

Globalisation and the continuing pace of technological change are driving rapid shifts in the competitive environment and creating new opportunities and challenges. Raising productivity in the UK is critical for sustained economic growth and continued prosperity. Reforms introduced since 1997 have built on the foundations of macroeconomic stability, flexibility and openness to competition to strengthen UK productivity growth. Maintaining this flexibility, supported by key long-term investments in infrastructure, skills and science, is essential to increase productivity and seize new global opportunities. Budget 2007 sets out how the Government will build on the progress over the last decade through:

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

Globalisation and productivity 3.1 The world is changing rapidly, and the global economy is becoming more integrated and competitive. Improving productivity and developing a dynamic economy is increasingly important for sustaining growth, prosperity and opportunities for all. The UK is well placed to meet the long-term challenges presented by a changing global economic environment, but continued progress on fostering productivity growth depends critically on building a flexible, open economy, with a highly skilled workforce, and well-developed infrastructure. Reforms introduced since 1997 have made significant progress in supporting productivity, by investing in infrastructure and skills to support the shift to a globalised, knowledge-based economy, and improving the UK as a place for businesses to start up, invest and grow.

The five driver framework 3.2 The Government's strategy for increasing the UK's productivity is based on two fundamental pillars: providing macroeconomic stability to enable firms and individuals to plan for the future, and implementing microeconomic reforms to the business and policy environment to remove the barriers that prevent markets from functioning efficiently.

3.3 This Budget sets out the next steps to improve the UK's productivity performance through five key drivers of productivity:

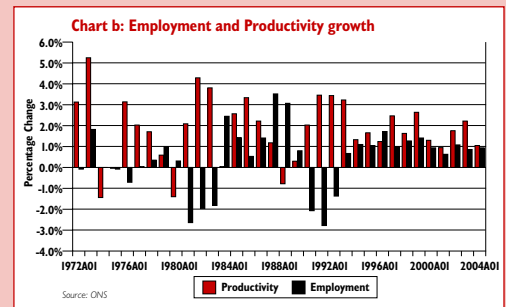
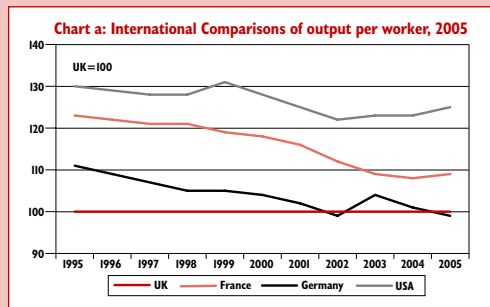
- improving competition to create the right incentives for firms to innovate, adopt new technologies and improve business efficiency;
- supporting science and innovation to spur new ideas and translate them into innovative goods and services for the UK's long-run economic success;
- raising skills levels to create a more flexible and productive workforce that can rapidly take advantage of new technologies and organisational structures;
- promoting enterprise to build a more flexible business environment, capable of adjusting to the opportunities and challenges in a more globalised economy; and
- encouraging investment to increase the quantity and quality of physical capital used in the production process.

Box 3.1: UK productivity performance

Productivity and employment growth are key to achieving high and stable rates of economic growth and higher standards of living. The latest international comparisons of productivity estimates show the UK is making real progress towards narrowing the productivity gap with its main industrialised competitors. Chart a illustrates the narrowing of the output per worker gap since 1995. The UK has halved the output per worker gap with France, closed the output per worker gap with Germany and, despite some recent cyclical widening, is the only G7 country to have kept pace with the US's impressive productivity performance since the mid 1990s. Similar progress has been made on an output per hour worked basis; the UK has narrowed the output per hour worked gap with France by 11 percentage points, narrowed the output per hour worked gap with Germany by 10 percentage points and while the gap with the US has not closed significantly since 1995, the UK is once again the only G7 country to have kept pace with the US's impressive performance.

There are also encouraging signs that the UK is on track to raise its productivity performance over the current economic cycle, compared with previous cycles. Trend productivity growth over the first half of the economic cycle (1997H1 – 2001Q3) was 2.60 per cent per year compared with 1.92 per cent in the previous economic cycle.

These latest achievements in productivity are particularly significant, as they have occurred during a period of unprecedented employment growth. Over 2.5 million more people are in jobs since 1997 and the UK has the highest employment rate in the G7. Traditionally, strong employment growth tends to lower productivity growth, as new workers are less productive while they learn job-specific skills. The UK is now experiencing the longest period of combined productivity and employment growth since current records began, as illustrated in Chart b.



Product and capital market flexibility **3.4** Flexible product and capital markets enable a more efficient allocation of resources and clearer price signals, promoting competition and encouraging growth. Flexibility enables firms to respond rapidly to changing market conditions in an increasingly integrated global economy. This chapter reports on progress in enhancing the UK's product and capital market flexibility. In addition, the UK is working with international partners to respond to the impacts of globalisation, as discussed in Box 2.4.

European economic reform **3.5** Twenty years of the Single Market has delivered real and sustained benefits for the UK economy, but further structural reform in the EU is still needed to create more competitive, open and flexible economies. To this end, the government has argued for a European target to reduce administrative burdens arising from EU legislation by 25 per cent, which was agreed at the Spring European Council. To ensure that the EU's regulatory framework is appropriate and encourages growth and job creation, the Government is promoting a risk-based approach to the design and enforcement of regulation and to the decision as to whether or not to regulate at all. The Government continues to support the Lisbon Strategy for Jobs and Growth, and reports annually on progress towards the Lisbon goals in the UK National Reform Programme.

Productivity in the regions **3.6** An essential element of raising the rate of productivity growth in the UK is to improve the economic performance of every part of the UK. The Government has a target to make sustainable improvements in the economic performance of all English regions by 2008, and over the long-term to reduce the persistent gap in growth rates between the best and worst performing regions.¹ The Government reported progress to date in meeting its regional economic performance target alongside the 2006 Pre Budget Report.²

Regional Development Agencies **3.7** The Government's approach to regional economic performance builds on the national approach of a stable macroeconomic framework and microeconomic reforms by seeking to devolve significant resources and responsibilities to Regional Development Agencies (RDAs). Building on their role as strategic leaders of economic growth in each region, the RDAs have contributed to the development of regional policy in Budget 2007 in three key areas: the role of the private sector in promoting regional economic growth, regional competitiveness in a global context and improving evaluation of RDA spend. The Government welcomes this advice and has responded in full. Following Christopher Allsopp's review of statistics for economic policy making, the Office for National Statistics, working in partnership with the RDAs, is establishing a full regional statistical presence this month.

Sub-national economic development and regeneration **3.8** The Government is undertaking a review of sub-national economic development and regeneration in England. It aims to build on the work of RDAs and local authorities in England and consider how to further improve the efficiency and effectiveness of existing sub-national structures in England so as to strengthen economic performance in regions, cities and localities throughout the country. It looks at mechanisms to drive sub-regional collaboration, such as city-regions.

3.9 The review includes an assessment of the impact, effectiveness and accountability of sub-national delivery agencies, including the outcomes of RDA spending and opportunities for efficiency savings. It also considers the long-term challenges that face the RDAs and other sub-national agencies to help ensure a robust prioritisation of activities in support of economic growth in each region and locality.

¹ The Devolved Administrations in Scotland, Wales and Northern Ireland work in partnership with the UK Government to promote economic development in their territories.

² *Regional Economic Performance: Progress to date*, HM Treasury, DTI, DCLG, December 2006 available at <http://www.hm-treasury.gov.uk>.

3.10 The review has benefited from extensive consultation with a wide variety of stakeholders across the public and private sectors, including Local Authorities, Regional Assemblies, RDAs, neighbourhood organisations and business groups in every English region, as well as inputs from national-level organisations. Box 3.2 below sets out the issues identified as part of this consultation and the potential areas for reform going forward. The review will help inform the 2007 Comprehensive Spending Review.

Box 3.2: Review of sub-national economic development and regeneration

Government reforms to improve sub-national economic development and regeneration have delivered improved economic performance in many areas. In order to further improve the prosperity of regions, cities and localities, the review has identified a range of issues which include: addressing problems of complexity, increasing local and regional flexibility, clarifying responsibilities, strengthening accountability frameworks and incentives to strengthen capacity and ensure coordinated and focused action at sub-national levels, and securing business engagement in all areas. In many areas the analysis supports further decentralisation and devolution, while in others, such as business support, the need is to improve consistency and coordination across the country. In response to this, the review is focusing on the following areas for potential reforms:

- strengthening local authority incentives and decision making powers to improve economic outcomes and tackle concentrations of deprivation, following the analysis in the Lyons Inquiry;
- developing mechanisms to drive sub-regional collaboration across functional economic areas, including city regions, building on the Local Government White Paper, and considering the case for devolving individual powers and functions;
- improving the economic planning and decision-making processes at the regional level, including through better alignment of regional strategies, enhancing the strategic role of RDAs, improving RDA capacity, efficiency and effectiveness and increasing regional accountability;
- ensuring clearer objectives for regeneration and renewal at national, regional, local and neighbourhood levels, with sharper incentives for improving performance, clearer accountability and more effective coordination, and a stronger link to wider economic strategies; and
- strengthening the interface between the public and private sectors to maximise the effectiveness of investment. The review will take account of the recommendations of the *Leitch Review of Skills and Employment*.

BUSINESS TAX REFORM

3.11 Since 1997, the UK economy has enjoyed an unprecedented period of stability, allowing businesses to plan and invest more effectively for the long term.

Taking advantage of economic stability **3.12** Macroeconomic stability provides the foundation for businesses to take efficient investment decisions. The UK has halved its output per worker gap with France and closed the gap with Germany, but more can be done to support business investment and promote productivity growth. It is important that the tax system provides the right incentives for businesses to meet the challenges presented by globalisation.

3.13 Since 1997, the UK has led the way among G7 countries, reducing the corporate tax rate from 33 per cent to 30 per cent. The Government has also continued to modernise the business tax system to ensure that it remains fit for purpose, in line with its twin principles for

reform: business competitiveness and fairness.³ However, globalisation and new patterns of business activity have created fresh pressures for reform to ensure the UK remains internationally competitive.

3.14 The Government today announces further reforms to the business tax system to allow businesses to exploit fully the advantages of macroeconomic stability and to meet the challenges of the modern business environment, while ensuring that businesses pay a fair share towards the public services they consume.

Objectives of reform

3.15 The package of reforms announced in Budget 2007 are designed to achieve three key objectives, while maintaining sound public finances:

- enhancing the international competitiveness of UK based business;
- encouraging growth through investment and innovation; and
- ensuring fairness across the tax system.

International competitiveness

3.16 Growing international competition increases the importance of having an efficient business tax system. To ensure that business decisions are based on commercial, rather than tax, considerations:

- a low tax rate helps keep any economic distortions to a minimum for any given level of revenue; and
- a broad base helps to ensure that there are fewer boundaries where differences in tax treatment can distort commercial decisions.

3.17 The main rate of Corporation Tax (CT) is one of a range of factors that influence the competitiveness of UK businesses. A lower rate of CT can boost the competitiveness of UK companies in the global economy and attract greater levels of foreign direct investment. Alongside factors such as skilled labour, infrastructure and easy access to customers, it is important that the main CT rate is set at a level that helps to maintain and improve competitiveness and the UK's already impressive record in attracting and retaining FDI.

3.18 The measures announced in Budget 2007 will complement the improvements to business tax administration that HMRC has committed to deliver following the Varney Review and the forthcoming consultation document on the taxation of foreign profits. This chapter and Chapter 5 contain more detail on the Review and the consultation document.

Growth through investment

3.19 The main rate of CT is one of the factors that can affect the level of large firm investment;⁴ capital allowances, which provide prescribed rates of tax relief for the depreciation of capital assets, can also have an impact. The rates and qualifying rules for capital allowances have remained substantially unchanged for over 20 years, with some originating in the immediate post-war period. Many of the incentives they seek to provide were based on the need to support particular industries and sectors and they no longer reflect the needs of a modern economy.

