the funding of public services. The Government remains committed to engaging with business on the direction of corporation tax reform.

5.98 Global economic integration and the increasing international focus of many businesses pose continuing challenges for the UK corporate tax system. Addressing these challenges is a shared priority for the Government and business, and will be the focus for continuing dialogue. Following helpful discussions with business, the Government has no current plans to take forward proposals on partial schedular reform or the taxation of capital assets.

5.99 The Government continues to consider the scope for modernising capital allowances. Responses to the 2004 technical note[20] identified the regime for business cars as a priority, and the Government therefore intends to continue developing potential reforms, including a new car pool with a range of first-year allowances for cars depending on carbon dioxide (CO_2) emissions. This would build on the existing 100 per cent first-year allowances for cars with very low emissions, and on reforms to vehicle excise duty and company car tax.

Accounting standards

5.100 The Government continues to work closely with business and the professions to manage the impact on the tax system of the introduction of International Accounting Standards (IAS) for UK companies. Following representations from business, **Regulations will be tabled to deal with some further technical issues and to spread the impact of the transition to IAS.** As the first accounts are filed under IAS, the Government will be monitoring the impact of the new standards on the corporation tax base and on the timing of tax receipts.

5.101 The Government will legislate in Finance Bill 2006 to **enable most businesses affected by the March 2005 changes in the income recognition rules in UK Generally Accepted Accounting Practice (GAAP) to spread any extra tax charge over three years**, while those businesses most severely affected will be able to spread the charge over a period not exceeding six years.

Shari'a compliant financial products

5.102 The Government introduced legislation in Finance Act 2005 that provides clear tax treatment and a level playing field for certain Shari'a compliant financial products. Building on this success, the Government is continuing to consult with a wide range of interested parties to take forward the agenda for further such products.

Residence and domicile

5.103 The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals, and in taking the review forward will proceed on the basis of evidence and in keeping with its principles.

[19] Further details of who is eligible for the relief, transitional rules and changes in the basic treatment of film expenditure are available on the HMRC website.

[20] *Corporation tax reform – technical note*, Inland Revenue, December 2004.

S765 Treasury consents **5.104** Businesses have expressed concern over the 'Treasury consents' legislation, which requires companies to seek permission from HM Treasury to carry out certain transactions relating to their overseas subsidiaries. In line with commitments made earlier this year, the Government will **in the New Year begin discussions with business on possible replacements for this legislation**.

Leasing **5.105** In the 2004 Pre-Budget Report, the Government announced that the tax treatment of leased plant and machinery would be aligned with that of other forms of finance, with legislation in Finance Bill 2006. Further details, including the latest draft legislation, are published today.

5.106 The Government will **make a change to the tax treatment of sales of lessor companies**, effective immediately, in response to increasing tax-driven activity in this area. This measure imposes a charge on the leasing company on the day that it is sold, in order to recover the tax benefits that have been taken, and grants an equal relief on the day after the sale. It should not deter commercially-driven transactions. Further details and draft legislation are published today.

Valuation of oil for non-arm's length sales **5.107** Following discussions with the industry, from 1 July 2006 the Government will reflect common commercial practice by for tax purposes valuing most non-arm's length disposals of oil by **taking an average value of the daily prices over a five-day period around the date of delivery**. The Government will continue to discuss particular pricing issues with industry, to ensure that tax-driven behaviours do not distort commercial practice.

Lloyd's insurance market **5.108** Following discussions with the Lloyd's market, the Government is tabling Regulations to modernise tax administration and collection, and will **simplify the way that Lloyd's corporate members can claim relief under double taxation treaties**.

Modernising VAT **5.109** The Government has considered responses to the consultation on a recent European Court of Justice (ECJ) judgment concerning VAT and insurance-related services. The Government has noted that the VAT treatment of financial services and insurance will be subject to review by the European Commission in the near future, and has decided to **delay implementation of this ECJ judgment**. The Government will monitor the progress of the review in deciding when to make the necessary changes to UK law, and will provide industry with sufficient notice in advance of implementation.

