5 BUILDING A FAIRER SOCIETY

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

- building on previous increases in financial support for families, **a commitment to increase the child element of the Child Tax Credit at least in line with average earnings up to and including 2007-8**;
- **enhancing the development of young people's skills**, through measures to improve financial support for 16 to 19 year olds in learning, including through extending Child Benefit and Child Tax Credit from April 2006; and piloting a new Activity Agreement and Allowance for 16 to 17 year olds not in education, employment or training from April 2006;
- to support parents and improve children's learning, **an additional £35 million in 2006-07 and 2007-08 for the Parenting Fund and to improve early learning help for families**;
- **free off-peak local area bus travel for all people over the age of 60 and disabled people in England from April 2006**;
- **an additional payment guaranteeing council tax paying households with someone over 65 will receive £200 towards the cost of council tax;**
- **extending the existing higher Individual Savings Accounts limits to April 2010**, to promote further saving;
- **consulting on payments at secondary school age in the Child Trust Fund;**
- **investing up to £100 million over the next three years, to deliver the Government's response to the Russell Commission report on youth volunteering**, including a matched volunteering opportunities fund rising to £40 million in 2007-08, conditional on private sector support;
- **doubling the zero-rate threshold for stamp duty land tax to £120,000 for residential property transactions**, exempting an extra 300,000 home buyers from stamp duty every year;
- **increasing the threshold for inheritance tax** to £275,000 in 2005-06, £285,000 in 2006-07 and £300,000 in 2007-08; and
- further reforms to **modernise the tax system**, including better aligning North Sea corporation tax payments with payments for petroleum revenue tax, and a number of measures to clamp down on **tax fraud and avoidance**.

5.1 The Government's aim is to promote a fair and inclusive society where everyone shares in rising national prosperity and no one is held back from achieving their potential through disadvantage or lack of opportunity. The Government is committed to ensuring that flexibility and fairness are advanced together, so everyone can achieve their full potential in a modern, dynamic economy. Education and skills are central to this ambition. A high-skilled, high-productivity workforce will ensure the UK can prosper in the global economy. For an individual, education and skills provide security and opportunity, enhance personal fulfilment and can enable people to contribute better to their communities. The Budget sets out a programme of long-term investment in education, and further measures to enhance the development of skills, to ensure that everyone has the opportunity to fulfil their potential.

Tax and benefit reform

5.2 Published alongside this Budget and summarised in Box 5.1, *Tax credits: reforming financial support for families*, sets out the reforms the Government has made to achieve a more inclusive society, reduce the tax burden on the low paid, ensure that financial support is targeted on those who need it most, provide dignity in retirement for all pensioners and guarantee minimum levels of income for the most vulnerable in society.[1] In the past, the tax and benefit system had failed to address the challenges of rising worklessness and poverty among families and pensioners that emerged from the early 1980s. To tackle this problem, the Government's reforms are based on the principle that, for those who can, work provides the best platform of security and independence.

Box 5.1: Reforming the tax and benefit system

***Tax credits: reforming financial support for families* sets out how, in the past, the tax and benefit system failed to address the challenges of rising worklessness and poverty among families and pensioners that emerged from the early 1980s. It sets out the Government's reforms since 1997, the principles that underpin them and the evidence of their impact so far. The document also explains how future policies will be guided by the principles for modernising the tax and benefit system.**

In particular, *Tax credits: reforming financial support for families* explains how the Child and Working Tax Credits have helped to support families, tackle child poverty and make work pay. Tax credits provide flexible support tailored to a family's circumstances, and around 10 million children in 5.9 million families are benefiting from tax credits.

The introduction of tax credits has created a system of financial support where families can actually receive a net tax payment. While the personal allowance can only reduce a household's tax bill to zero, tax credits can go further, reducing the net tax rate faced by a family to below zero. *Tax credits: reforming financial support for families* shows that:

- **around 4 in 10 families in Britain pay no net tax as a result of tax credits, and the number of families paying no net tax has risen by around 500,000 since 1997;**
- **tax credits offer a number of advantages over increasing the personal allowance as a means of targeting support on low and middle income families. Raising the personal allowance also provides greatest benefit to higher-rate taxpayers. The personal allowance can cut a family's tax bill to zero, but it cannot make payments to them, and neither can the personal allowance provide support tailored to a family's circumstances, such as the number of children the family has or whether it cares for a disabled child; and**
- **as a result of tax credits, a single earner two child family on half male mean earnings receives a net tax payment of £2,200 a year in 2005-06. This means their net tax rate in 2004-05 was minus 15 per cent, compared to 4 per cent in 1977-78 when Child Benefit was introduced and 9 per cent in 1997-98.**

Chart 5.1 provides more information on how the net tax rate faced by a family changes with income and the number of children in a family.

5.3 The Government's approach to promoting employment opportunity for all is set out in Chapter 4. Alongside this, the Government is reforming the tax and benefit system to ensure security and opportunity for the most vulnerable in society. This chapter sets out the

[1] *Tax credits: reforming financial support for families – The modernisation of Britain's tax and benefit system*, Number Eleven, HM Treasury, March 2005.

progress the Government has made in tackling child poverty, improving childcare, promoting saving and asset ownership, and ensuring security for all in old age. The Government is also committed to creating a modern and fair tax system, which adapts to changes in business and the global economy and ensures everyone pays their fair share toward building world class public services.

5.4 This chapter also sets out how the Government is using the UK's Presidencies of the G7/G8 and the EU in 2005 to make progress on finance for international development, including through taking forward the recommendations of the Commission for Africa, and with measures for a new deal between developed and developing countries as bold as the Marshall Plan of the 1940s.

SUPPORT FOR FAMILIES AND CHILDREN

5.5 Child poverty increased dramatically in the last two decades of the twentieth century. By 1998, the UK had the highest child poverty rate in the EU. Around a quarter of children lived in relative low-income households before taking account of housing costs and around a third lived in relative low-income households after housing costs. A number of factors contributed to the high level of poverty, including the failure of the tax and benefit system to address the challenges of rising worklessness and poverty among families. Fundamental reform of Britain's tax and benefit system was needed if the Government was to meet its long-term goal of eradicating child poverty by 2020.