Growth through innovation

3.20 As one of the key drivers of productivity growth, the Government has ensured the tax system acts as a positive incentive for business innovation. There is a strong body of

³ For example, see HM Treasury/Inland Revenue (2001) *Large Business Taxation: The Government's strategy and corporate tax reforms*.

⁴ For a survey of the empirical literature see Hassett and Hubbard (2002), "Tax Policy and Business Investment," in A. Auerbach and M. Feldstein, eds., *Handbook of Public Economics* 3.

economic evidence to demonstrate that the private returns to business research and development (R&D) are exceeded by the wider spillover benefits to society, causing an undersupply of R&D. Worldwide evidence⁵ on the success of tax incentives in addressing this market failure led to the introduction of the R&D tax credit in 2000. As innovation becomes increasingly important in maintaining the UK's globally competitive position, R&D tax credits play an even greater role in the UK's response to globalisation.

Fairness 3.21 The Government's discussion paper: *Small Companies, the self-employed and the tax system*⁶ set out a framework for discussion on the incentives for small business investment in the current tax system.

3.22 Successive Governments have tried to encourage greater investment through low rates of tax for small companies with the Small Companies' Rate (SCR). However:

- it has become apparent that the SCR can be taken advantage of by people incorporating with the main aim of reducing their personal tax and national insurance liability by extracting labour income as dividends. This results in an unfair difference between the overall tax and NICs paid by the incorporated and the unincorporated, even where they are engaged in the same economic activity. This tax-motivated incorporation, if left unaddressed, would pose a growing risk to the Exchequer; and
- the SCR is not well targeted. As companies qualify according to their taxable profits, not their size, around one third of tax paying large companies benefit from the SCR.

Budget 2007 reforms

3.23 Budget 2007 announces a major package of reforms to enhance international competitiveness, encourage investment, promote innovation and ensure fairness across the tax system in line with the key principles that have underpinned business tax policy since 1997. Full detail on these Budget announcements is continued in Box 3.3.

- **a reduction in the main rate of Corporation Tax from 30 per cent to 28 per cent;**
- **first-year capital allowances will be replaced by an Annual Investment Allowance (AIA) of £50,000 for all firms.** This will target support on all businesses that are investing for growth. The AIA will be particularly beneficial to small and medium-sized businesses;
- **an extensive set of reforms to the capital allowances regime to increase the efficiency of the system,** and remove outdated incentives, some of which date from the immediate post-war period and a new payable enhanced capital allowance for environmentally beneficial investments;
- **an increase in the SME and large company R&D tax credits to build on the success of the current incentives;** and
- **a staged increase in the small companies rate of CT from 19 per cent to 20 per cent from April 2007, 21 per cent from April 2008 and 22 per cent from April 2009,** to reduce the differential between incorporated and unincorporated businesses and refocus investment incentives for small businesses.

3.24 The Government is committed to open consultation with business on major reforms to the tax system. Over the following year, the Government will publish draft legislation and

⁵ Hall and Van Reenen (1999), *How Effective are Fiscal Incentives for R&D? A Review of the Evidence*, NBER Working paper No. 7098.

⁶ *Small companies, the self-employed and the tax system: a discussion paper*. HM Treasury December 2004.

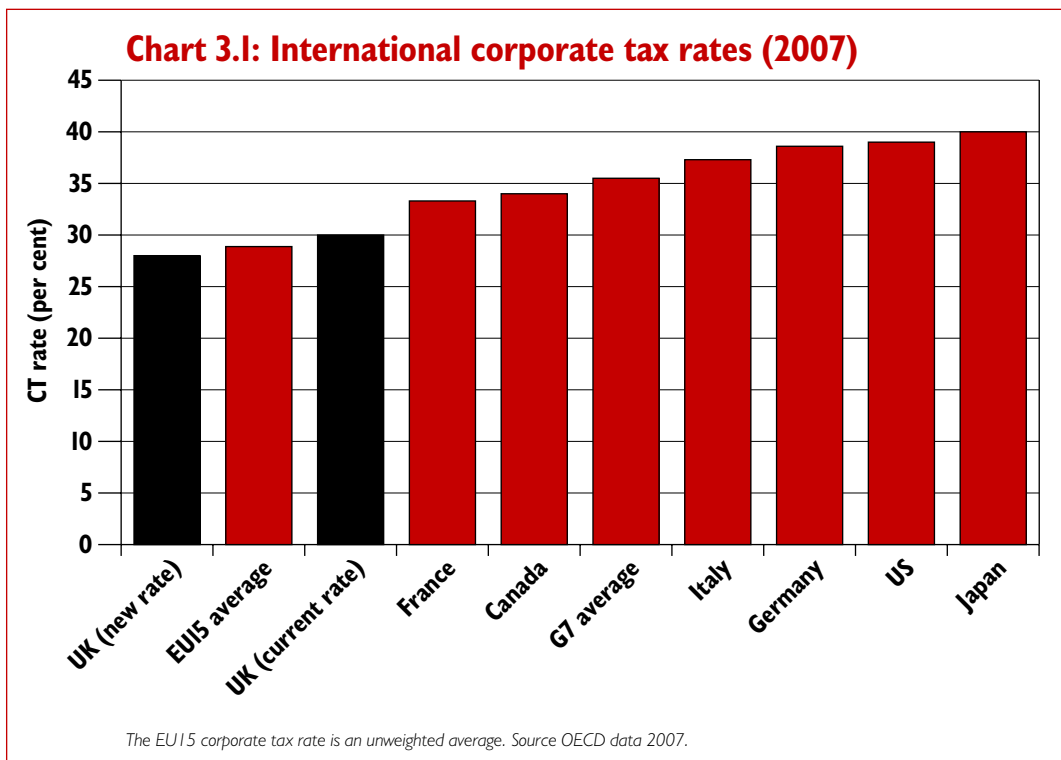
will consult with business on the implementation of the new AIA, changes to the treatment of integral fixtures and payable enhanced capital allowances.

Meeting the objectives

Increasing international competitiveness

3.25 The reduction in the main rate of CT will build on the established principle that low tax rates reduce economic inefficiencies in the tax system. The reduction firmly establishes the UK's CT rate as the lowest among the G7 and other major economies and also below the EU15 average (Chart 3.1).

3.26 The Government's goal is, and will continue to be, to maintain the most competitive CT rate of the major economies. **The Government will continue to assess the case for further reductions in the CT rate**, consistent with its objective to maintain sound public finances.



Encouraging growth through investment

3.27 A lower CT rate will both stimulate both large company domestic investment and make the UK a more attractive location for FDI. By reducing the difference between pre- and post-tax returns, the lower rate will reduce the extent to which commercial decisions are influenced by tax considerations.

3.28 While reducing the main rate of CT will promote higher investment, the reforms to capital allowances will promote more efficient and more long-term investment by bringing the value of allowances more closely into line with economic depreciation. Elements of the current regime are outdated and distortive. The current Industrial Buildings Allowance (IBA), for example, was introduced in 1945 to encourage post-war reconstruction. It is poorly focused, applying to a disparate range of assets that includes foreign plantations and hotels, but not commercial offices or science parks. IBAs have been a long-standing and unjustified distortion in commercial property investment. This Budget also announces a simplified structure for capital allowances, ensuring all depreciating assets receive allowances at two clear rates: 20 per cent and 10 per cent. Assets that appreciate, such as land and buildings, will not receive depreciation allowances.

3.28 Budget 2007 announces a major package of reforms to the UK business tax system. Box 3.3 sets out details of the key reforms.

Box 3.3: Detail of the Budget announcement

The following reforms are announced in Budget 2007:

Cutting the rate of corporation tax

- a reduction in the main rate of CT from 30 per cent to 28 per cent, effective from April 2008;

A simpler two-rate system of capital allowances

- a reduction in the rate of capital allowances on the general pool of plant and machinery from 25 per cent to 20 per cent, effective April 2008, bringing it closer into line with economic depreciation;
- an increase in the rate of capital allowances on the pool of long-life assets, which applies to assets with expected lives of more than 25 years, from 6 per cent to 10 per cent, effective April 2008;
- fixtures that are integral to a building will be separately classified and will be included in the 10 per cent capital allowances pool, effective April 2008;
- the phased removal of the Industrial Buildings Allowances (IBA) and Agricultural Building Allowance (ABA) with the effective rate of allowance falling to 3 per cent from April 2008, 2 per cent from April 2009, 1 per cent from April 2010 and full abolition taking effect from April 2011. As part of this phased withdrawal, balancing adjustments will be withdrawn from today (21 March);

Re-focusing the incentives for small companies

- a phased increase in the small companies' rate from 19 per cent to 20 per cent from April 2007, 21 per cent from April 2008 and 22 per cent from April 2009 to reduce the differential between incorporated and unincorporated businesses;
- the 50 per cent first year allowance for small enterprises will continue to April 2008;
- the introduction of an Annual Investment Allowance (AIA) available to all businesses regardless of size and regardless of their legal form. This new allowance will mean that 100 per cent of expenditure up to £50,000 on general plant and machinery (other than cars) can be offset against taxable profits. The AIA will be effective from April 2008 and will target support on all businesses that are investing for growth. It will be particularly beneficial to small and medium sized businesses;

Promoting innovation

- an increase in the large company R&D tax credit from 125 per cent to 130 per cent from April 2008; and
- an increase in the enhanced deduction element of the SME and mid-sized R&D tax credit from 150 per cent to 175 per cent from April 2008 subject to state aid clearance.

The Government will consult over the coming year on the detail of draft legislation to implement the AIA, changes to the treatment of integral fixtures and payable Enhanced Capital Allowances. Further details on payable ECAs are described in Chapter A.

Encouraging growth through innovation 3.30 Developed through consultation with business, the R&D tax credit lies at the heart of the Government's strategy to raise levels of business R&D and encourage business innovation. Take-up of the R&D tax credit has been strong, more than 6,000 claims were received in 2004-05 alone amounting to nearly £600 million of Government support for business R&D. In total, more than £1.8 billion of support has been given to business R&D through R&D tax credits since their introduction in 2000.

3.31 Building on the Government's commitment to ensure high levels of innovation and growth, **Budget 2007 announces additional major enhancements to the R&D tax credit.** The Government will increase the value of both the SME and the large company R&D tax credits.

Ensuring fairness across the tax system **3.32** Through a staged increase in the small companies' rate to 22 per cent by 2010, and a more valuable incentive for investment, the tax system can be refocused to better meet the Government's objective of fairness between the self-employed and incorporated. The measures in this Budget focus incentives directly on those small businesses that invest, regardless of whether they are operating in the corporate or non-corporate form.

3.33 Chapter 5 sets out how the Government will continue to monitor small business investment patterns and the level and extent to which labour income is extracted in dividends.

Business and the environment **3.34** **The Budget announces that the landfill tax escalator will rise by £8 per tonne per year from 2008 until at least 2010-11.** In line with previous commitments to make the landfill tax escalator revenue neutral to business as a whole, revenue from this measure will be recycled back to business through the package of business tax cuts. The landfill tax reforms are therefore consistent with the Government's statement of intent to shifting the burden of tax from 'goods' to 'bads' such as pollution. Chapter 7 sets out more detail on the environment.

3.35 The Government is committed to supporting renewable electricity generation and will work with this industry over the coming year to understand the impacts of Budget reforms on the sector, and to ensure that its support for renewable electricity generation is maintained.

Simplifying the tax structure **3.36** The reforms announced in Budget 2007 represent a simplification of the underlying tax structure. Together with the £300 million reduction in administrative burdens referred to later in this chapter and the improvements in tax administration delivered by *Sir David Varney's Review of Links with Large Business*,⁷ these reforms will help deliver significant improvements to the way that the tax system is administered, building a relationship based on greater trust.

North Sea tax regime **3.37** The Government recognises that the North Sea presents unique challenges and opportunities for both industry and government. In recognition of these challenges, this Government has introduced a unique capital allowance regime that encourages investment by providing full relief on cashflow outflow as it arises. This minimises the impact of the fiscal regime on investment decisions. In light of this, and of the need for stability and certainty, and given continuing high levels of profitability and investment, the reforms to business tax announced in Budget 2007 will not therefore apply to activity within the North Sea fiscal regime, which will retain its existing capital allowances regime and rate of tax.