5.110 In addition, the Government is **introducing a package of measures to modernise, simplify and provide greater certainty for businesses in dealing with certain VAT and land and property matters**.

Gambling **5.111** The Government is committed to a modern and fair gambling tax system, consistent with wider tax principles and with supporting social and economic objectives. Budget 2004 announced that the Government would review gambling taxation in light of the Gambling Bill. This review has benefited from substantial input from stakeholders. The Government has considered taxation arrangements within the wider context of changes to regulation, technology and gambling markets. It has concluded that the current taxation arrangements for gambling are generally working well at present and that maintaining stability in the overall structure of taxation is desirable in a period of transition. In these circumstances, the Government has therefore decided to maintain the current regimes which are working well for betting, betting exchanges, lottery and bingo, and to retain the system of amusement machine licence duty (AMLD), rather than move to a gross profits tax. However, the Government will make some modifications to align the tax regime with the Gambling Act:

- **the definition of a gaming machine for VAT purposes will be aligned** with that of the Gambling Act, with effect from tomorrow. From Budget 2006, **the AMLD regime will also be aligned** with the Gambling Act;
- the Government will **consider options for simplifying the administration of AMLD and reducing compliance costs**; and
- following the Gambling Act's provision for remote gaming licences to be offered in the UK, **remote gaming will be brought within the scope of gambling taxation**. The rate of taxation will be set in Budget 2006.

Protecting tax revenues

5.112 For the tax system to be effective, everyone needs to pay their fair share of taxes and receive the tax credits they are entitled to. Tax avoidance and tax or tax credit fraud undermine the ability of the tax system to deliver its objectives, imposing significant costs on society. The Government's strategic approach to tackling tax avoidance, evasion and fraud will continue to be based on the principles of fairness and customer focus, ensuring actions are effectively tailored to the needs and behaviours of different taxpayers.

Tackling tax avoidance

5.113 Tax avoidance undermines the fairness of the system and causes market distortions. As part of its strategic approach, the Government will continue to use a range of legislative methods that tackle avoidance without hindering genuine commercially-driven behaviour, including: specific loophole-closing measures; targeted, purpose-based anti-avoidance provisions; and structural changes to tax systems to reduce the capacity for avoidance.

5.114 Budget 2004 introduced a disclosure regime to target tax avoidance schemes in a number of specific areas of the tax system. This has enabled the Government to detect and respond to avoidance swiftly. The Government will therefore:

- **extend the disclosure regime** to all of income tax, corporation tax and capital gains tax; and
- respond to changes in avoidance behaviour by **modifying the existing disclosure rules** and **changing the time limit for in-house disclosures by business to 30 days** to bring it more into line with that for promoters.

5.115 These changes will be effective from April 2006. HMRC will be discussing them with stakeholders before they come into effect.

5.116 As part of its anti-avoidance strategy, the Government is introducing measures, effective from today, that will:

- **prevent companies creating and using capital losses purely to gain a tax advantage**, by repealing existing mechanical provisions and replacing them with a more targeted, purpose-based approach;
- **close an avoidance scheme involving stock lending that converts taxable income into a non-taxable receipt**;
- **counter avoidance that seeks to generate unintended relief for corporate intangible assets**;
- **counter schemes designed to generate capital losses on disposals of rights conferred by certain insurance policies**;
- **tighten existing anti-avoidance legislation on transfer of assets abroad** to prevent income tax avoidance; and

- **counter inheritance tax avoidance that uses second-hand interests in foreign trusts** and **close a loophole which allows individuals to avoid paying either inheritance tax or the income tax charge on pre-owned assets**.

5.117 Since an announcement in the 2004 Pre-Budget Report, the Government has legislated to close down contrived schemes that were used to avoid tax and national insurance contributions. The Government will monitor remuneration arrangements over the bonus season, and will not hesitate to legislate further to close down such schemes. Where necessary this legislation will be effective from 2 December 2004.