Financial support for families with children

5.6 The Government's programme of tax and benefit reform is described in more detail in *Tax credits: reforming financial support for families*. Reforms aimed at providing more support for families include:

- increasing the value of Child Benefit, benefiting all families with children. Since 1997, the value of Child Benefit for the first child has been increased by 25 per cent in real terms; and
- introducing the Child and Working Tax Credits from April 2003. Tax credits are benefiting 5.9 million families and 10 million children, including those families receiving their child allowances through their benefits. The Child Tax Credit is part of the Government's progressive universalist approach, providing more support for all families and the greatest support to those who need it most, including those with low incomes, families with children under one and those with disabled children.

Increased support for families

5.7 The 2004 Pre-Budget Report announced that **from April 2005, the child element of Child Tax Credit will be raised to £1,690 a year**, representing a total increase of £245 since its introduction in April 2003. A family with two young children and a full-time earner on £15,500 per year – around half male average earnings – will receive over £103 per week in Child Tax Credit and Child Benefit from April 2005. This represents a real terms increase of 85 per cent since 1997-98. Table 5.1 shows the levels of support that Child Tax Credit and Child Benefit will provide for families from April 2005. Since the introduction of Child Tax Credit in April 2003, the Government has kept and exceeded its commitment to increase the child element in line with average earnings. **Budget 2005 announces that the Government will continue to increase the child element of the Child Tax Credit at least in line with average earnings up to and including 2007-08**.

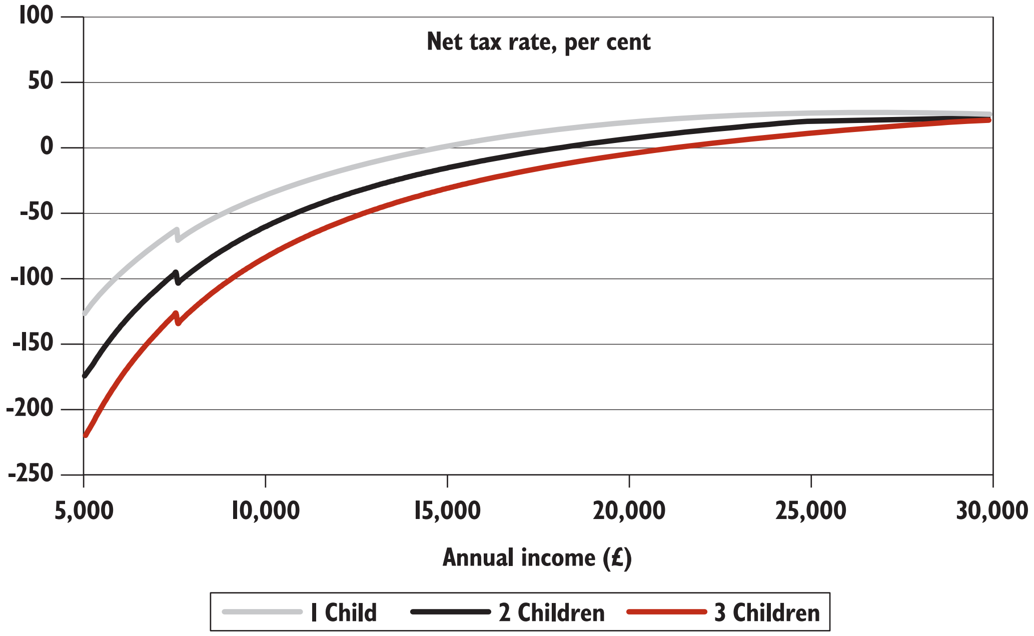
Table 5.1: Annual levels of support for families from April 2005

Family income (£ a year) *Per cent of families*	less than £13,910 *30*	less than £50,000 *82*	all families *100*
1 child	£3,125	£1,430	£880
2 children	£5,410	£2,020	£1,475
3 children	£7,695	£2,615	£2,065

5.8 As set out in *Tax credits: reforming financial support for families*, tax credits such as the Child and Working Tax Credit ensure that financial support is provided fairly, responding both to family income and circumstances. This means some families will receive enough tax credits and Child Benefit to cancel out their income tax liabilities and national insurance contributions, and will in effect be paying no net tax. Other families will receive net tax payments and have a negative net tax rate.

5.9 Chart 5.1 shows the net tax rate for single earner families. Those with one child do not start to pay net tax until income reaches £15,400. For a family with two children the level is £18,700 and with three children £21,900.[2]

Chart 5.1: Net tax rate for families of different size



Source: HM Treasury.

5.10 Tax credits are far more flexible and are fairer than traditional methods of altering the burden of tax. For example, increasing the personal allowance in income tax provides a tax reduction for a higher rate taxpayer four times greater than for an individual with a much lower income, paying the 10 pence starting rate of tax. Additionally, adjusting the personal allowance cannot reduce the tax burden below zero, nor can it respond flexibly to family circumstances, for example the number of children or the presence of a disabled child in a family.

[2] The definition of tax liability and the tax rate would depend on whether NICs were included. For some purposes it would be appropriate to include NICs but in other cases it may not be because they finance pension entitlements and health services through the National Insurance Fund, and are therefore distinct from general taxation.

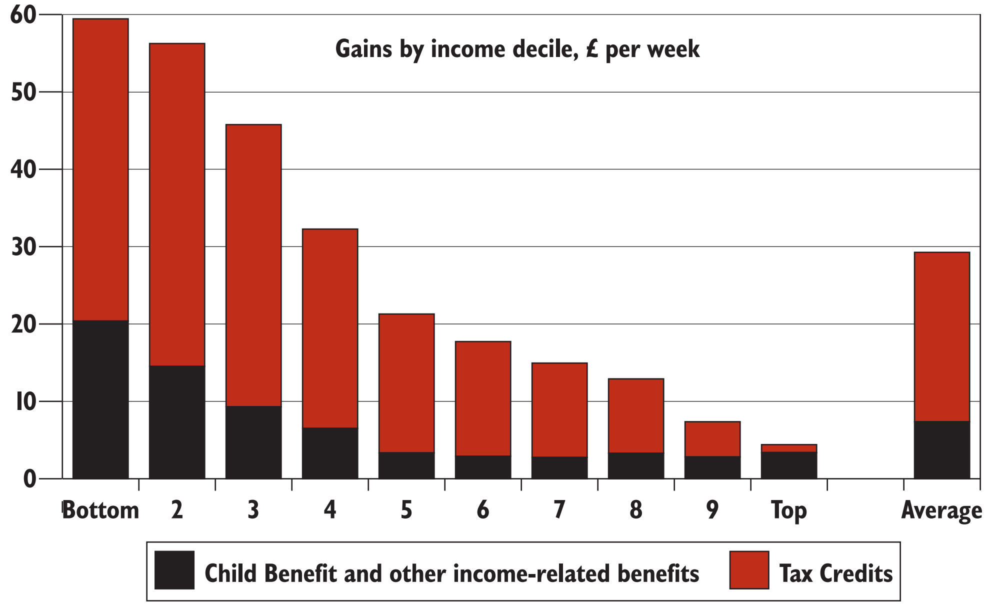
5.11 With tax credits, the support people receive from the tax system is not limited by their tax liability. Instead, they can receive tax credit payments from the Inland Revenue even where they could receive no benefit from an increase in the personal allowance. All single earner households pay no tax on their first £4,895 of income. For a two child family, Child Benefit cancels out their income tax until they earn around £12,700 and tax credits mean they pay no net income tax until they earn £21,200. Increasing the personal allowance by £500 would raise the point at which this family's income tax liability was cancelled out by Child Benefit to £13,200, an increase of £500, but putting the same money into the Child Tax Credit would raise the point at which they start to pay net income tax to £22,500, an increase of around £1,300. So tax credits help more people to pay no net tax.