3.38 In the 2005 Pre-Budget report, the Government announced that it would hold discussions with the North Sea oil and gas industry on wider structural issues that have implications for the stability of the North Sea fiscal regime. A paper has been published alongside the Budget summarising these discussions, setting out the Government's initial conclusions and confirming that discussions on these issues will continue over the following months.

Taxation of foreign profits **3.39** The Government has held a productive dialogue with business on the taxation of foreign profits in the context of maintaining the overall competitiveness of the UK. The Government will issue a consultation document later in the spring, which will consider in particular the taxation of foreign dividends received by UK companies and the Controlled

⁷HMRC 2006 Review of Links with Large Business.

Foreign Companies (CFC) rules. This is an area where business has expressed a preference for reform and where options that will be considered include European-style exemption for foreign dividends and income-based CFC rules. The document will also consider the implications of any such reform for other aspects of the UK tax regime, such as interest relief.

COMPETITION

3.40 Competition is a fundamental aspect of the business and policy environment. It rewards efficiency, flexibility and innovation in business, driving productivity. Competitive and open markets at home increase the global competitiveness of UK firms, raising economic growth and standards of living in the UK and benefiting consumers by ensuring lower prices and a greater variety of goods and services.

Promoting competition in UK markets

A world class competition regime **3.41** Through recent reforms the Government has been able to secure a world-class competition regime, ranked among the top three globally.⁸ The Enterprise Act 2002 made UK competition authorities independent – the Office of Fair Trading (OFT) and the Competition Commission (CC) – by removing ministerial involvement from almost all cases. It introduced criminal penalties for cartel activity as well as an improved framework for investigating and remedying mergers or markets raising potential competition concerns.

Public enforcement **3.42** The 2006 Pre-Budget Report outlined the achievements to date, with the competition authorities launching investigations into 800 mergers and 150 potential abuse of dominance or cartel cases, generating consumer savings of at least £750 million between 2000 and 2005.

3.43 Since the start of this year the OFT has obtained £31.2m in fines from cartelists and finalised its investigations into at least 12 mergers. The OFT is currently finalising its decision on whether or not to refer the UK airport services market, which served over 200 million passengers in 2005,⁹ to the CC for further investigation and possible remedy and the CC is currently studying the groceries market, a sector with an annual sales of around £120 billion.¹⁰ However, the Government recognises the need to continue to monitor the operation of the competition regime and consider possible enhancements to its speed, efficiency, and effectiveness.

3.44 As part of the 2007 Comprehensive Spending Review (CSR) settlement agreed with HM Treasury, as set out in more detail in chapter 6, the OFT have committed to continue to increase the impact of their work for consumers through increased prioritisation and efficiency savings. **The OFT have agreed to new performance targets, which include delivering benefits to consumers worth more than five times the organisation's spending on competition enforcement and three and a half times its spending on consumer activities.**

Private actions **3.45** Private actions are an important aspect of a well-functioning competition regime. An effective regime would allow those affected by anti-competitive behaviour to receive redress for harm suffered and broaden the scope of cases that can be investigated, promoting a greater awareness of competition law and reinforcing deterrence, without encouraging ill-founded litigation.

3.46 The Enterprise Act 2002 enhanced the framework for private actions. It ensured that decisions on infringements of competition law by the UK Competition Authorities or European Commission are binding on the courts and allowed designated consumer groups

⁸ *Peer Review of Competition Policy*, KPMG and the Department of Trade and Industry (2007). Publication pending.

⁹ *Summary of activity at UK airports*, CCA, 2005. Available at www.caa.co.uk/

¹⁰ *Groceries Market: Statement of Issues*, CC (2006) Available at www.competition-commission.org.uk/

to bring representative actions, following such decisions, to the Competition Appeals Tribunal (CAT). However, to date very few private action cases have been heard by courts in the UK.

3.47 In April 2007, the OFT will consult on a discussion paper identifying barriers to private actions, including the complexity, uncertainty and cost required in bringing claims. The paper will also discuss options for addressing these, such as widening the scope for representative bodies to bring representative actions and allowing such bodies to bring cases not previously investigated by the Competition Authorities.

3.48 The Government welcomes the progress the OFT has made on this issue and will continue to work with the OFT to identify the key barriers to private actions. **Over the coming year the Government intends to identify and consult on measures needed to overcome the barriers to redress without encouraging ill-founded claims, in particular examining the arrangements for representative actions.**

Premium rate services **3.49** OFCOM has agreed to conduct a review of whether the existing regulatory model for premium rate telephone services is fully effective and proportionate and whether the code for regulating these services needs strengthening, particularly in relation to broadcasting.

European competition policy

3.50 In recent years the European Commission has made significant progress in adopting a more proactive approach to exercising its competition powers. The modernisation of EU competition policy¹¹ has allowed the Commission to focus attention on more important mergers and anti-competitive cartel cases with clear Single Market impacts. Faced with a number of challenges over the past 12 months the Commission has led a robust defence of Single Market rules, taking tough action where they have been breached. The first two sector inquiries into the energy and financial services sectors have been an important step towards a better understanding of the functioning of those markets.

Strengthening the EU competition regime **3.51** The Government believes that the Commission must continue to take a robust stance in pushing forward a pro-active competition policy to improve the Single Market. The UK's recently published vision for the Single Market is summarised in Box 3.4.¹² In addition, the Government believes that the central role of competition policy should be strengthened by promoting:

- greater use of market investigations. As part of its fundamental review of the Single Market the Commission should commit to embedding sector inquiries into the EU competition regime and to undertaking further inquiries into priority sectors, where competition is lacking. Sector inquiries should be followed up with strong action;
- a greater role for private actions against anti-competitive behaviour. The Government recognises that some of the barriers to private actions might be best solved at the European level and it will continue to support the Commission in the follow-up to its 2005 Green Paper; and
- an “economic approach” to tackling state aid. The UK believes that further reform to state aid rules and their enforcement should be pursued within an overall framework in which aid which has a minimal impact on competition can be swiftly agreed, whilst tough action is taken against subsidies that seriously harm competition.

¹¹ Council Regulation 1/2003 of 14 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty.

¹² *The Single Market: A vision for the 21st Century*, HMT and DTI, January 2007. Available at www.hm-treasury.gov.uk

Box 3.4: The Single Market: a vision for the 21st century

The Government welcomes the European Commission's Review of the Single Market, due to report this year, which provides an opportunity to look again at how the Single Market can equip Europe to compete in the 21st century global economy. The Government has set out a strategy for a modern Single Market that delivers for Europe's citizens, businesses and consumers through a pro-competition, flexible and outward-looking approach. It believes that Single Market policy should be based on the following key principles:

- focusing policy on outcomes of promoting jobs, growth and prosperity;
- prioritising actions in areas where economic impacts are greatest;
- emphasising cooperation and the principle of subsidiarity; and
- using a wider range of policy tools.

In putting these principles into action, the Government would like to see action to:

- strengthen the role of pro-active competition policy and market based monitoring to identify sectors where competition is lacking and priorities for future market investigations, building on the work carried out by the Commission in the recent sector inquiries into energy and financial services;
- embed better regulation principles across the Single Market, with proper consideration of the alternatives to legislation in every case, such as information and guidance or codes of practice. The Government would like to see greater use of flexible regulatory mechanisms, such as the Lamfalussy arrangements in financial services, and strengthening of the mutual recognition principle;
- improve implementation and strengthen enforcement of existing EU rules. The Government would like to see a new system for prioritising investigations into breaches of EU law, and improved redress mechanisms for businesses and consumers, both informal problem solving techniques and improved access to courts; and
- match community level policy with renewed commitment of Member States to undertake structural reforms and pursue modern social policies, and commitment to external openness to trade, with conclusion of full negotiations in the Doha round of trade talks.

New economic research published alongside the paper argues for the prioritisation of further reforms in key sectors, notably in Europe's network industries, such as energy, communications and post, that impact on the wider economy. Further market opening in the network industries could increase Europe's GDP by 1.7 per cent and create up to 360,000 additional jobs.

ENTERPRISE

3.52 In an increasingly open and competitive global economy, a vibrant and thriving business and policy environment for firms and enterprise is critical in ensuring that the UK can respond flexibly to new challenges, and to increase productivity and living standards for all.

3.53 It is not the case that most businesses, if unregulated, will act irresponsibly. Well-informed consumers, responsible companies, unions and pressure and interest groups have all encouraged businesses to take measures to reduce risks to society. Regulatory regimes need to adapt to this changing world, delivering what is intended while minimising unnecessary regulatory burdens, and retaining public confidence. To this end, the Government is delivering better regulation by implementing the Hampton review's risk-based approach to enforcement, ensuring that regulatory costs are proportionate to the risks posed, and encouraging risk-based regulatory reform in Europe.

Delivering better regulation

Implementing Hampton 3.54 The Better Regulation Executive (BRE) and National Audit Office (NAO) have been working with regulators, business groups, local authorities and consumer groups to develop a framework for external review of national regulators' adherence to the Hampton principles.¹³ The framework will be published in May. The Health and Safety Executive has volunteered to work with the BRE and the NAO on the first of the reviews, with the Food Standards Agency, the Environment Agency, the Office of Fair Trading and Financial Services Authority to follow in 2007.

3.55 At the 2006 Pre-Budget Report, the BRE was tasked with setting up the Local Better Regulation Office (LBRO) to encourage the implementation of a consistent and coordinated risk-based approach to enforcement and inspection at local authority level. The recruitment process for the independent Chair, Chief Executive and Board is underway, with the appointment of the Chair due to be announced in the next month, followed by the Chief Executive and Board appointments.

Employment law 3.56 Disputes in the workplace are costly for employers, stressful for individuals and harmful to productivity. In December, the Secretary of State for Trade and Industry asked Michael Gibbons, a former Director at Powergen and current member of the independent Better Regulation Commission, to undertake a review of government support for resolving disputes in the workplace. His review has looked at the current legal requirements, how employment tribunals work and the scope for new initiatives to help resolve disputes at an earlier stage.

Box 3.5: Gibbons Review of dispute resolution

The review proposes a package of measures to promote early resolution of disputes and reduce the number of tribunal claims.

It recommends repealing the current statutory dispute resolution procedures and replacing them with non-prescriptive guidelines on grievances, discipline and dismissal. This would reduce administrative burdens and enable employers and employees to use the most appropriate way of resolving disputes.

The review also recommends that additional free ACAS conciliation should be offered to employers and employees in dispute in the period before a tribunal claim is made. To encourage use of this and other dispute resolution mechanisms, the review recommends improving government advice to employers and employees on resolving disputes, and integrating the improved advice service into the tribunal application process.

The review also recommends:

- engaging employer and employee bodies in promoting early dispute resolution in the workplace;
- directing simple monetary claims to a new fast-track resolution process; and
- simplifying employment tribunal processes and paperwork.

3.57 The Government welcomes the recommendations of the Gibbons Review of employment dispute resolution published today. A consultation on these proposals is published alongside the review. The Government is committed to piloting any new approach to dispute settlement that results from this consultation.

Rogers Review 3.58 In order to ensure that local authorities focus their enforcement on high-risk policy areas, the Government asked Peter Rogers, Chief Executive of Westminster City Council, to

¹³ Box 2.2 Reducing administrative burdens: effective inspection and enforcement, Philip Hampton, March 2005.

examine approximately 60 policy areas that local authorities enforce. The Rogers Review, published today, recommends that the Government should specify that the five enforcement priorities for trading standards and environmental health services in England are air quality, alcohol licensing, hygiene of businesses, improving health in the workplace and fair trading. The Rogers Review also recommends that animal and public health should be a further, time-limited enforcement priority.¹⁴ The LBRO should refresh these enforcement priorities on a regular basis, and recommend them to Government.