Tackling VAT losses

5.118 The Government continues to challenge VAT fraud and avoidance through a combination of legislation, litigation and operational initiatives. The success of this strategy has been evidenced by a recent Court of Appeal decision and the conclusion of litigation relating to the card-handling VAT avoidance scheme used by many retailers.

5.119 Missing Trader Intra-Community (MTIC) fraud is an EU-wide attack on the VAT system. The Government remains determined to tackle this fraud, and the criminals perpetrating it, and is taking steps to strengthen its MTIC strategy. HMRC is intensifying its operational activities throughout the UK and its cooperation with other countries to combat this fraud. The Government will not hesitate to bring forward additional legislation if necessary.

Tackling tobacco smuggling

5.120 To enhance its strategy to tackle tobacco smuggling, the Government is:

- **agreeing improved Memoranda of Understanding with UK tobacco manufacturers** to restrict the availability of cigarettes and hand-rolling tobacco to smugglers, and to tackle the problem of counterfeit material, including consultation on **options for introducing covert markings for the UK tobacco retail market**;
- consulting with the industry on complementary legislation to be introduced in Finance Bill 2006, aimed at **preventing organised criminal gangs from exploiting weaknesses in supply chains** for tobacco products;
- **deploying 200 staff** specifically to tackle the smuggling of hand-rolling tobacco; and
- reviewing operational activities to deliver maximum impact against the growing threat from counterfeit tobacco products.

Spirits fraud

5.121 Spirits fraud continues to be a significant problem, and the duty stamps scheme is central to the Government's strategy for tackling it. **Secondary legislation will be laid before Parliament shortly**, allowing the spirits industry to make early preparations for the new scheme coming into force in October 2006.

Oils fraud

5.122 In 2001, oils fraud cost the Exchequer around £700 million – 6 per cent of the UK diesel market. The UK Oils Strategy to tackle fraud has already helped reduce this to 4 per cent, and has a target to reduce it to 2 per cent by 2006. To reduce incentives for fraud, the Government will narrow duty differentials by **increasing the duty rate by 1.22 pence per litre for rebated gas oil** ('red diesel'), with effect from midnight tonight. Announcements on other fuel duties are set out in Chapter 7.

5.123 The Government published in 2004 a consultation document on the categories of vehicles eligible to use rebated gas oil.[21] The Government was concerned that the scope of the relief was unclear and had extended beyond the original intention, leading to revenue leakage and areas of unfair competition, and hampering enforcement efforts. The Government is **proposing changes to the categories of eligible vehicles**, as outlined in a summary of responses to the consultation. HMRC has published this today, along with a partial regulatory impact assessment.

Protecting the UK tax base

5.124 The Government is determined to continue to defend robustly the corporation tax system against legal challenges under EU law.

5.125 Globalisation and technological change mean that it is increasingly important for tax authorities to have the tools to tackle evasion and avoidance involving non-EU countries. The Government will bring forward legislation, complementing that which exists for direct taxes, to allow it to **make bilateral agreements with non-EU countries** in relation to exchange of information on indirect taxes and to **ratify the Council of Europe / OECD 1988 Convention on Mutual Administrative Assistance in Tax Matters**.

Tax credits compliance

5.126 Alongside new measures to improve the operation of tax credits, the Government will take further action to improve compliance in the tax credits system. The Government is constantly looking to minimise risks from non-compliance, while ensuring claimants receive the money they are entitled to. HMRC already has sophisticated checks to avoid paying out money on claims that have the hallmarks of non-compliance, and to identify cases to investigate because of a potential risk. Building on this HMRC will take further steps to improve the accuracy and security of tax credits:

- HMRC will more than double the number of pre-payments checks carried out on new claims, including doubling the number of pre-payment checks carried out in cases where it suspects there may be an undeclared partner living in the household; and
- HMRC will introduce new training and procedures for all Contact Centre staff who handle calls from tax credits claimants, so that they can recognise and intercept potential fraud in telephone contacts from the public.