Making families better off

5.12 Chart 5.2 shows the impact by income decile on families with children of the Government's reforms to the tax and benefit system since 1997. As a result, by October this year, in real terms:

- families with children will be, on average, £1,400 a year better off, while those in the poorest fifth of the population will be, on average, £3,200 a year better off;
- a single-earner family on half average male earnings with two children will be £3,700 a year better off; and
- a single-earner family on average male earnings with two young children will be £205 a year better off.

Chart 5.2: Gains for families as a result of tax credits and other children's measures by 2005



Source: HM Treasury.

Eradicating child poverty

Progress to date

5.13 As the first milestone towards meeting its long-term goal of eradicating child poverty by 2020, the Government is on track to reduce the number of children in relative low-income households by a quarter between 1998-99 and 2004-05. The most recent data show that by 2002-03, the numbers of children in relative low-income households had fallen by 0.5 million before housing costs and by 0.6 million after housing costs, from 3.1 million and 4.2 million respectively.[3]

[3] Data from *Households Below Average Income; An analysis of the income distribution 1994/95 – 2002/03*, Department for Work and Pensions, 2004. Data for 2003-04 will be published on 30 March 2005 and final outturn data against the 2004-05 target will be available in early 2006.

New target for 2010-11

5.14 As the next milestone towards the eradication of child poverty, the Government is committed to halving the number of children in relative low-income households between 1998-99 and 2010-11.[4] The Government will set an additional target in the next Spending Review to halve by 2010-11 the number of children suffering from both material deprivation and relative low-income.

Implementing the Child Poverty Review

5.15 As well as ensuring work for those who can and providing financial support for families, the Government's strategy for reducing child poverty involves tackling material deprivation and ensuring public services contribute to improving poor children's life chances. The *Child Poverty Review* set out the next steps necessary to move towards halving child poverty by 2010.[5] The Government is committed to working closely with partner organisations, including local authorities, to make progress across the range of policy areas covered by the Review. Key developments since the Review include:

- *work for those who can and financial support for families*. To encourage lone parents who have been out of work for a year or more back into employment, the Government is piloting an In-Work Credit in areas where the cost of living is highest;[6]
- *tackling material deprivation*. To improve the quality of accommodation for families with children, the Housing Act 2004 included measures aimed at helping those families most at risk from poor conditions. The Government also set out measures to tackle financial exclusion, which reduces household income available to spend on children, described in more detail later in this chapter; and
- *improving poor children's life chances*. To ensure that every child gets the best possible start in life, the Government has committed to delivering 3,500 Children's Centres by 2010, which will provide integrated services for families in every community by 2010. The Public Health White Paper and its delivery plan set out the next steps for tackling health inequalities and supporting children and families to make healthy choices.[7] To break cycles of poverty and criminality, the Government has committed to increasing the coverage of early intervention programmes by 50 per cent by 2008.

Childcare and work-life balance

5.16 The Government is committed to investing in early years and childcare to help expand the range of choices available to families with children. The Government's vision is to ensure that every child gets the best start in life and to give parents more choice about how to balance work and family life. Steps taken have included increasing the duration and the level of maternity leave and pay, introducing paternity and adoption pay and leave and establishing the right to request flexible working. Since 1997, the Government has put in place 524 Sure Start local programmes, free part-time early education for every three and four year old, and 529,000 more childcare places.

[4] In line with international practice, low income will be measured on a before housing cost basis. The Government continues to monitor progress against a range of other indicators, including income measured on an after housing cost basis and data on regional variations in child poverty.

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

[6] In-Work Credit for lone parents will be extended from October 2005 to Surrey and Sussex; Essex; Kent; Berkshire, Buckinghamshire and Oxfordshire; Bedfordshire and Hertfordshire; and Hampshire and Isle of Wight.

[7] *Choosing Health: making healthier choices easier*, Department of Health, November 2004 and *Delivering choosing health*, Department of Health, March 2005.

Ten year strategy for childcare

5.17 However, the Government acknowledges that more needs to be done. Many parents still find it difficult to find affordable childcare that meets their circumstances and is of the quality they want for their children. *Choice for parents, the best start for children: a ten year strategy for childcare*, published alongside the 2004 Pre-Budget Report, sets out an ambitious agenda of reform and investment to create a childcare sector fit for the 21st century. [8]

5.18 The strategy sets out the Government's aim of a childcare place available for all families who want it by 2010, for all children aged 3-14 between the hours of 8am and 6pm each weekday. The number of free hours of early education for three and four year olds will begin to be extended to 15 hours from 2007, with a goal of 20 hours a week. To improve the quality of childcare and boost parents' confidence in how their child is looked after, all full daycare centres will be professionally led. A £125 million Transformation Fund each year will be available in 2006-07 and 2007-08 to support high quality, sustainable, affordable care.

5.19 The strategy also introduces measures to improve childcare affordability, including an increase in the eligible cost limits of the childcare element of Working Tax Credit to £300 a week (£175 for one child) from April 2005, and an increase in the maximum proportion of costs that can be claimed from 70 to 80 per cent from April 2006. Significant progress has already been made on many of the commitments announced in the ten year strategy.