3.59 The Government welcomes the Rogers Review and accepts the recommendations in full. These national priorities for local authority trading standards and environmental health services will ensure that they can plan their resources and prioritise their activities to ensure that the most critical of central government regulatory objectives are achieved. This will result in a substantially rationalised burden around regulatory services. Businesses will benefit from improved consistency of enforcement and sharper regulatory focus.

Data sharing 3.60 One of the key Hampton principles is that business should not have to give unnecessary information, nor give the same piece of information twice. Data sharing is a key route through which Government and regulators can reduce the burden on business. Two recent examples include:

- the Department for Environment, Food and Rural Affairs (Defra), the Environment Agency and the Food Standards Agency are identifying opportunities for sharing information on the performance of businesses in managing risk. This will provide valuable input to the development of any shared business confidence assessment methodologies and regulator data sharing protocols; and
- the Environment Agency and the Health and Safety Executive are undertaking a scoping study to identify if there is a significant benefit to business from the streamlining of existing systems by sharing data on asbestos notification between the two regulatory bodies.

3.61 Chapter 6 sets out in more detail the Government's approach to decreasing the cost to frontline service deliverers of central data requests.

Small firms impact test 3.62 The Small Firms Impact Test (SFIT) is a key part of the Government's commitment to 'think small first' when developing policy, and is integrated into the process of Impact Assessment. In 2006, the Government consulted publicly on changes to Impact Assessment and is currently preparing a response to the consultation. As part of this work, the Government plans to update the SFIT, so that increased consideration is given to the needs of small firms in policy design, including giving fuller consideration to exemptions, either complete or partial, for small firms where possible.

Planning regulations 3.63 The final report of *Kate Barker's Review of Land Use Planning*, published in December 2006, makes clear that planning is a valued and necessary activity but that there is further scope for reducing the burdens that the system imposes on applicants. The Government will set out its plans in a forthcoming planning reform White Paper. These will include measures to deliver a substantial reduction in the bureaucracy associated with making planning applications, including a reduction in paperwork. More details of the Government's response to the Barker Review are set out later in Chapter 3.

Regulation of financial services 3.64 In the 2005 Pre-Budget Report, the Government set out a ten-point action plan aimed at reforming wholesale and retail financial markets. These issues drew on the two-year review of the Financial Services and Markets Act 2000 (FSMA) and represent the greatest concerns of

¹⁴ The roles and responsibilities of local authorities and other bodies involved in regulatory and enforcement activities for animal health and welfare have been subject to a review by David Eves CB. The Government intends to consult on this.

business in relation to the burden of financial services regulation. Further progress has been made against this action plan including reform of the controller's regime through an EU Directive and progress with the financial services authorities reviews into its conduct of business rules covering mortgages and general insurance.

European regulatory reform

3.65 The UK continues to drive regulatory reform in Europe and helped to ensure that all 27 Member States and the Commission agreed to a target to reduce administrative burdens arising from EU legislation by 25 per cent by 2012. This complements the UK's own target for administrative burden reduction and will boost the competitiveness of business, especially SMEs, which suffer most from over-burdensome regulation.

3.66 The UK is pressing for rapid results and has worked successfully with the Commission in putting together a concrete programme of action. The programme has started with Commission proposals for immediate action to cut 10 specific burdens in the areas of company law, agriculture, statistics, transport and food hygiene. The Commission estimates that these proposed changes would save business in the EU £1.3 billion. This programme will be backed by actions to address the greatest burdens in identified priority areas and the establishment of an Impact Assessment Board to scrutinise and challenge Impact Assessments and improve their quality.

3.67 The principles that will be used to guide burden reduction include the use of a risk-based approach for information obligations and the consideration of exemptions from providing information for SMEs. The UK recognises that more can be done and will continue to promote the use of a risk-based approach to improve the rationale, design and enforcement of regulation.

Davidson Review 3.68 Lord Davidson published his final report on the implementation of European legislation in the UK in November 2006.¹⁵ The Government accepted his recommendations in full. The BRE will publish revised guidance on transposing EU law for policy makers and lawyers in the spring. Departments are also taking forward his recommendations, for example:

- the Department for Transport (DfT) will consult later in spring on options for reforming the MOT regime; and
- the Treasury published a consultation document on removing the insurance activities of freight forwarders from Financial Services Authority regulation on 21 December 2006.

Modernising tax administration

Simplification 3.69 At Budget 2006, the Chancellor announced targets for HMRC to reduce the administrative burdens imposed on business by the tax system, focusing on forms and returns, and on audits and inspections. By April 2007, HMRC will have reduced these significant burdens by an estimated £170m per annum, and will have also reduced wider administrative burdens on business by £130m. The major reforms delivering all of these savings include:

- a simplified pensions tax regime, welcomed by the industry, which from April 2006 has reduced much of the complexity caused by the previous rules;

¹⁵ Davidson Review of the Implementation of EU Legislation, November 2006.

- the revised P46, introduced in April 2006, which reduced enquiries to employers from employees who are unable to provide their latest pay and tax details;
- exempting, since April 2006, ninety per cent of new companies from the requirements of Form 42, benefiting around 300,000 companies every year;
- the redesigned VAT 1 form, launched in December 2006, improving the process for the 280,000 businesses registering for VAT each year; and
- the reformed construction industry scheme, effective from April 2007, which provides an electronic alternative to paper processes, replaces individual vouchers with a contractor's monthly return, and removes the need for the contractor's end of year return.

3.70 Although HMRC is making significant progress, these reforms are only a first step towards making noticeable improvements to businesses' experience of the tax system. HMRC will continue to work closely with the Administrative Burden Advisory Board¹⁶ and with the business community to identify new areas for action that tackle the burdens of most concern to business. HMRC has today published further details of this work.¹⁷

3.71 These changes compliment a range of policy reforms outlined in this chapter that will also impact on the administrative burden placed on business. Overall, these will be deregulatory for business. For example, Box 3.3 outlines how capital allowances will be reformed; further detail of its impact on business will be published once implementation plans have been finalised.

HMRC Review of Links with Large Business **3.72** The 2006 Review of Links with Large Business, published in November 2006, made proposals aimed at delivering a modern, responsive tax administration to foster an environment in which business can flourish and to improve the competitiveness of the UK. HMRC today publishes a detailed delivery plan setting out the implementation plans and timeframes for delivering the Review's proposals in consultation with business, including how HMRC will develop a framework of advance agreements to give both UK business and significant inward investors certainty on the tax treatment of their transactions. Chapter 5 provides further information on the delivery plan.

Supporting growing businesses

Better business support **3.73** Budget 2006 announced plans to reduce the number of business support services offered from over 3,000 to 100 or fewer by 2010. As part of this process, the programme is taking a fresh look at the kinds of business support – the products and services – it is most appropriate for Government to provide. **A consultation document will be published before the Summer Recess, seeking views from businesses and other stakeholders on the proposals for the design of the new portfolio of government business support.** This programme will also inform the sub-national review of economic development and regeneration and will be reflected in the 2007 CSR.

3.74 Building on the progress announced at the 2006 Pre-Budget Report, further rationalisation can now be announced, including closure of UK Trade and Investment's "New Products from Britain" service and DTI's "Grant for Investigating an Innovative Idea" – allowing

¹⁶ The Administrative Burden Advisory Board, independently chaired by Teresa Graham, was appointed at Budget 2006.

¹⁷ *Delivering a new relationship with business: Progress towards reducing the administrative burdens on business*, HMRC, March 2007. This is available at <http://www.hmrc.gov.uk>

the re-direction of funds to higher performing support products – and rationalisation of all the South East England Development Agency's existing investment funds into one.

3.75 The Business Link brand will be strengthened as the channel for all publicly-funded business information, support and advice. Progress is already being made, by bringing into Business Link:

- Defra's business advice to farmers; and
- The East Midlands Development Agency and the East of England Development Agency's support to start-ups.

VAT registration threshold **3.76** From 1 April 2007 the Government will increase the VAT registration threshold in line with inflation from £61,000 to £64,000, maintaining the highest threshold in Europe and keeping up to a further 6,000 small businesses out of the VAT system.

Tax based venture capital schemes **3.77** Following the publication of the new State Aid for Risk Capital Guidelines¹⁸ by the European Commission, the Government is required to introduce changes to the Enterprise Investment Scheme (EIS), Venture Capital Trusts (VCTs) and the Corporate Venturing Scheme (CVS). Although the Government believes that the changes risk reducing the effectiveness of the schemes in addressing the equity gap faced by smaller companies with high growth potential, it is imperative that these changes are made to give greater certainty to investors and the companies they invest in, and to secure the future of the schemes. The Government will introduce, effective 6 April 2007 for VCTs and from Royal Assent for EIS and CVS:

- an annual investment limit across the three schemes of £2 million per target company; and
- for target companies, at the time of investment, a limit equivalent to fewer than 50 full-time employees.

3.78 The Government continues to believe in the importance of a strong and effective state aids regime that prevents aid that threatens to undermine competition and efficiency of the Single Market. However, it also believes that there is a clear role for well-targeted interventions to promote structural reform and tackle market failures in support of the goals of the Lisbon agenda. The Government has therefore written to the European Commission calling on it to review the way in which it applies the state aids guidelines to ensure that proper account is taken of the economic arguments for government intervention.

3.79 Savings from these changes will be wholly recycled to fund enhancements to R&D tax credits, as described earlier in this chapter, to promote innovation and productivity in the UK.

3.80 In response to feedback from users, the Government is also introducing a number of changes to improve the commercial, effectiveness, usability and consistency of the schemes.

Local Authority Business Growth Incentive scheme **3.81** The Government introduced the Local Authority Business Growth Incentive (LABGI) scheme in April 2005 to create a direct financial incentive for local authorities to promote local business growth. LABGI delivers financial rewards directly to local authorities that promote the greatest levels of continued economic growth in their local areas by allowing them to retain increases in revenue derived from business rates. The money is genuinely additional and the scheme encourages local authorities to build partnerships with local business and promote long-term economic sustainability in their areas. Last year 278 authorities received £126 million in LABGI. In 2006-07, the second year of the scheme, 328 local authorities received grants totalling £316 million. The Government expects to see up to

¹⁸ Community Guidelines on State Aid to Promote Risk Capital Investments in Small and Medium-sized enterprises, Official Journal of the European Union, August 2006

£1 billion allocated to local authorities by 2007-08. **Following the publication of the Lyons Inquiry report today (see Chapter 6) the Government will bring forward proposals to reform the LABGI Scheme before the summer to continue to provide strong incentives for local authorities to act to increase economic prosperity.**

Enterprise in disadvantaged areas

- Community Development Finance Institutions** **3.82** Many enterprises in disadvantaged communities currently face problems in obtaining access to suitable support, advice, and finance from mainstream commercial providers. To address this problem, Government introduced support to the Community Development Finance (CDF) sector in 2000 to grow the CDF sector in a sustainable way and to assist enterprises in disadvantaged areas access finance. **To ensure sustainability of the CDF model, the Government will liaise with the banking sector, including the European Investment Bank and Community Development Finance Institutions, to explore how the framework could be developed further.**
- Community Investment Tax Relief** **3.83** As part of its ongoing review of the operation and delivery of the Community Investment Tax Relief (CITR) scheme, **the Government will improve the flexibility of the scheme by changing the onward investment requirements after the third anniversary of accreditation from 75 per cent at all times to an average of 75 per cent over the course of the year.** The scheme's accreditation and reporting procedures will also be updated, to reflect the forthcoming change to the status of the Small Business Service.