RESPONDING TO OIL PRICES & TACKLING FUEL POVERTY

5.127 The Government is committed to maintaining an active UK oil and gas industry and to promoting the future development of the nation's gas and oil reserves. The Government introduced a package of reforms to North Sea oil taxation in Budget 2002. At that time prices were around US$25 per barrel. Since then world oil prices have risen to levels of around $55 per barrel over the last couple of months, having peaked at $67 per barrel in September. Since Budget 2002 prices have averaged $37; in the previous ten years they averaged $19. These increases have led to the pre-tax return on capital for North Sea oil producers rising to an average of over 30 per cent since 2002, and to around 40 per cent this year, compared with an average of 13 per cent for companies in other non-financial sectors of the economy.

[21] *Hydrocarbon oil duty*, HM Customs & Excise and HM Treasury, December 2004.

5.128 Previously most market analysts attributed rising prices to a combination of short-term demand and supply factors, such as weather effects on demand and supply, actual or potential supply disruptions in Iraq, and wider geopolitical uncertainty. However, more recent analysis has emphasised medium-term factors such as the impact of robust demand from emerging markets, in combination with constrained supply and refining capacity. External estimates now expect the upward shift in oil prices to be sustained in the medium term, reflecting in particular the prospect for sustained increased demand for oil from emerging markets and the pace at which new supply capacity can be brought on line.

North sea oil taxation

5.129 In striking the right balance between producers and consumers, the North Sea oil taxation regime needs to promote investment and ensure fairness for taxpayers. In response to the recent significant rises in oil prices which are now expected to be sustained in the coming years, the Government will, with effect from 1 January 2006, **increase the rate of supplementary charge to 20 per cent to maintain this balance**. North Sea oil companies will be able to **elect to defer 100 per cent relief for capital expenditure incurred in 2005 into the following year.**

5.130 The Government will also **introduce a Ring Fence Expenditure Supplement to uplift all expenditure by North Sea oil companies without taxable income**, to ensure that the value of tax relief is maintained over time. This replaces and extends the current Exploration Expenditure Supplement. The Government intends to open discussions with industry to examine wider structural issues which have implications for the stability of the North Sea oil tax regime. The Government is clear that there will be **no further increases in North Sea oil taxation during the life of this Parliament**.

Tackling fuel poverty

5.131 The Government will use additional revenue from the nation's North Sea oil resources to help consumers most affected by the significant increases in oil and energy prices. Higher fuel and heating prices can cause particular problems for pensioners on fixed incomes and the Government recognises that it is vital that older people can keep warm in the winter. The Government will therefore use additional revenue from the North Sea to support pensioner households and to invest for the longer term in tackling fuel poverty, as described earlier in this chapter.

5.132 More information on how the Government's policies are responding to high oil prices, by investing in energy efficiency and alternative sources of energy, including decisions on fuel duties, is set out in Chapter 7.

TACKLING GLOBAL POVERTY

5.133 2005 has been a vital year for development. The UN Millennium Development Goals (MDGs) and global poverty have been at the heart of the UK Presidencies of the G7/8 and EU. It is crucial to ensure that action is taken on trade in Hong Kong and that G8 commitments deliver accelerated progress towards the MDGs. Meeting the MDGs requires a fully-funded, comprehensive plan to eliminate poverty and put countries on a sustainable path to growth and eventual graduation from aid.

Box 5.5: 2005 – Key events for international development

G7 Finance Ministers have discussed international development issues extensively at their meetings this year. At their first meeting in February they reaffirmed their commitment to help developing countries achieve the MDGs, and agreed a series of progressive 'conclusions on development'. At the June meeting held in London they reached an agreement on 100 per cent multilateral debt cancellation for Heavily Indebted Poor Countries (HIPCs); universal access for AIDS treatment by 2010; and the need for poor countries to have the flexibility to decide, plan and sequence reforms to their trade policies to fit with country-owned development strategies. They also set out their financing commitments, which were reconfirmed by G8 Heads of State at Gleneagles on 6-8 July 2005 and will result in an additional $50 billion a year in development aid by 2010 compared with 2004, $25 billion a year of which will be for Africa.