Consultation with parents and other stakeholders

5.20 The ten year childcare strategy invited responses from parents and other stakeholders. Over 75 written responses have been received, with contributions from a range of groups including parents, local authorities, representative bodies and businesses. The Government has also proactively engaged with parents through a series of structured parent forums across the country and held a range of meetings with key stakeholders and experts in the sector. Initial results from the consultation process have been positive, with strong support for the Government's commitment to build a highly skilled childcare and early years workforce. A summary of responses is published alongside this Budget.[9]

Parenting and early learning support

5.21 The analysis in the ten year strategy for childcare demonstrated the importance of children's early learning to their readiness to learn at school. This analysis also showed that a child's home learning environment is vital to his or her development. **The Government is therefore allocating an additional £25 million in 2006-07 and 2007-08 for early learning partnerships with parents, working with Sure Start Local Programmes, Children's Centres and other pre-school providers. In addition, an extra £10 million is allocated in 2006-07 and 2007-08 for the Parenting Fund to support parenting programmes provided by the voluntary and community sectors.**

Affordability in London

5.22 The ten year strategy announced a contribution of £5 million a year from April 2006 for a pilot to work with the Greater London Authority and London Development Agency to address childcare affordability issues in London. The pilots, which will test a range of approaches aimed at improving the accessibility and affordability of good quality childcare for lower-income parents, are planned to come on stream in autumn 2005.

VAT and childcare

5.23 Local authorities have a key role in delivering the Government's vision for childcare. They will be given a new duty to secure sufficient supply of affordable, high-quality childcare to meet the needs of local children and families. Local authorities will also play a critical role in delivering on the Government's ambitious plans for a Children's Centre in every community.

[8] *Choice for parents, the best start for children: a ten year strategy for childcare*, HM Treasury, Department for Education and Skills, Department for Work and Pensions, Department of Trade and Industry, December 2004.

[9] A summary of responses to the childcare strategy is available at: www.hm-treasury.gov.uk/childcare

5.24 To ensure that VAT does not obstruct the delivery of the Government's vision for childcare, and in recognition of the role that local authorities play in delivering the strategy, **the Government will refund local authorities all of the VAT that they incur in the provision of welfare services, such as childcare and Children's Centres**. The Government intends to legislate on this, in due course, but in the interim will use existing powers to operate this administratively. The Government will also explore whether there are any further VAT changes that might be made to enable local authorities to play their part in ensuring local delivery of childcare.

Work-life balance

5.25 In order to support child development and parents' choices during the crucial first year of a child's life, the ten year strategy sets out the aim for a year of paid maternity leave by 2010. Further details on work-life balance proposals announced in the ten year childcare strategy were published in *Work and Families: Choice and Flexibility* in February 2005.[10] These measures include: the extension of maternity pay to 39 weeks; the introduction of a new right for a mother to transfer a proportion of her pay and leave to the father; the extension of flexible working to carers of sick and disabled relatives and parents of older children; and the case for transferring responsibility for the administration of Statutory Maternity Pay, Statutory Paternity Pay, Maternity Allowance and Statutory Adoption Pay to the Inland Revenue. The consultation period ends on 25 May 2005.

SUPPORTING YOUNG PEOPLE

5.26 The Government is committed to enhancing skills and has a long-term aspiration to increase the UK's rates of post-16 participation in education and training to match the best in the OECD. For an individual, education and skills provide security and opportunity, enhance personal fulfilment and can enable people to better contribute to their communities. As described in Chapter 6, this Budget sets out new long-term plans for investment in education and skills, which are central to the Government's aim of creating a high-skilled, high-productivity workforce which will ensure the UK can prosper in the increasingly competitive global economy.

Review of financial support for 16-19s

5.27 The review of financial support for 16-19 year olds aims to remove the financial barriers to learning for all young people, including the most vulnerable. The success of the Education Maintenance Allowance (EMA) pilots demonstrates the important role of financial incentives in delivering higher staying-on rates. EMA was rolled-out nationally in September 2004 for 16 year olds continuing in full-time education, introducing a framework of rights and responsibilities based on a learning agreement signed by each recipient.

5.28 Building on this milestone, *Supporting young people to achieve*, published alongside Budget 2004, launched a consultation on the Government's long-term vision of a single, coherent system of financial support, focused on encouraging and supporting all young people to participate in education or training.[11] This system would include young people engaged in different activities and respond to their individual circumstances, simplifying administration and improving accessibility. It would provide support that encourages young people to progress and ensures smooth transitions as they move between different activities, for example as they move into formal learning. The consultation clearly demonstrated that there is a strong consensus in favour of the Government's proposals. The Government is publishing a full response to the consultation alongside this Budget.[12]

[10] *Work and Families: Choice and Flexibility, A Consultation Document*, Department of Trade and Industry, February 2005.

[11] *Supporting young people to achieve: towards a new deal for skills*, HM Treasury, DfES and DWP, March 2004.

[12] The Government's response to the *Supporting young people to achieve* consultation is available at www.hm-treasury.gov.uk/financialsupport

Improving financial support for 16-19s in learning

5.29 As an important step towards this long-term vision, a Child Benefit Bill is currently being considered by Parliament. **The Government can confirm its intention to extend entitlement to Child Benefit, Child Tax Credit and Income Support from April 2006 to 19 year olds completing a course of non-advanced education or training which they started before their 19th birthday, up to a limit of age 20.** Benefiting around 80,000 individuals a year, this change will ensure that more young people achieve their qualifications rather than dropping out at 19 due to financial pressures.

5.30 Furthermore, **the Government can confirm its intention to extend entitlement to Child Benefit and Child Tax Credit from April 2006 to unwaged trainees on work-based learning programmes arranged by the Government**. The courses covered by the new rules are set out in the draft Child Benefit regulations published on 10 January 2005.[13] There are around 100,000 unwaged training places a year provided through these programmes, which help young people to progress to a waged apprenticeship, further education or skilled employment.

5.31 These reforms will improve the financial support available to these learners and, with the extension of EMA in England, deliver parity in financial support for education and unwaged training. This will give individuals genuine choice, enabling them to select the learning route most appropriate for their needs and aspirations, rather than basing their decision on the amount of financial support available. The Child Benefit Bill will also provide the flexibility to extend support to other groups of young people in the future. For example, the Government will consider the Russell Commission's recommendations on financial support for young people participating in the new framework for youth action and engagement, described later in this chapter.