Creating an enterprise culture

- Enterprise education** **3.84** Attitudes towards entrepreneurship are improving with the proportion of young people aged 16-24 considering going into business having risen from 14 per cent in 2003 to 18 per cent in 2005¹⁹. There have been increases in the number of people who encourage friends to start their own business, 66 per cent in 2005, up to 2 percentage points from 2003, and a reduced averse attitude to starting businesses, 56 per cent were averse in 2005, compared with 60 per cent in 2003. The Government is committed to strengthening further the UK's enterprise culture and is working to promote even greater enterprise capability among young people in education. To maintain the momentum of implementing the recommendations of the Davies Review,²⁰ **the Government will continue the funding of enterprise education at £60 million per year over the 2007 CSR period, as part of Department for Education and Skills' (DfES) 2007 CSR settlement.** The Government aims to build on the achievements to date, developing a strategy to encompass all tiers of education and is working to foster closer links between financial capability and enterprise education in the curriculum. In particular it is encouraging all secondary schools to participate fully in enterprise education, including by working in partnership with primary schools, colleges and higher education institutes.
- 3.85** To raise awareness of the benefits of enterprise learning and to showcase particular examples of the most enterprising schools, DfES will be publishing *Enterprising Heads, Enterprising Schools*, in late spring 2007.
- 3.86** To facilitate greater support from employers to teachers, in the 2006 Pre-Budget Report the Government announced the launch of 50 Young Chambers of Commerce. In March 2007, participating schools and Chambers were allocated nearly £2 million to set these up. Government also welcomes the further development of a quality assurance scheme for the members of the National Education Business Partnership Network, that help schools to work with over 200,000 businesses in England. This scheme aims to further incorporate other

¹⁹ Household Survey of Entrepreneurship 2005, DTI.

²⁰ A review of enterprise and the economy in Education 2002.

Education Business Links to drive self improvement by the organisations that help businesses and schools to work together for young people's economic wellbeing.

3.87 As part of the wider enterprise education strategy and to build on the progress made to date in raising the awareness of entrepreneurship amongst graduates, **the National Council for Graduate Entrepreneurship will work with the Government and other stakeholders to assess the feasibility and viability of an enterprise foundation** intended to develop further programmes to raise awareness of graduate entrepreneurship and to facilitate key research.

SCIENCE AND INNOVATION

3.88 In a global economy, innovation is increasingly important to UK competitiveness, productivity and long-term growth. The Government is committed to providing the right environment for innovation and creativity to flourish, in both maturing industries and in new emerging sectors.

Building an innovation system

3.89 *The Science and Innovation Investment Framework 2004-2014*²⁰ set out the Government's intention to increase investment in the public science base at least in line with the trend growth rate of the economy over the ten-year period, contributing toward the Government's long-term ambition for public and private investment in R&D to reach 2.5 per cent of GDP. The last spending period saw an unprecedented increase in public funding for the research base, and by 2007-08, total UK science spending will be £5.4 billion. This has been critical in establishing the long-term sustainability of the science base. To assess the effectiveness of the Government's science and innovation policies, the Government asked Lord Sainsbury to carry out a review taking a forward look at what more needs to be done to ensure the UK's continued success.

3.90 **Budget 2007 announces early 2007 CSR settlements for the Department of Trade and Industry's ring-fenced science budget and the Department for Education and Skills, which together deliver average annual growth of 2.5 per cent in real terms over the CSR period.** These early settlements provide long-term certainty for the research community, and will deliver resources to meet a range of priorities, including further investment to support excellent research; increasing the economic impact of the science base; and implementing the recommendations of the Sainsbury and Cooksey Reviews.

Technology Strategy Board

3.91 The UK is second only to the US in global scientific excellence, but in order to meet the challenges of globalisation, it is essential that excellent research is translated more effectively into innovative products and services. *The Science and Innovation Investment Framework 2004-2014* announced increased support for the Technology Strategy Board (TSB) to support collaborative R&D with businesses, with funding of at least £178 million by 2007-08. Due to its success in supporting innovation, the TSB will now take on a wider remit to stimulate business innovation in those areas that offer the greatest scope for boosting growth and productivity. This covers all areas of the economy, from the manufacturing industries to the arts and creative industries.

3.92 In order to give the TSB greater independence in delivering a national, business-focused innovation strategy, the Secretary of State for Trade & Industry announced in November that the TSB would have the status of an executive Non Departmental Public Body (NDPB). This will enable the TSB to operate at arm's length from central government, with a business-led Board taking a strategic overview of innovation priorities across all sectors of the UK economy, creating closer links between the science base and industry and advising the

²⁰ *Science & innovation investment framework 2004-2014*, July 2004. Available at www.hm-treasury.gov.uk

Government on the allocation of resources to priority technology areas. This new structure will become fully operational by July 2007. To support the TSB's enhanced leadership role as an independent body, the Government is today announcing a number of initiatives to strengthen the impact of the TSB, building on the early conclusions of the Sainsbury Review.

Box 3.6: The Technology Strategy Board

The UK Research Councils are actively working to strengthen their economic impact and increase the amount of collaborative research they conduct with business. To date, Research Councils have invested £25 million in TSB programmes to support collaborative R&D projects. Building on the success of this model, **the Director-General of Science and Innovation will agree specific targets with each Research Council to increase the amount of collaborative R&D they conduct in partnership with the TSB over the Comprehensive Spending Review period.** This planned Research Council business collaboration funding will be allocated in a joint process by the Research Councils and the TSB, and will form a clear basis for investment for the Research Councils over the CSR. It will maximise the capacity of investment from the science base to attract matching funding from other sources.

Today, **the TSB will allocate £100 million for Collaborative R&D**, bringing business and the research community together to work on user driven R&D from which new products, processes and services emerge. Over 600 R&D projects have been approved for funding so far and this new call will include substantial funding directed to larger projects that provide maximum economic impact.

The TSB will explore three new Innovation Platforms, bringing the Government and business together to generate innovative solutions to policy challenges, and engage different stakeholders through procurement opportunities. Two Innovation Platforms have been piloted in Intelligent Transport Systems and Services and Network Security. The three new Platforms will focus on assisted living and health care technologies, low environmental impact buildings, and environmentally friendly vehicles.

A key challenge for the new Board is to develop an appropriate strategy and support for the Creative Industries recognising the different nature of the sector. In addition to the existing 22 networks (such as sensors, micro and nano technology), **the TSB is announcing support for two new Knowledge Transfer Networks (KTNs) in the areas of Creative & Media Industries and Digital Communications**, bringing business and academia together to identify opportunities for collaboration.

The new Board plans to learn from the US Defence Advanced Research Projects Agency (DARPA) and recruit secondees directly from industry. The TSB will also complement its portfolio of support by taking over responsibility for leading the Knowledge Transfer Partnerships (KTPs) that provide support to companies who need to bring skills or knowledge from the research base into the business.

3.93 The Sainsbury Review is looking at what more can be done to ensure the UK's success in the face of the opportunities and challenges of globalisation. At both regional and national levels, the review is identifying areas in which effective government intervention can continue to support the UK's world-class science base and better enable wealth-creation, reporting by summer 2007.

Box 3.7: Sainsbury Review Emerging Conclusions

Building on the Government's existing policy agenda, the Review will set out a range of policies to enable the UK to respond to the opportunities and challenges of globalisation:

Providing leadership: the Government is today taking forward early recommendations from the Sainsbury Review regarding changes to the Technology Strategy Board (see Box 3.6).

Delivering skills: to further raise the standards of STEM skill delivery, the Review is considering ways to improve: the qualifications of school science teachers and support for their professional development; measures to recruit and retain teachers; and careers services. It is also considering the impact of the introduction of the second maths GCSE in 2010.

Furthering Knowledge transfer: the Review is considering how the effectiveness of the Higher Education Innovation Fund (HEIF) could be improved to support knowledge exchange and promote economic growth involving the full spectrum of Higher Education Institutions. The conclusions of the Review will inform decisions by the Office of Science and Innovation, the Department for Education and Skills, and the Higher Education Funding Council for England on the method of allocation for future rounds of HEIF. The Review is also considering a shorter more flexible Knowledge Transfer Partnership scheme targeted at SMEs.

Improving effectiveness of government departments: the Review is exploring how Innovation Platforms can be used to enhance departmental procurement through more strategic supplier engagement. It is also looking at how departments' R&D strategies can be used to stimulate innovation in industry, and how they can be better coordinated to address the Government's long-term challenges.

Supporting entrepreneurship: the Review believes an improved Small Business Research Initiative could provide support to early-stage high-technology companies, encouraging innovation.

Enabling the regions: in consultation with the Sub-National Review and the RDAs, the review will explore options for a new strategic framework for the regions for allocating resources to key science and innovation objectives. It will also explore ways in which RDAs can make best use of their science and innovation expenditure to drive regional economic growth.

Encouraging international collaboration: the Review is looking at how to deliver the collaborative scientific research a globalised economy demands. It is considering: Research Council representation abroad; the Science Bridges programme; and a Royal Society scheme to encourage internationally recognised researchers to come to the UK. In association with the Sub-National Review, the Review is also looking at ways to optimise UK representation abroad.

Business Research and Development

R&D tax credits 3.94 As part of the wider package of reforms to the corporate tax system, the Government is introducing further improvements to R&D tax credits, increasing the enhanced deduction of the SME R&D tax credit to 175 per cent and the large company R&D tax credit to 130 per cent from April 2008. Details on the R&D tax credit reforms are set out earlier in this chapter. A more generous R&D tax credit will ensure the tax system supports the Government's desire to enable UK businesses to compete in an increasingly globalised, knowledge-based economy. The UK's current R&D tax credit already compares very favourably in international

comparisons. Increases in the rate of relief available for R&D will further cement the UK's position as a prime location for R&D investment.

3.95 Recognising the importance of fully supporting the growth of the UK's mid-sized innovators, Budget 2006 announced an expansion to R&D tax credits to further enhance support for this vital segment of the economy. Legislation will be included in Finance Bill 2007 to extend the current SME R&D tax credit to companies with fewer than 500 employees. The extension will provide firms with between 250 and 500 employees with 150 per cent tax relief and a payable cash credit for loss-making companies. The legislation will be activated upon receipt of state aid clearance.

Energy Technologies Institute **3.96** Budget 2006 announced that the Government, after discussions with some of the world's biggest energy companies, agreed to work in partnership with business to create a new energy and environmental research institute. The Energy Technologies Institute (ETI) will be fully operational in 2008 as a 50:50 Public: Private Partnership. The aspiration is to raise £100 million per year for UK-based energy research, design, demonstration and development: a total of £1 billion over a ten-year period. BP, Shell, E.ON UK, EDF, Rolls Royce and Scottish and Southern Energy have already committed to support the Institute, and **this Budget announces that in addition Caterpillar has committed £5 million a year over the 10 year period, bringing the total private sector commitment up to £312.5 million.**

Intellectual Property Rights **3.97** The *Gowers Review of intellectual property*, which reported to the Government in December 2006, suggested a number of reforms to ensure the UK's Intellectual Property (IP) system is fit for the digital age. In the 2006 Pre-Budget Report, the Government announced its intention to take forward those recommendations for which it is responsible, and significant progress has been made since then.

3.98 The Gowers Review highlighted the importance of supporting the creative industries through tackling IP Crime. IP crime has already been recognised as an area for Police action in the updated National Community Safety Plan. Trading Standards Officers will be able to enforce copyright offences from this April, and £5 million will be made available to local government to fund this function in the first year.

3.99 The Government will also provide greater support to UK business to help recognise, protect and maximise the value of their intellectual property, and will implement a pilot scheme offering IP health checks to small businesses. The pilot is part of the Patent Office's Innovation Support Strategy, and will start in March 2007. Implementation of Gowers' recommendations is scheduled to be completed by the end of 2008. A number of consultations exploring options for implementation of the recommendations on UK copyright exceptions, Patent Office fees, fast-track services for the grant of patents and registration of trade marks, civil damages and fast track litigation are planned, most of which will be launched in spring 2007.

3.100 The UK and Japanese Patent Offices will trial a new initiative, the Patent Prosecution Highway, which will allow accelerated examination of a patent application where examination has already taken place in the other country. In addition to speeding up the patenting process for UK businesses in Japan, the initiative will help promote work sharing between patent offices around the world, thereby reducing costly duplication of effort.

Northern Ireland Innovation Fund **3.101** Subject to the St. Andrew's Agreement being implemented and devolution restored on 26 March, a Northern Ireland Innovation Fund will be established to promote R&D and the science base, reinforcing the Northern Ireland peace process. The fund will be established in April 2007 building on the substantial existing levels of funding to promote private sector investment and collaborative research, including with the Republic of Ireland, subject to detailed decisions being made by the incoming devolved administrations.