Aid – delivering commitments

5.134 The commitments made by the EU and the G8 to provide an additional $50 billion in aid by 2010 compared to 2004, and for the EU to reach overseas development assistance of 0.7 per cent of Gross National Income (GNI) by 2015, are important steps towards helping the poorest countries achieve the MDGs. But more needs to be done both to deliver and to bring forward these commitments. For this reason, the Government supports the International Finance Facility (IFF), which would frontload donors' existing long-term aid commitments through bond issuances on the international capital markets, to deliver immediately the additional and predictable funding needed to achieve the MDGs. The UK and France have announced their joint commitment to implement the IFF using part of the revenues from air passenger ticket levies. The UK already has such an air ticket levy (Air Passenger Duty), and will use part of the existing revenue this generates to provide a long-term financial commitment to the IFF.

Box 5.6: The International Finance Facility for Immunisation

On 9 September the UK launched the pilot International Finance Facility for Immunisation (IFFIm), in partnership with France, Italy, Spain and Sweden, and alongside contributions from the Bill & Melinda Gates Foundation. The IFFIm will use the frontloading principles of the main IFF to provide an additional $4 billion over the next ten years in support of the Vaccine Fund and the Global Alliance for Vaccines and Immunisation, which work to tackle some of the deadliest diseases in some of the world's poorest countries. The IFFIm will demonstrate the technical feasibility of the larger IFF and the clear economic benefits of frontloading resources. By frontloading $4 billion over ten years through the IFFIm mechanism, an estimated five million lives could be saved in the years to 2015. A further five million adult lives could also be saved from later death caused by hepatitis B in adulthood.

5.135 The UK has set a clear timetable for achieving the UN target for overseas aid of 0.7 per cent of GNI by 2013. The 2004 Spending Review announced that by 2007-08, total UK aid will rise to nearly £6.5 billion a year (0.47 per cent of GNI), a real terms increase of 140 per cent since 1997. If the proposal for the IFF is agreed, the equivalent of 0.7 per cent of GNI could be achieved in 2008-09.

5.136 The G8 has agreed to focus aid on low-income countries that are committed to growth and poverty reduction, to democratic, accountable and transparent government and to sound public financial management – while acknowledging that aid is also important to respond to humanitarian crises and countries affected by or at risk of conflict. It is up to developing countries and their governments to take the lead on development. They need to decide, plan and sequence their economic policies to fit with their development strategies, for which they should be accountable to all their people. The UK and other donors will be monitored on commitments made in the OECD Development Assistance Committee's Paris Declaration on aid effectiveness, including: enhancing efforts to untie aid; disbursing aid in a timely and predictable fashion (and through partner systems where possible); and increasing harmonisation and donor co-ordination, including through more programme-based approaches. The Government remains committed to the principles of country ownership of policy, as set out in *Partnerships for poverty reduction: rethinking conditionality*, published earlier this year.

Debt relief

5.137 The experience of the last five years of the Heavily Indebted Poor Countries (HIPC) Initiative has shown that debt relief can be an extremely effective tool in support of poverty reduction. Under this initiative the debt burden of the world's poorest countries is being reduced over time by some $70 billion, allowing the savings from debt relief to fund country-owned strategies aimed at reducing poverty. The HIPC Initiative has played a significant role in debt relief already, reducing debt payments from an average of nearly 24 per cent of government revenues to 11 per cent. Of the resources released by debt relief, 65 per cent are now going to health and education. The Government will continue to work to ensure the completion of the HIPC Initiative so that all eligible countries can benefit from HIPC debt relief and that all creditors participate, and to ensure that the initiative is securely and fully financed. Nevertheless, the achievements of the HIPC Initiative need to be set against the greater challenges and the UK has consistently argued for deeper and wider debt relief.