Engaging inactive young people

5.32 Despite significant increases in the numbers of young people who continue in learning after the end of compulsory schooling, at any one time around 150,000 UK 16 and 17 year olds are not in education, employment or training. Evidence suggests that it is detrimental to their long-term opportunities for young people to spend prolonged periods unemployed or inactive when they could be gaining further skills and qualifications. The Government's ambition is to ensure no teenager faces long-term unemployment or inactivity, by providing every young person with the opportunities and financial support to continue in education or training. As the next step towards a single, coherent system of financial support, the Government intends to extend the successful framework of rights and responsibilities which underpins EMAs for example to the hardest to help 16-17 year olds. The consultation strongly endorsed the extension of conditional financial support, which would set a clear expectation for young people to progress into learning and reach their potential. To inform this next stage of reform, **the Government will allocate £60 million over two years to pilot Activity Agreements and an Activity Allowance for 16 to 17 year olds not in employment or learning in eight areas of England from April 2006.** The Activity Agreement will form a personally negotiated contract with the young person, identifying specific steps they should take to move into education or training, in return for access to financial support. For disadvantaged young people who need more help to prepare for formal learning, the Activity Allowance would support them to undertake basic skills training, including courses provided by the voluntary and community sector. The pilots will test different options for the Activity Agreement and Allowance, to help identify which model would be most effective in a national roll-out. Chapter 6 sets out the Government's plans for piloting a Learning Agreement to engage young people who are in low-skilled work without training, to ensure they are also encouraged to continue developing skills.

[13] Available at www.hm-treasury.gov.uk/

5.33 To improve accessibility to the financial support system for vulnerable young people who are unable to live in the family home, the Government has been consulting with the voluntary sector on ways of simplifying and improving the processing of benefits claims for 16-17 year olds under the estrangement criteria. This consultation will feed into revised guidance and training for Jobcentre Plus advisers to be rolled out nationally in April 2006. The Government is also considering further simplication of the benefits structure for 16-17 year olds.

FAIRNESS FOR DISABLED PEOPLE

5.34 The Government is committed to advancing the civil rights of disabled people, and to ensuring they are able to participate fully in society. Reforms introduced to support people with a health condition or disability into work, as set out in Chapter 4, must go hand in hand with action to tackle discrimination and to give disabled people more choice. The Government is tackling the barriers that can prevent disabled people from participating fully in society, including by widening the scope of the Disability Discrimination Act and establishing the Disability Rights Commission.

Improving the life chances of disabled people

5.35 In January 2005, the Government published *Improving the life chances of disabled people,* which set out the Government's vision for improving the life chances of disabled people over the next 20 years.[14] The recommendations made in the report are designed to increase disabled people's ability to live independently; enable disabled children and their families to enjoy a good quality of life; support young disabled people effectively as they become adults; and improve the support available to disabled people to help them remain in contact with the labour market. A new Office for Disability Issues will be established to coordinate disability policy across Government.

PROMOTING SAVING, ASSET OWNERSHIP AND INCLUSION

5.36 Assets and savings provide people with opportunity and independence throughout life, flexibility to adjust to unforeseen events and financial security in retirement. Broad asset ownership contributes to social cohesion, giving more people a stake in the economy and society. Building on the platform of macroeconomic stability set out in Chapter 2, which aids long-term planning, the Government seeks to support saving and asset building for all from childhood, through working life and into retirement. People save in a range of assets, from deposit accounts, shares and pensions, to homes and businesses. Traditional measures of aggregate saving, such as the household saving ratio, are therefore only part of the story.[15]

5.37 Household net wealth has grown by around 50 per cent in real terms since 1997. Total household assets, including savings, pensions, life insurance and housing, are over £6 trillion. The debt taken on by households in aggregate is primarily as they accumulate assets, rather than borrowing to fund current consumption.[16] Nevertheless, the Government recognises that some households face debt problems and set out in July 2004 its strategy for tackling over-indebtedness.[17]

[14] *Improving the life chances of disabled people*, Prime Minister's Strategy Unit, January 2005.

[15] See for example, *Bank of England Quarterly Bulletin*, Spring 2001.

[16] 'Household Secured Debt,' *Bank of England Quarterly Bulletin*, Autumn 2004.

[17] *Tackling Over-Indebtedness: Action Plan 2004*, Department of Trade and Industry, July 2004.

Promoting saving and asset ownership

5.38 The Government's policies provide over £2 billion a year in tax relief on savings, and promote saving through the benefit system, improved regulation, public spending and education. As set out in the 2004 Pre-Budget Report, the Government's plans to promote further saving and asset ownership focus on three areas:

- *Individual Savings Accounts* – tax-free saving opportunities for all adults;
- *the Saving Gateway* – piloting the provision of a Government cash contribution to 'match' individual savings for those on low incomes; and
- *Stakeholder savings and investment products* – simple and risk-controlled, with a charge cap to protect consumers from high charges.

Individual Savings Accounts

5.39 Individual Savings Accounts (ISAs) were introduced in 1999. Over 16 million people now have an ISA, with over £160 billion subscribed. ISAs have a higher take-up among both low-income groups and the young compared to Tax Exempt Special Savings Accounts (TESSAs) or Personal Equity Plans (PEPs), which they replaced. These savings are supported by around £1.6 billion in tax relief every year. When introduced, ISAs were guaranteed to run for an initial ten years to 2009 and the overall annual investment limit was set at £5,000, with a maximum of £1,000 in cash. A higher limit of £7,000, with a maximum of £3,000 in cash, was set for the first year to encourage new saving. In 2000, these higher limits were extended to April 2006. **In response to the consultation announced in the 2004 Pre-Budget Report, the Government will extend further the existing higher ISA limits, not only to 2009 but now to April 2010.**

5.40 As announced in the 2003 Pre-Budget Report, **from April 2005, Stakeholder medium-term investment products and existing life insurance products will be available through stocks and shares ISAs**. This will improve flexibility and increase the tax relief available by allowing investment of £4,000 in stocks and shares mini-ISAs. In response to changes introduced by the FSA, **the Government will extend the list of qualifying investments for ISAs to include all FSA-authorised retail investment schemes.**[18] Taking these decisions together, it is estimated that by 2010 the Government will provide around an additional £350 million a year in tax relief on ISAs.