Excellent research

Cooksey Review 3.102 The *Cooksey Review of UK Health Research Funding* recommended new institutional arrangements for a new single health research fund to improve the coordination of health R&D and facilitate the translation of this research into health and economic benefits to the UK. The Government has established the Office for Strategic Coordination of Health Research (OSCHR) to implement these recommendations. In order to maximise impact while maintaining the 'light touch' recommended in the Review, OSCHR will work through two Boards – the Translational Medicine Board (TMB) and the Public Health Research Board (PHRB) – as well as beginning to realise the research benefit of NHS IT systems through a separate E-Health funding stream.

3.103 Today's early settlement of the Department of Trade and Industry's ring-fenced science budget ensures that the recommendations of the Cooksey Review will be implemented. The budget for OSCHR will be confirmed at the end of the 2007 CSR process.

3.104 The main role of the TMB and PHRB will be to develop and oversee a single, integrated strategy for translational research and public health research, realising the vision for innovation and commercialisation of the outcomes of research funded by the Medical Research Council and the National Institute of Health Research, and ensuring sustainable culture change and cross-working between agencies.

Stem cells 3.105 In the 2005 Pre-Budget Report, the UK Stem Cell Initiative reported back to Government on a strategy for the next decade of stem cell research in the UK. The first recommendation was for the Government to establish a Public-Private Partnership (PPP) using stem cells to enhance pre-competitive aspects of drug development. The Government continues to work in partnership with industry to establish this consortium and will begin work with a series of pilot projects in 2007. Work is also progressing on the establishment of a not-for-profit company, with board membership from both the public and private sectors. The company should become operational during 2007.

SKILLS

3.106 The skills of the workforce are increasingly important in determining the UK's ability to respond to the emerging challenges presented by globalisation: demographic, socio-economic and technological change. Improving the UK's skills profile has benefits for individuals, companies and the economy. Individuals can increase their productivity and mobility and gain more opportunities for sustainable employment and progression in the labour market. Companies with a highly skilled workforce are better able to innovate and compete on the basis of higher value added products and services. For the economy as a whole, improving skills can deliver clear benefits in terms of improved productivity, social justice and mobility. In the last ten years, the UK has seen improvements in its skills profile at all levels. However, to become comparable with countries possessing a world-class skills profile, more needs to be done, in particular to tackle low skills.

Leitch Review of Skills 3.107 The Leitch Review of Skills, *Prosperity for all in the global economy – world-class skills*, was published on 5 December 2006, setting out an ambitious and stretching vision for skills in the UK in 2020. It set out a series of objectives for improving skills at all levels, with the aim of creating a world-class skills base comparable to other advanced industrial economies. In the 2006 Pre-Budget Report, the Government accepted both the ambition of the Leitch Review, and the underpinning delivery principles of its approach.

3.I08 In the context of the significant increases in resources for education for the 2007 CSR period outlined in Chapter 6, the Government will publish a full implementation plan for the Leitch Review in the summer. It will set out in detail how the Government is taking forward the recommendations made by the Review and the timetable for implementation.

Public Service Agreements 3.I09 There are a number of areas where progress is already being made to ensure the UK is able to respond to the challenges set out by the Leitch Review. The Government recently achieved the interim milestones for both the Basic Skills and Level 2 targets within the adult skills Public Service Agreement (PSA). Over 1.6 million adults have improved their basic skills and achieved qualifications in literacy, language and numeracy since the Skills for Life strategy was introduced in 2001. 1.2 million adults have achieved a first Level 2 qualification since 2002, reducing the stock of adults who lack the basic platform of skills needed for sustainable employment in the modern workplace. Achieving these targets will create a strong foundation, necessary to meet the ambitious vision for skills in the UK set out in the Leitch Review.

Demand-led skills 3.I10 Ensuring that the training delivered through the Further Education sector is tailored to the needs of employers is central to ensuring that vocational qualifications are economically valuable and deliver real returns both to individuals and to businesses. The Government is continuing to expand the availability of the Train to Gain service, which provides firms with free, flexibly delivered training in the workplace for their low-skilled employees. So far, over 25,000 employers have engaged with the service and almost 90,000 low-skilled individuals have already started training. This is in addition to the 30,000 employers and 260,000 employees who participated in the pilot scheme. A recent evaluation of the Train to Gain skills broker network highlighted continuing high levels of employer satisfaction with the service.²¹ In particular, employers value the knowledge and expertise of the brokers and their ability to identify appropriate training.

3.I11 Building on the 2006 Further Education White Paper²² and the recently published Leitch Review, the Government is exploring the steps required to channel a greater proportion of funding available for adult skills through demand-led routes, such as Train to Gain. In January 2007, the Learning and Skills Council launched a formal and detailed consultation seeking views from the Further Education sector,²³ including providers and learners, to create a more demand led system.

Commission for Employment and Skills 3.I12 The Government recognises that employers should play a central role in ensuring that the employment and skills systems work together to meet the needs of employers and support individuals in progressing in the labour market. A Commission for Employment and Skills will be created, following the vision set out in the Leitch Review, which will be responsible for providing a strong employer voice and leadership of the employment and skills system. It will increase employer engagement and investment in skills and ensure that an integrated employment and skills service meets the needs of individuals, including those on benefits, by focusing on sustaining employment and progression as an outcome. A Chair for the Commission is currently being recruited. Once in post, the Chair will work closely with the Government to appoint the members of the Commission and to establish the new body by the end of 2007.

²¹ *Evaluation of Employer Satisfaction with the National Employer Training Programme/Train to Gain*, BMG Research, December 2006.

²² *Further Education: Raising Skills, Improving Life Chances*, DfES, March 2006.

²³ *Delivering World-class Skills in a Demand-led System*, Learning and Skills Council, January 2007.

Government Envoy for Skills 3.113 The Government Envoy for Skills, Sir Digby Jones, is working with employers from key sectors of the economy to build a consensus on improving skills of their workforce. Sir Digby Jones is calling upon employers to sign up to a Skills Pledge to ensure that all their employees reach a skills level equivalent to five good GCSEs. The Skills Pledge was recommended by Lord Leitch as one way to help drive up the UK's skills. It seeks to share responsibility between the State, employer and employees and will be open to all employers irrespective of size, status or sector. It is designed to stimulate demand for training services and support a new culture where gaining skills is taken as a matter of course.

Skills for young people 3.114 Achieving world-class skills in the UK will require improving the skills of young people flowing into employment. Improving the number of young people continuing in education and training after the end of the compulsory school age will provide the foundation to improve the skills of young people and ensure the UK has a strong, flexible labour market in the future. The Government has introduced a number of measures to encourage young people to continue to participate in education and training until the age of 18, including reforms to the financial support system and the advice, guidance and support structures.

3.115 The *14-19 Education and Skills White Paper*, published in February 2005, set out the next steps the Government is taking to engage young people in education and training until the age of 18. Tailored support for young people at risk of disengagement and reform of the 14-19 curriculum will provide young people with the opportunity to learn in ways which motivate and engage them, providing the skills valued by further and higher education and employers.

3.116 Since April 2006, the Government has been piloting new learning agreements. These are aimed at 16 and 17 year olds who are in work but not receiving accredited training, to ensure they undertake appropriate learning. Building on the existing statutory right to paid time off to train or study for this group, the pilot is testing the effectiveness of formal learning agreements, financial incentives and wage compensation for young people and their employers when engaging in training. **Budget 2007 announces an extension of the Learning Agreement pilot into the 2007 CSR period.** As outlined in chapter 5, the Government will also extend Activity Agreement pilots to re-engage young people not in education, employment and training.

3.117 The Government has made progress in recent years in increasing the number of young people continuing in education and training until the age of 18. Despite this, further progress is required. The Government believes that raising the age of compulsory participation in education from 16 to 18 is the best way to lay the foundations to improve skills of all young people, and equip them to succeed in life. To this end, a Green Paper on raising the age of compulsory participation in education and training²⁴ to 18 will be published on 22 March 2007. Young people will be required to participate either at school, in college, in work-based learning, or in accredited training provided by an employer.

3.118 The Green Paper will consider how individuals, the Government, and employers can work together to ensure that young people have the skills they need for the future. The Government will consult with business on ways in which this objective can be achieved while meeting the principles of better regulation. Under the Green Paper proposals:

²⁴ *The Raising the Participation Age Green Paper*, DfES, March 2007.

- the Government will continue to pay for accredited training, and support employers to get their training accredited where it meets requirements;
- the Government will support employers to find training opportunities for their employees through Train to Gain; and
- employers who do not want to provide or arrange training for their employees would be required to release young people from work to undertake training (equivalent to around a day a week).

INVESTMENT

3.119 The accumulation of physical capital through investment is an important determinant of an economy's productivity performance. Physical capital stock is closely correlated with productivity performance, as it directly influences how much a unit of labour can produce. Investments in physical capital are complementary to other forms of investment such as skills and innovation. The Government's macroeconomic reforms have provided an environment of low and stable interest rates and a flexible labour market. These reforms help to provide a certain and rewarding environment for businesses to invest for the future.

3.120 This supportive environment for investment has meant business investment has now expanded for eight consecutive quarters, the longest continuous expansion in nine years. However, this impressive performance is from historically low levels, compared with comparator countries. Investment in housing has been low, relative to comparable economies over long periods of the UK's post-war history. Furthermore, investments in infrastructure have become increasingly important in a globalised world: a good transport infrastructure improves productivity by facilitating the movement of goods and services influencing the location decisions of business.

Investing in housing and property

Investing in housing supply **3.121** A responsive and flexible housing market is essential to secure the UK's future economic prosperity. Published alongside the 2005 Pre-Budget Report, *The Government's Response to Kate Barker's Review of Housing Supply* sets out a range of measures to increase housing supply and improve affordability.²⁵ This included a target to raise the number of new houses being built to at least 200,000 net additions a year by 2016. Substantial progress towards this target is being made with over 180,000 net additions in the year to March 2006. However, an ageing and growing population indicates that further rises in new housing supply will be required over the coming decade.

3.122 To support Local Authorities in meeting their housing targets, the Government has recently consulted on, and now plans to introduce, a new Housing and Planning Delivery Grant.²⁶ A new independent National Housing and Planning Advice Unit is also being established to provide expert advice to regional planning bodies, helping them to better understand the relationship between housing supply and affordability.

²⁵ *The Government's Response to Kate Barker's Review of Housing Supply*, HM Treasury and ODPM, December 2005

²⁶ *Housing and Planning Delivery Grant: Consultation Paper*, DCLG, July 2006

Housing infrastructure 3.123 To ensure that its ambitious plan for a step-change in housing supply is supported by the necessary investment in infrastructure, the Government's response to Kate Barker's Review of Housing Supply announced a *Policy Review into Supporting Housing Growth* to determine the social, transport and environmental infrastructure implications of housing growth, establish a framework for sustainable and cost-effective patterns of growth, and ensure that departmental resources across government are targeted appropriately to support growth (see Box 3.8).

Box 3.8: Policy Review into Supporting Housing Growth

Flourishing communities are not created by new housing alone. New housing comes with the need to provide public services, such as schools, health centres, waste disposal, public transport, green space and policing. There may also be a need for additional flood defence and transport infrastructure.

The 2007 CSR Policy Review into Supporting Housing Growth has been developing the Government's approach to address this infrastructure challenge and has been actively engaging with key stakeholders to understand the barriers to delivery and develop possible solutions.

For central government, the Review is proposing using the CSR performance management framework to ensure that housing growth is given appropriate prioritisation by key infrastructure departments, with subsequent changes to allocation systems, alongside strong ministerial governance and greater incentives for local authorities to increase housing growth. At the local and regional level, the Review is proposing changes to infrastructure planning and delivery (discussed in the Planning Gain Supplement section below), and is committed to working with stakeholders to develop suitable mechanisms for 'front funding' infrastructure at an early stage of development. Further announcements on the Review will be made as part of the 2007 CSR.