5.138 In September at the meetings of the IMF and the World Bank, following the June G7 meeting, political agreement was reached on the Multilateral Debt Relief Initiative which will result in 100 per cent cancellation of debts owed to the IMF and concessional lending arms of the World Bank and the African Development Bank. In total a burden of over $50 billion of debt could be removed for up to 38 of the HIPCs. In November the IMF Board formally adopted the decisions that will allow this debt relief to be delivered at the beginning of next year, and work on implementation of the initiative continues in the World Bank and African Development Bank.

5.139 In addition, as announced in September 2004, the UK will continue to pay its share of the debt service to the World Bank and the African Development Fund for a wider group of low-income countries that can show that debt reduction will lead to poverty reduction. Overall a further 28 countries could potentially benefit from this, and the UK will continue to press international partners to provide debt relief to a wider group of countries.

5.140 Resolving Nigeria's debt problems was a key objective for the UK in 2005, and the deal agreed with Paris Club creditors on 20 October cancels approximately $18 billion of Nigeria's debt. Nigeria will pay creditors $12.4 billion using part of its oil windfall. By mid 2006 Nigeria will have eliminated its $30 billion debt to Paris Club creditors, provided it sticks to the Paris Club deal and the path set out in its Policy Support Instrument with the IMF. The UK will provide Nigeria with debt relief of approximately $5 billion. The Nigerian Government will spend the savings from debt relief on programmes to accelerate progress towards the MDGs, including employing an extra 120,000 teachers and putting 3.5 million children into school. A virtual poverty fund is being established to track spending on the MDGs, and donors have been invited to join a high-level committee chaired by President Obasanjo to monitor progress.

Universal and free health services

5.141 Healthy populations are key to growth and poverty reduction. To underpin progress against all of the MDGs, donors need to support countries that wish to invest in strengthening health systems and making them responsive to poor people. User fees are a key barrier preventing access to health services in low-income countries. As outlined in *From Commitment to Action: Health,* published in November by the Department for International Development (DFID) and HM Treasury, the UK stands ready to assist countries that wish to eliminate user fees and make services free at the point of delivery. The UK is also taking significant action on prevention and treatment for diseases that primarily affect poor countries. The G8 communiqué committed counties to supporting as close as possible to universal access to HIV treatment by 2010, through mechanisms such as the Global Fund for AIDS, TB and malaria. The UK is also exploring the use of Advance Market Commitments (AMCs) to stimulate research into killer diseases. G7 Finance Ministers considered a report on AMCs at their December Ministerial meeting, and agreed to develop a pilot AMC next year.

Universal free education

5.142 Education is the best investment that a person or country can make – not just for economic growth but also for wider societal reasons. User fees for education are sometimes as much as a quarter of the annual income of a poor household, and are the single biggest barrier to increasing enrolment across sub-Saharan Africa. Predictable long-term funding is needed to meet increasing demand, replace the revenues raised from fees, and to meet the cost of the additional buildings, equipment and teachers' salaries needed for primary education to expand dramatically. The $10 billion cost of bringing free, quality, basic education to all children in Africa and South Asia is an investment that could be paid for with some of the frontloaded finance raised by an International Finance Facility. The Education for All Fast Track Initiative (FTI) is playing a vital role in channelling donor funding to those countries with fully developed plans for universal primary education. The UK has committed to contribute £40 million to the FTI in 2006-07, and will continue to encourage other donors to play their part in filling the FTI financing gap. *From Commitment to Action: Education,* published in November by DFID and HM Treasury, outlined the approach the UK Government will take to support countries that wish to scale up education delivery and abolish user fees.

Trade

5.143 A fairer international trading system is key both to development and poverty reduction, and to global growth. An ambitious outcome to the Doha Development Round is essential to deliver substantial increases in market access and real benefits for developing countries. With the opportunity for all countries to benefit from what could be at least an extra $300 billion in world growth every year, the EU and other key participants must seize the opportunity at the Hong Kong trade meeting later this month to secure a new trade deal that will reverse the retreat into protectionism.