5.41 Responses to the consultation on ISA limits, and a wider debate among industry bodies, providers and consumer groups contain interesting ideas on how to continue and build on the success of ISAs. Their flexible structure allows them to be updated easily in response to regulatory and financial market developments. The Government is keen to play its part in facilitating the transferability of savings between different vehicles in order to give savers more flexibility over their lifetime and to link short, medium, and long-term savings.

Matching and the Saving Gateway

5.42 In addition to tax relief, the Government is using the Saving Gateway to explore how matching and carefully tailored information can help promote saving among those who do not usually save. This provides a more understandable, transparent and equitable framework of support for savers, and greater incentives for those on low incomes who benefit less, or not at all, from tax relief. In the initial Saving Gateway pilot established in 2002, the Government matched individuals' savings pound-for-pound up to a limit, and provided tailored financial information and education to participants. The final evaluation report, published alongside this Budget, confirms that matching can encourage genuinely new savers and new saving.[19] The evidence shows that participants doubled their saving with minimal substitution from existing savings.

[18] *ISA and Child Trust Funds: All FSA authorised or regulated retail investment schemes will be qualifying investments*, Inland Revenue, March 2005.

[19] *Incentives to save: Encouraging saving among low-income households*, University of Bristol, Personal Finance Research Centre, March 2005.

5.43 The 2004 Pre-Budget Report announced a new, larger, £15 million Saving Gateway pilot. The accounts will run for 18 months and the first are already open. Halifax bank is providing banking facilities in six areas: Cambridgeshire; Cumbria and North Lancashire; East Yorkshire; Manchester; East London; and South Yorkshire. The pilot will test alternative match rates, different monthly contribution limits, the effect of an initial endowment, and the support of a wider range of community financial education bodies.[20] It will also be made available to a wider range of income groups than the first pilot. The pilot will inform the development of matching as a central pillar in the Government's strategy for promoting saving and asset ownership.

Stakeholder savings and investment products

5.44 Following the Sandler Review of the retail savings industry, the Government will introduce a new 'Stakeholder' suite of simple, low cost, risk-controlled savings and investment products in April 2005.[21] The suite will include a deposit account and a medium-term investment product – both of which will be available within ISAs – as well as a Child Trust Fund account and a revised Stakeholder pension. There is also a new advice regime, Basic Advice, which the FSA finalised in November 2004.[22] Following consultation, **the launch of the Stakeholder Suite will be supported by a £4 million programme to inform consumers**.

Treatment of capital limits

5.45 The Government is committed to ensuring the benefit system encourages households to save appropriately, particularly those on lower incomes. As announced in Budget 2004, **from April 2006 the threshold above which savings begin to reduce eligibility for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit will be raised from £3,000 to £6,000**. In addition, in this Budget **the Government announces that it will raise the upper capital thresholds for Income Support and Jobseeker's Allowance from £8,000 to £16,000 from April 2006**.

Child Trust Fund

5.46 The Government launched the Child Trust Fund in January 2005. The Child Trust Fund is at the heart of the Government's asset-based welfare strategy. It will promote saving and ensure all children have a financial asset at age 18, regardless of their family background. It will also provide children with practical financial education. All children born since September 2002 will receive at least £250 to invest in a long-term savings or investment account and children from families with lower incomes will receive £500. Children, parents, family and friends will together be able to contribute up to £1,200 a year to each account and there will be no tax for them to pay on any interest or gains made on this money. There are now over 90 official providers and distributors of Child Trust Funds, including institutions across the financial services industry and numerous high street retailers. 1.6 million vouchers are being sent to families in the first few months of this year, accompanied by a major information campaign. Child Trust Fund accounts will become fully operational on 6 April 2005.

5.47 As announced in the 2004 Pre-Budget Report, the Government is consulting on a universal payment at age seven of £250, with children from low-income families receiving £500 more. This will link in with financial education in primary schools, by providing a relevant and practical example of saving. **The Government now invites views on what further payments should be made into Child Trust Fund accounts at secondary school age.** Details of the consultation can be found on the HM Treasury website.

5.48 Building on the success of the ISA model, the Government has designed the rules for Child Trust Fund accounts to allow a range of investment options, including Stakeholder accounts, ethical accounts and Shari'a compliant accounts. As it is doing for ISAs, the Government will extend the list of qualifying investments for Child Trust Fund accounts to include all FSA-authorised retail investment schemes. Credit unions can already make

[20] MORI and the Institute of Fiscal Studies will evaluate the pilot scheme.

[21] *Medium and Long-Term Retail Savings In The UK: A Review*, Ron Sandler, July 2002.

[22] *A basic advice regime for the sale of Stakeholder products*, Financial Services Authority, November 2004.

available Stakeholder accounts and in addition **the Government will enable credit unions to offer Child Trust Fund cash accounts, providing that depositors are afforded the same level of protection they would have had, had they invested with any other provider**.

Financial capability

5.49 The Government is supporting efforts to improve financial capability, to help people make financial decisions with confidence throughout their lives. The importance of financial education is recognised in the Government's recent White Paper on the national curriculum.[23] Financial education is also a key part of the Child Trust Fund and the Saving Gateway. The Government actively supports the FSA in coordinating a national financial capability strategy, in conjunction with the Government, financial services firms, consumer organisations and others.[24]

Saving through pooled investments

5.50 Around £2 trillion of household assets are held in pooled investments, which combine funds to diversify risk and provide professional asset management.[25] These schemes form an important part of the investment chain, as discussed in Chapter 3. The Government recognises the potential benefits of simplifying and modernising the taxation of pooled investments and continues to invite views on whether radical reform similar to that underway for pensions is viable. The aim is a simpler regime for both savers and investment intermediaries and a more efficient channel for businesses to raise capital.

5.51 **Details of changes to the taxation of authorised investment funds (AIFs)and further consultation on potential changes are announced alongside the Budget.**[26] These are designed to facilitate a more flexible approach to investment strategies following the FSA's changes to the regulatory regime in 2004. However, as the flexibility of the new Qualified Investor Scheme (QIS) offers greater scope for exploitation of the AIF tax regime, Finance Bill 2005 will introduce a power to make regulations to apply different tax rules to investors holding a substantial portion of a QIS. The Government will continue to work with those affected to ensure that the benefits of the regime are properly focused.

Promoting financial inclusion

5.52 Access to mainstream financial services is restricted for many people on low incomes. This imposes costs on those who can least afford them and can prevent people from getting started on the savings ladder. *Promoting Financial Inclusion*, published alongside the 2004 Pre-Budget Report, set out the Government's strategy for tackling financial exclusion, outlining policy measures in three key areas: access to banking; access to affordable credit; and access to money advice. It established a Financial Inclusion Fund of £120 million over three years to support these measures, and a Financial Inclusion Taskforce, launched in February 2005, to oversee progress.