Building sustainable homes 3.124 At the 2006 Pre-Budget Report, the Government set out its ambitions for ensuring that new homes contribute to tackling climate change and are constructed to high standards of sustainability: the consultation document *Building a Greener Future* set out the Government's proposals for moving towards zero carbon in new housing.²⁷ This included the proposition to progressively incorporate energy efficiency standards set out in *the Code for Sustainable Homes* into future building regulations, thereby ensuring that, within a decade, all new homes will be zero carbon.²⁸ **Supporting this aim, today's Budget announces further details of a stamp duty exemption for zero-carbon homes.** See Chapter 7 for details.

Surplus Public Sector Land 3.125 A taskforce on Surplus Public Sector Land was established at the 2005 Pre-Budget Report as part of the Government response to the Barker Review of Housing Supply. At the 2006 Pre-Budget Report, the Chancellor raised the Government's ambition for housing delivery on surplus public land to 130,000 new homes from existing and new sites over the next decade. Delivery of this ambition will involve a strengthened commitment across central government, Local Authorities and the wider public sector.

²⁷ *Building a Greener Future – Consultation Document*, DCLG, December 2006.

²⁸ *Code for Sustainable Homes*, DCLG, December 2006.

Promoting Shared Equity and Shared Ownership **3.126** The Shared Equity Taskforce reported in the 2006 Pre-Budget Report that the Government now expects over 160,000 households to access home-ownership through private or public shared equity products by 2010, double the original plans.²⁹ One element of the Government's response to this report is to extend the reach of the Open Market HomeBuy scheme to households on lower incomes. **The Government is today launching the first stage of a new competition, inviting market providers to work with the Housing Corporation in developing affordable shared equity products for first time buyers.**

3.127 The Task Force also recognised the important role charitable Registered Social Landlords (RSLs) play in helping to deliver the Government's affordable housing agenda through shared ownership. The Government will work with charitable RSLs in ensuring that corporation tax is not a barrier to investment in affordable housing and will, if necessary and feasible, introduce legislation aimed at clarifying the tax position. Further details will be made available at Pre-Budget Report 2007.

3.128 One structure currently used to provide affordable housing is the 'shared ownership lease'. Shared ownership leases give the benefits of ownership to people who cannot afford to buy a property outright, even with the mortgage finance available to them. The Commonhold and Leasehold Reform Act 2002 introduced commonhold as a new type of property ownership. However, shared ownership leases are not feasible for commonhold. To provide the same treatment for commonhold shared ownership as is currently available to leasehold, **Budget 2007 announces that the Government will legislate in this year's Finance Bill to replicate the stamp duty and land tax arrangement that is currently in place for shared ownership leases for shared ownership trusts.**

Sinking funds **3.129** The Finance Act 2006 provided relief from the 40 per cent trust rate of tax on income arising from service charges and sinking funds in the social housing sector. Sinking funds are an efficient way to save money for the upkeep and repair of properties. To place the private housing sector on the same footing as the social housing sector, the **Government announces that it will extend this relief to the income on service charges and sinking funds held by private sector landlords on trust.**

Planning Reform and major infrastructure **3.130** The Government is committed to ensuring that the planning system delivers the housing and economic development the UK needs in a way which is sustainable and consistent with the Government's wider objectives including on climate change, the environment, energy security and improving UK competitiveness. The Chancellor and the Deputy Prime Minister asked Kate Barker at the 2005 Pre-Budget Report to conduct a review to consider how planning policy and procedures can better deliver economic growth and prosperity alongside other sustainable development goals. The final report of *Kate Barker's Review of Land Use Planning*, published in December 2006, makes clear that planning is a valued and necessary activity that can deliver positive economic outcomes, alongside important social and environmental objectives. However, it concluded that the context for the planning system is becoming ever more challenging and therefore recommends further wide-ranging reform, building on recent changes and the plan-led approach, to ensure that the planning system addresses long-term challenges, supporting sustainable economic growth in a global economy and contributing to climate change mitigation. The Government welcomed Kate Barker's report and agrees with her overall analysis.

3.131 Sir Rod Eddington's Study, published on 1 December last year, reaffirmed the importance of well-targeted investment in transport to the continued success of the UK economy in the global marketplace. The Government has endorsed Rod Eddington's strategic analysis. It is actively pursuing the major reforms to the planning, funding and delivery of transport interventions his report outlined.

²⁹ *Report of the Shared Equity Taskforce*, HM Treasury and DCLG, December 2006.

3.132 These reforms are wide-ranging. They cover strategy, processes and delivery. On strategy, this will include as an output of the 2007 CSR a policy and decision-making framework over the medium term, incorporating Eddington's strategic recommendations across the DfT objectives. On processes, it will cover appraisal, planning and resource allocation. On delivery, it will include consideration of proposals to reform planning for transport infrastructure, and taking forward Eddington's analysis of sub-national governance in the 2007 CSR.

3.133 This review is a key part of the delivery of sustained economic growth. The Government is determined to pursue its implementation quickly, and the Department for Transport has reformed its board structure to align better with Eddington's conclusions. It will report on progress in taking forward the measures, and its further consideration of the new evidence and analysis presented by the Eddington Study, in the course of this year.

3.134 Later this spring, the Government will set out in a White Paper its proposals in response to Kate Barker's recommendations for improving the speed, responsiveness and efficiency in land use planning, and for taking forward Kate Barker's and Rod Eddington's proposals for reform of major infrastructure planning.

3.135 Kate Barker's analysis shows that the planning system does not always fully consider the benefits that economic development can bring in terms of increasing employment and prosperity or ensuring transparent, certain and efficient decision making on infrastructure of national economic importance. Therefore, the White Paper will include measures, as part of a wider package of proposals to ensure that, by reflecting properly the economic, social and environmental costs and benefits, planning takes a positive approach to sustainable economic development by:

- setting out a new single system of planning for major infrastructure, with clear national policy statements which balance economic, social and environmental objectives, effective public consultation, and decisions taken by an Independent Planning Commission;
- a significant streamlining of national planning policy, including a new framework for positive planning for economic development, and a more explicit role for market signals to inform plans and planning decisions; and
- a substantial improvement in the process for obtaining planning permission for all users with clearer and simpler processes and quicker handling of appeals cases, backed by a more efficient plan-making process.

Business aspects of the Lyons Inquiry **3.136** The report of Sir Michael Lyons' Inquiry into Local Government Finance is published alongside this Budget. The Inquiry's recommendations on personal taxes and broader local government finance are discussed in Chapter 6. However, Sir Michael argues that the role of local government should not just be defined in relation to public services, but also local economic prosperity and investment.

3.137 The Inquiry considered the structure and incentives in the local system of business rates, and concludes that the current link between the Retail Price Index and yield from business rates should be retained. The Inquiry also considered the case for returning business rates to local control. Its analysis is that this would not be appropriate at this time. The Government agrees that the current structure of business rates provides certainty for business and therefore promotes investment, and so is not proposing changes to the RPI cap and the national system of business rates.

3.138 In order to promote the role of Local Authorities in boosting economic growth and to create communities with sustainable environments for business growth, the Inquiry proposes local supplements on business rates. The Government believes that a local supplement has the potential to support local economic development, but would need to be subject to credible accountability to rate payers and real protection for any businesses – particularly SMEs – that might be disproportionately affected. The Government will give consideration to what the best options may be, working closely with business, local government and other stakeholders.

3.139 The Inquiry also examined options for development of specific taxes or charges on tourism as a means of financing investment in local communities with significant visitor populations. It concluded that a robust evidence base has not been developed to support the introduction of such taxes. The Government therefore does not intend to introduce a tourist tax.

Modernising empty property relief **3.140** The system of business rates includes a number of reliefs and exemptions. The Inquiry recommends that some of these should be reformed. In response to these recommendations and those of the Barker Review of Land Use Planning, as described above, **the Government today announces its intention to modernise empty property relief from business rates.** These reforms will reduce the duration of the existing empty property relief to three months for all properties and six months for industrial and warehouse properties. These reforms will reduce the current distinction between different types of property. The duration of empty property relief (EPR) will be limited to three months for all property when they first fall empty with a further three months for industrial and warehouse properties only. Complete exemptions from rates will be awarded to empty properties held by charities.

3.141 This will enhance the supply of commercial property, reducing rents and improving access for new and existing firms. Downward pressure on rents will have significant benefits for UK business and wider UK competitiveness with particular benefits for new starters, and companies investing in additional property, in addition to all companies – especially SMEs – who rent their premises. The Government will consult on the various additional exemptions that are currently offered. This measure will also enhance the supply of brownfield sites for redevelopment, helping to meet the Government's commitment to use brownfield land for new housing and commercial property developments wherever possible.

3.142 The Inquiry recommends that the other relief and exemptions in business rates be subject to review. The Government accepts this recommendation, with the exception of the relief for charities, which will remain in its current form. The Department for Communities and Local Government will consider the merits of extending rates to include derelict and vacant previously developed land, and assess other reliefs and exemptions in business rates.

Land remediation relief reform **3.143** This Budget launches a consultation on brownfield land tax incentives. The Government is considering reform of land remediation relief and the landfill tax exemption for waste from contaminated land. The consultation seeks to improve the efficiency of land remediation relief and proposes extending it to long-term derelict land, allowing expenditure on Japanese Knotweed to qualify, and improving its development focus. It also invites comments on timing issues and asks whether relief for cleaning up contaminated land is more efficiently given through land remediation relief than the landfill tax exemption for waste from contaminated land.

3.144 The Government aims to respond to the consultation by the end of 2007. Any changes in legislation will take place no earlier than 2008. The Government intends that overall support for remediation of hard to remediate sites through the tax system should not be less after reform than it is at present. The reformed reliefs will support the Government's wider objectives for redeveloping vacant and derelict previously developed land on which a separate consultation will be conducted.

Onerous leases 3.145 To further encourage efficient use of commercial land and property, the Government will also consult during the course of the year on the tax treatment of onerous leases.

Business premises renovation allowance 3.146 Budget 2007 announces that the Business Premises Renovation Allowance will be introduced for expenditure incurred on the renovation of businesses premises on or after 11 April 2007. The original proposals will be modified by secondary legislation to meet EU state aid rules, and will apply in Assisted Areas, excluding certain sensitive industries. It will provide 100 per cent capital allowances for the capital costs of bringing empty business properties back into use in Assisted Areas. The Government will consider whether it may be possible to reduce restrictions in the scheme in a manner compatible with EU law.

Progress on the Planning-gain Supplement

Planning gain Supplement 3.147 The Planning-gain Supplement (PGS) is a proposed levy on the value uplift accruing to land granted planning permission. Kate Barker originally recommended the introduction of PGS, alongside a scaled-back system of planning obligations, in her 2004 Review of Housing Supply as a means of generating resources to finance local infrastructure.³⁰ The Government has discussed these proposals widely with stakeholders across the UK and twice consulted formally, including detailed consultations on valuations, the payment process, and changes to planning obligations which closed on 28 February 2007. The Government is now considering the responses to these consultations carefully, alongside levels of the need for infrastructure investment and the range of mechanisms for delivering this. If after further consideration it continues to be deemed workable and effective, PGS would be introduced no earlier than 2009.

3.148 Alongside planning reforms and other tax measures described in this chapter, PGS aims to support growth and the efficient supply of land. PGS would be levied at a modest rate to ensure that incentives to develop land are preserved. Budget 2007 makes further proposals on the allocation of PGS revenues in England as part of a package of reforms aimed at improving the planning and delivery of infrastructure to support growth.

Local revenue allocation 3.149 At the 2006 Pre-Budget Report, the Government committed to returning at least 70 per cent of PGS revenues to the local authority area from where the revenues derived, to ensure that developers see local benefit from the PGS contribution they have made. **The Government now proposes that, to lock in this local benefit, the local share of PGS would be paid directly to the Local Planning Authority (LPA) that granted the planning permission to which the PGS liability is attached.** Payments would be made on a regular basis to ensure that Local Authorities could deploy PGS receipts in a timely way to support infrastructure delivery. The Government will consider whether special arrangements should be made where there exists a special purpose vehicle with planning powers (such as an Urban Development Corporation) and for consents granted by county authorities.