5.144 Action is needed to completely open rich countries' markets to exports from poorer countries; set a 2010 timetable for abolishing export subsidies; cut significantly trade-distorting domestic subsidies for agriculture; and eliminate tariff escalation and peaks. At the same time, rich countries must not erect new non-tariff barriers through excessive product standards or other means.

5.145 Current protectionism is damaging developing countries and preventing their integration into the global economy. It will be of fundamental importance that, side by side with efforts to open markets and phase out subsidies, developed countries make the necessary investments in the capacity of poor countries to trade as well as their ability to cope with the challenges they face in the short term. For developing countries to benefit from trade, they will need:

- the flexibility to decide, plan and sequence reforms to their trade policies to fit with their country-owned development strategies. The Government does not support forcing liberalisation through aid conditionality or other agreements;
- financial assistance to overcome short-term costs associated with liberalisation if they do decide to open sectors of their economy. These costs might include those arising from preference erosion (including sugar and bananas), tariff revenue loss, or higher food import bills; and
- investment to overcome the supply-side constraints that prevent countries from responding to market signals, and from producing and delivering goods to international markets competitively. It is essential to support the basic building blocks for growth and trade, ensuring healthy and well-skilled populations, sound economic infrastructure (transport and power, customs), and social welfare systems that protect people through change.

5.146 The same principles apply to other bilateral and regional trade agreements such as Economic Partnership Agreements (EPAs) being negotiated between the EU and Africa, Caribbean and Pacific countries. Rich countries are well placed to deal with adjustment costs and stand to benefit from competition, so should not use these negotiations to extract additional concessions from poor countries.

Emergency relief

5.147 The UK is committed to responding swiftly and effectively, and with the international community, to humanitarian disasters. The UK provided over £180 million for humanitarian relief efforts and longer-term reconstruction in countries affected by the devastating impact of the tsunami in the Indian Ocean. The UK also responded quickly to other disasters such as the earthquake in Kashmir, contributing £58 million to the immediate relief effort and a further £70 million to longer-term reconstruction. The Government is now seeking international agreement to reform the Disaster Emergency Relief Fund, so that it is endowed with its own substantial budget. In addition, the UK is promoting a new IMF Shocks Facility to help reconstruction in countries ravaged by natural disasters or hit by commodity shocks, and has already contributed £50 million.

Remittances

5.148 Remittances have a significant positive economic impact in developing countries, although they should be seen as a complement to aid, not a replacement. People from developing countries who are living and working in the UK are an important source of remittances, with flows to developing countries totalling around £2.3 billion annually. The Government is active in a number of areas to facilitate the flow of remittances, including working with recipient countries on financial sector development, engaging with the private sector to improve remittance services, and working to increase domestic financial inclusion. The Government intends to keep the amount and destination of remittances and their contribution to development under review.

Peacekeeping and conflict prevention

5.149 Peace is the first condition for successful development. The Government will continue to support African-led peacekeeping operations, and work to strengthen the African Standby Force. Since September 2003, the UK has committed £32 million to the African Union Mission in Darfur and provided over £92 million in humanitarian assistance. The Government has also provided £56 million to support peacebuilding and conflict prevention in the Democratic Republic of Congo, and has provided the largest bilateral contribution, £22 million, toward the organisation of free and fair elections.

Terrorist financing

5.150 The Government has today published an update on key recent developments in its approach to countering the financing of terrorism. This will be followed by a comprehensive progress report on countering money laundering and terrorist finance in the spring.

Reconstruction in Iraq

5.151 The UK continues to work alongside the Transitional Government of Iraq and its international partners to support reconstruction in Iraq. Since March 2003, the UK has pledged over £544 million for reconstruction in Iraq. With UK support, Iraq continues to implement the Emergency Post-Conflict Assistance IMF programme. The UK is working to strengthen the capacity of Iraqi government institutions, including policymaking capacity within the Ministry of Finance.