Access to banking

5.53 In 2002-03, there were around 2.8 million adults in households without access to a bank account. In December 2004, the banks and the Government agreed to work together towards the goal of halving the number of adults in households without a bank account, and of demonstrating significant progress in that direction within two years.

Access to affordable credit

5.54 Many low-income households rely on the 'alternative credit market', where typical products have Annual Percentage Rates of over 100 per cent. Through the Consumer Credit Bill, the Government aims to increase transparency and fairness in the market and improve consumers' access to redress mechanisms. To reduce the costs and risks of lending to vulnerable groups, and following consultation, **the Government will work towards a scheme where, under certain circumstances, lenders could apply for repayment through deduction from benefits, where normal repayment arrangements have broken down.**

[23] *14-19 Education and Skills*, Department for Education and Skills, February 2005.

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

[25] Investment Management Association. Pooled investment schemes can include authorised investment funds, life insurance products, private and occupational pension funds and other collective investment vehicles that pool investors' funds.

[26] *Reform of Taxation of Collective Investment Schemes*, Inland Revenue, March 2005.

5.55 'Third sector' lenders, such as credit unions and community development finance institutions (CDFIs), have a key role to play in providing affordable credit to those on low incomes. The Government will set up a growth fund for third sector lenders, from within the Financial Inclusion Fund, to boost the coverage, capacity and sustainability of the sector in providing an affordable source of credit for the financially excluded. **The Government is today publishing a consultation document on the costs and benefits of raising the cap on interest that credit unions can charge on loans to members**, to establish what impact, if any, this would have on the ability of credit unions to offer loans to low-income consumers.[27] **The Government will also shortly consult on the case for, and practicalities of, extending Community Investment Tax Relief to investments in CDFIs' personal lending activities**.

5.56 The Social Fund provides a safety net of grants and loans for the most vulnerable in times of crisis, supporting those without a stock of savings and assets to fall back on. As announced in the 2004 Pre-Budget Report, **the Government will introduce reforms to the Social Fund Budgeting Loans scheme in April 2006**. These measures will increase funding for the Social Fund by £210 million over three years and improve its transparency and effectiveness. Further reforms will be considered in the context of the Government's commitment to promoting financial inclusion.

Access to money advice

5.57 The Government recognises that free face-to-face money advice provision is a particularly effective mechanism in tackling over-indebtedness for more vulnerable consumers. The Financial Inclusion Fund will support an increase in the capacity of the face-to-face money advice sector. The Government will also pilot models of money advice provision to reach those who do not normally go to debt advisors.

FAIRNESS FOR PENSIONERS

5.58 In the past, the tax and benefit system failed to deliver security for the poorest pensioners, while providing inadequate support for low-income households who were saving for retirement. A fair society guarantees security in old age and ensures that all pensioners can share in rising national prosperity. *Principles for reform: The national pensions debate* set out the extent of pensioner poverty in 1997 and the inadequate framework for the working-age population, especially for those on low and moderate earnings, to plan for retirement.[28]

5.59 *Tax credits: reforming financial support for families* sets out the policies the Government has introduced aimed at guaranteeing security in old age and ensuring that all pensioners can share in rising prosperity. The introduction of the programme for Informed Choice, accompanying radical reform of the taxation of pensions, the introduction of the State Second Pension and the development of simple, low cost savings products, are enabling all individuals and families to build up retirement incomes that meet their aspirations. The Government's measures will continue to to be guided by the principles set out in *Principles for reform*.

Fairness for today's pensioners

5.60 Building on the foundation of support for retirement provided by the basic and additional state pensions, the Government continues to focus resources on the poorest pensioners. In 1997, the poorest single pensioners lived on £69 a week; in 2005-06, all single persons aged 60 or over are entitled to a minimum of £109.45 a week.

[27] *The credit union interest rate cap: a consultation document*, HM Treasury, March 2004.
[28] *Principles for reform: The national pensions debate*, Department for Work and Pensions, February 2005.

Pension Credit

5.61 Key to this success has been the Pension Credit, which further extends support to the poorest pensioners and rewards those who have built up small savings for retirement. By December 2004, 2.65 million pensioner households (over 3.2 million individuals) were receiving the Pension Credit with 2.08 million households receiving the guarantee credit element. Current estimates suggest that take-up of the Pension Credit guarantee by the poorest pensioners is over 80 per cent. The Pension Service has a take-up target of 3 million pensioner households by 2006, rising to 3.2 million by 2008, and is working with local authorities and the voluntary sector to achieve this. Pension Credit also rewards 1.9 million pensioners who have saved for their own retirement, and has ended the unfair penalty on many savers of a 100 per cent marginal deduction rate on their savings. Women pensioners, many of whom have not been able to build up an entitlement to a full basic state pension in their own right in the past, have been among those to benefit the most from Pension Credit. Twice as many women as men receive Pension Credit.

5.62 To ensure that Pension Credit continues to take and keep pensioners out of poverty, in the 2004 Pre-Budget Report the Government committed to increasing the guarantee element of Pension Credit by earnings until 2008. On current forecasts, it will be worth £119 a week by March 2008. This means that the Pension Credit guarantee will rise to £109.45 for single pensioners and £167.05 for couples from April 2005; and the Pension Credit savings credit reward will rise to a maximum of £16.44 a week for single pensioners and £21.51 for couples from April 2005.

Support for all pensioners

5.63 The Government has guaranteed that the annual April increase in the basic state pension will be in line with the Retail Prices Index for the previous September or 2.5 per cent (whichever is higher). This will mean that from April 2005 the basic state pension will rise to £82.05 for single pensioners and £131.20 for couples. The Government is also providing free television licences for the over 75s, and free prescriptions and free eye tests for those aged 60 and over. Moreover, Winter Fuel Payments of £200 to all households with someone aged 60 or more, rising to £300 for households with someone aged over 80, will benefit over 11 million people by the end of 2005.

5.64 The Government is continuing to ensure that all pensioners can share in rising national prosperity. Since 1997, it has done this through directly increasing the incomes of older people and by indirectly reducing the cost of key public services to older people.