3.150 The Government proposes that the LPA would manage the local share of PGS revenues. Working with local businesses, communities and other public sector bodies, they would be expected to use PGS resources, in combination with other funding streams, to

³⁰ Review of Housing Supply: Delivery Stability: Securing our Future Housing Needs, HM Treasury, March 2004.

secure delivery of infrastructure in pursuit of the objectives identified in their statutory Local Development Framework (LDF). Through their participation in local housing market partnerships, and through consultation on the LDF, developers and other local businesses will have a voice in infrastructure planning in their areas. The Government will also explore ways of ensuring robust joined working in two-tier areas and pooling of PGS revenues across local boundaries.

Regional revenue allocation 3.151 The remaining share of all PGS revenues raised in a region would be returned to that region. Regions would have access to a fund for spending in support of regional infrastructure priorities in pursuit of the objectives identified in Regional Spatial Strategies (RSSs). This would enable regional PGS revenues to be spent on infrastructure projects or areas of the region where additional resources, particularly transport, are most needed. *The Eddington Transport Study* and the work of the 2007 CSR Review into Supporting Housing Growth (see Box 3.8) have both identified the central importance of transport for growth.³¹ The expectation is therefore that transport will be the focus of regional PGS spending in the short term.

London 3.152 The Government proposes that either the Mayor of London, or one of his functional bodies, would directly receive the regional share of PGS revenues for infrastructure to deliver the objectives identified in the London Plan. As in other regions, the expectation is that transport will be the focus of spending in the short term.

Planning and delivering infrastructure 3.153 The Government's commitments on PGS revenue allocation form part of a wider package of investment and reform being taken forward as part of the 2007 CSR Policy Review into Supporting Housing Growth (see Box 3.8). **To build on existing good practice and to promote a more systematic approach to infrastructure planning and delivery, the Review proposes that:**

- LPAs should be required to undertake sound infrastructure planning as part of the formation and review of their LDFs, maximising the use of existing infrastructure and deploying demand management options before setting out plans for new infrastructure. The Government will encourage local areas to use Annual Monitoring Reports to review plans and manage infrastructure delivery;
- key stakeholders, such as local developers, public sector infrastructure providers, utility companies, Local Strategic Partnerships (LSPs) and local communities should be involved in the infrastructure planning process; and
- in deciding whether to approve LDFs, the Planning Inspectorate should consider the soundness of infrastructure planning, taking into account the resources likely to be available to implement the plan (which should include PGS revenues were PGS to be introduced).

3.154 Once areas have developed robust infrastructure plans, strong governance needs to be in place to ensure effective delivery of the plans. As such, the Review proposes that:

- LPAs (and where appropriate Local Delivery Vehicles) should have lead responsibility for coordinating and driving forward infrastructure delivery, working in partnership with LSPs, local developers and key infrastructure providers;

³¹ *The Eddington Transport Study*, HM Treasury, December 2006.

- where unlocking housing growth is reflected as an improvement priority outcome in the Local Area Agreement (LAA), the effective and timely provision of infrastructure to support housing growth should be assessed as part of the LAA performance management system; and
- the Government seeks to develop guidance setting out the components of good infrastructure planning, working in consultation with stakeholders.

Planning obligations **3.155** Alongside the introduction of PGS, the Government has proposed to scale back the current planning obligations regime in England to matters relevant to the environment of the development-site itself and affordable housing. In its recent consultation, *Changes to Planning Obligations*, the Government consulted further on its approach, including proposals for a criteria-based test to reduce the scope of matters subject to planning obligations.³² In considering options for reform of the planning obligations regime, the Government is examining carefully the views of respondents to the consultation, including on how best to achieve clarity in the criteria-based approach.

Protecting the haulage industry

Protecting the haulage industry **3.156** Following the successful co-operation with the haulage industry through the Haulage Industry Task Group, the 2006 Pre-Budget-Report announced that Government would undertake a feasibility study into options for delivering a database of foreign vehicles, including through a “vignette”. The Department for Transport will engage with the haulage industry, enforcement agencies and ferry operators through a stakeholder-working group. The feasibility study is expected to report final conclusions in time for the 2007 Pre-Budget Report.

3.157 It is important to protect the competitiveness of legitimate hauliers by maximising the likelihood that non-compliant vehicles are identified and stopped. **The Government is therefore announcing today that it will triple the amount that is currently spent on the South East International Traffic pilot in order to improve further the targetted enforcement achieved by rolling out the combined use of intelligence and technology to target those who compete unfairly and threaten the safety of other road users.** At least 50,000 such targeted checks of vehicles on international journeys are planned for 2007-08. The Government welcomes the contributions the haulage industry has made to enhance the enforcement and will continue to discuss developments with the representative industry bodies.

The UK as a competitive centre for global investment

UK Trade and Investment **3.158** The strategy for marketing the UK economy internationally, as set out in *Globalisation and the UK: strength and opportunity to meet the economic challenge*, published on 2 December 2005 and *Prosperity in a Changing World* published in July 2006, forms an important part of the UK’s response to Globalisation. The strategy outline the steps that the Government will take to achieve a step change in its efforts to attract high quality inward investment and promote UK businesses.

UKTI skills response **3.159** UK Trade and Investment (UKTI) are responsible for coordinating and driving the strategy. A key theme of the strategy is being responsive to potential investors needs. Many investment decisions are dependent on the availability of skilled labour in the host country. That is why, as part of their services, UKTI will now deliver a rapid response framework for skills to ensure the UK has the skills profile it needs to attract foreign investment and new jobs.

³² *Changes to Planning Obligations: a Planning-gain Supplement Consultation*, Communities and Local Government, December 2006.

3.160 To help harness existing talent in the UK and fill specific short-term skills gaps, **UKTI will broker links between investors, RDAs and universities to set up courses to deliver targeted, high level skills, as well as assisting firms to access recent graduates.** To complement this new approach, UKTI will also assist firms to supplement the UK skills mix with expertise from abroad. Where skills are not immediately available in the UK, and while UK talent is being trained through training placements and new training programmes, **UKTI will assist firms to navigate the current points-based migration system and provide advice for employees and their families.** This will enable firms to bring essential highly skilled employees to fill the short-term need without which the investment would not take place.

UKTI Services for companies locating in UK **3.161** UKTI also provides a range of more general services, on issues wider than skills availability. Each investor's needs are different, so within this broad package of services UKTI will tailor its approach to the individual case. This Budget announces the general prospectus of services UKTI will provide to companies locating in the UK: **UKTI will provide a single dedicated client manager and team for targeted firms** who will oversee UKTI's relationship with a potential investor from initial approach to aftercare once they have located in the UK. **UKTI will also provide basic information to firms** in all areas necessary to setting up a business in the UK.

3.162 In order that both Government policy and UKTI's services keep pace with the changing global business climate, UKTI will **submit an annual "State of Investment" report** to DTI and HMT. It will be based on detailed surveying of all the firms they approach. UKTI will also benchmark themselves against leading competitors to drive up their standard of service.

UKTI sectors strategy **3.163** UKTI are making progress on a number of other fronts including leading the development and implementation of five international marketing strategies for sectors vital to the UK's future global competitive position. The Financial Services strategy, agreed by the Chancellor and the high-level industry group in October 2006, is now being delivered. A similar approach is being taken for four other sectors: Creative Industries, Life Sciences, Information & Communication Technologies, and Energy strategies will be produced during 2007 that bring together industry, stakeholders and relevant government departments to identify core UK strengths, prioritise overseas opportunities, coordinate activity and target resources. These will be built on solid propositions to market the UK as the springboard for global growth – both for overseas companies to invest in the UK, and for UK companies to penetrate overseas markets.

UKTI R&D strategy **3.164** Over the coming months UKTI will be working with other government departments to implement a new R&D programme to attract and support high value-added R&D investment into the UK. The programme will target the world's leading high-tech companies and is an important part of the wider UKTI-led strategy on marketing the UK more effectively abroad, launched last year.

International Business Advisory Council **3.165** In March 2006, the Chancellor established the International Business Advisory Council (IBAC). The role of the IBAC is to advise the Government on how the UK can rise to the challenge of globalisation, promote itself as one of the key locations of choice for international business investment in high value-added activity, and work with international partners to pursue a less protectionist world. Its inaugural meeting took place on 17 November 2006. The Government also hosted a Business Advisory Summit in November 2006 with over seventy Chairs and CEOs from many leading UK companies. The Government strongly welcomes this engagement with business on the challenges of globalisation, particularly in the areas of trade, economic flexibility and education. Looking forward, the IBAC is expected to meet formally once a year to discuss the challenges that the UK faces in a globalised economy

Financial services 3.166 Supporting and promoting London, and the UK, as a centre for financial and business services remains a priority for the Government. London is the world's most competitive financial centre and is in a strong position to benefit from opportunities presented by continuing global economic growth and integration.

3.167 In March 2006 the Chancellor established the High-Level Group, bringing together senior representatives from across the financial services sector, to develop a strategy to enhance the UK and the City of London's international competitiveness. The High Level Group, chaired by the Chancellor of the Exchequer, had its inaugural meeting in October 2006 and will next meet in May. The Government is taking forward substantive proposals in a number of key areas, as set out in Box 3.9.

Box 3.9: High-Level Group on the City of London's international competitiveness

Following the first meeting of the High-Level Group on 18 October 2006 the Government agreed to take forward proposals to:

- maintain cutting edge, principle based regulation – the Government is examining, with the Financial Services Authority, whether the regulatory regime might be lightened for those services with lower consumer detriment or systemic risk. In order to help protect our risk-based regulatory system the Government introduced the Investment Exchanges and Clearing Houses Act 2006. This legislation will help protect the well-regulated but proportionate environment for listing and trading securities in the UK;
- modernise the wholesale insurance market – a review group, led by Lord Levene, has been considering the modernisation of London's wholesale insurance and reinsurance markets. The Group's initial report is expected shortly. The Treasury is, in parallel, conducting an analysis of the business environment for wholesale insurance;
- boost professional financial skills. Lord Currie is chairing a working group to develop the proposal for an international centre for financial regulation in the UK. The Government will make a financial contribution towards the start-up costs for the centre for three financial years. The Working Group is scheduled to report on the detailed framework for the centre in May. In addition to this the Financial Services Skills Council will also publish their assessment of the skills needed to maintain future competitiveness of the sector; and
- promote, in a co-ordinated strategy led by UKTI, the UK based financial sector in high growth overseas markets. This work includes developing country specific strategies for China and India that will be finalised by May. As part of this ongoing work, the Chancellor and the Secretary of State for Industry visited India earlier this year.

On 20 February 2007 the Economic Secretary to the Treasury chaired an informal meeting of the High-Level Group, with EU Commissioners McCreevy and Kroes in attendance, to discuss the future policy direction for financial services in Europe. A further informal meeting, chaired by the Economic Secretary to the Treasury, will take place on 19 April with the focus on principle-based regulation.

In addition to this, work continues on a number of broader issues affecting the financial and business services sector, including migration and infrastructure. The Chancellor is scheduled to chair the next meeting of the full High-Level Group on 9 May, where progress on these issues will be reviewed and the Secretary of State for Scotland will lead a discussion on the contribution of the Scottish Financial Services Sector.

3.168 Ensuring that the tax system continues to support business competitiveness is vital to support the further development of an innovative and fast moving financial sector. With this in mind, the Government keeps the corporate tax system and other taxes related to financial services under review. For example the Government is continuing to work in partnership with the Investment Management Association to consider issues raised by the recent KPMG report on *Taxation and the Competitiveness of UK Funds*. The Economic Secretary is due to report the findings of this working group to the next meeting of the High Level Group in May.

3.169 In Budget 2007, London's current pre-eminence as a leading financial centre will be further strengthened by measures announced to reduce the main rate of corporation tax from 30 per cent to 28 per cent in 2008-09, a rate that compares favourably internationally, and particularly with other G7 countries. Chapter 5 provides more information on tax measures.