5.65 Budget 2005 continues this policy by **announcing free off peak local area bus travel for those aged over 60 and disabled people in England from April 2006**. Not only will this reduce the cost of travel for approximately 11 million people aged over 60 and approximately 2 million disabled people, it should also help approximately 54 per cent of pensioner households who do not have a car to travel freely in their local area.

5.66 The Government understands the position of older people on fixed incomes facing pressures such as council tax bills. Alongside Council Tax Benefit for the poorest pensioners, the Government believes that it is right to help elderly households with their council tax. **This Budget announces an additional payment to all council tax paying households with someone over 65.** Together with payments, in addition to the Winter Fuel Payment announced in the 2004 Pre-Budget Report, this will mean some 4.7 million council tax paying households with someone over 65 will receive £200. These payments will be made at the same time as the 2005 Winter Fuel Payment.

5.67 Budget 2003 announced that all pensioners in hospital would continue to receive their state pension entitlement for stays of up to 52 weeks. Budget 2005 announces that this will now be extended so that **all those entering hospital from April 2005 will continue to**

receive their full state pension and their full entitlement to Incapacity Benefit, Severe Disablement Allowance and Income Support for the entire duration of their stay in hospital from April 2006. Those already in hospital will have their benefits increased from April 2006 if they have then been in hospital for 52 weeks or more. This is in recognition of the fact that individuals have many on-going fixed commitments such as housing costs and utility bills while they are in hospital.

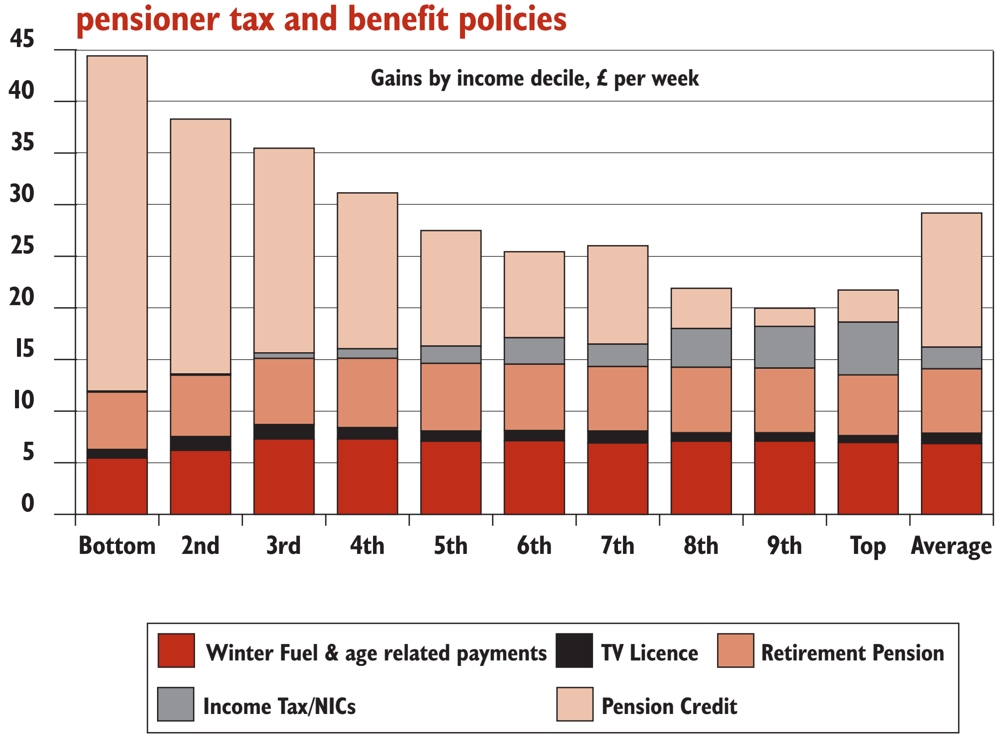
Support for pensioners who pay tax

5.68 The Government is committed to supporting pensioners who pay income tax. Around half of all pensioners pay no tax on their income, but for those who do the Government has committed to increasing age-related tax allowances in line with earnings for this Parliament which means that the age-related allowances for 2005-06 will increase to £7,090 for people aged between 65 and 74 and to £7,220 for those aged 75 and over. This will mean that no person aged 65 or over need pay tax on an income of less than £136 a week.

Effects of measures to support pensioners

5.69 As a result of measures implemented since 1997, the Government is spending around £11 billion a year more on pensioners – around £8 billion a year more than if it had simply linked the basic state pension to earnings over the same period. The Government's strategy is not only more generous overall, but has also focused support on those who need it most. If the extra £11 billion had been spent on raising the basic state pension, the poorest 10 per cent would on average be £24 a week worse off than they are now. As a result of tax and benefit measures the Government has introduced, the poorest 10 per cent of pensioner households will be on average £2,300 a year, or around £44 a week better off; and pensioner households will be on average £1,500 a year better off, or around £29 extra a week. Chart 5.3 shows the distributional impact of the Government's measures to support pensioners.

Chart 5.3: Overall gains for pensioner families from pensioner tax and benefit policies



Fairness for tomorrow's pensioners

5.70 The Government is committed to providing a clear and sustainable framework for retirement provision within which individuals can make informed choices about how much to save and when to retire, as set out in the Pensions Green Paper in 2002. Since then, the measures in the Green Paper have been taken forward through legislation and the Government documents, *Informed Choices for Working and Saving* and *Principles for reform: The national pensions debate.*[29] The Government's policies aim to deliver:

- *a guarantee of a decent minimum income in retirement* – provided by the state, and below which no pensioner need live;
- *transparency* – the Informed Choice programme is helping people to make informed and effective choices about working and saving for their retirement;
- *simplicity* – simplifying the tax regime for pensions, and ensuring that people have access to simple and flexible savings products;
- *security* – the Pension Protection Fund (PPF) and a new pro-active regulator will improve protection for members of occupational pension schemes, while the Financial Assistance Scheme will provide support covering the period before the PPF becomes operational; and
- *opportunities for extended working lives* – combating age discrimination and providing people with greater opportunity and reward for working longer, if they wish to do so.

Pensions Commission

5.71 In 2002, the Government invited the Pensions Commission to examine the regime for private pensions and long-term saving and consider whether the level of compulsion within the UK pensions and retirement system is appropriate. An interim report was published in autumn 2004 and a final report will be published later this year.[30] The Government's policies will continue to be guided by the imperative of maintaining long-term fiscal sustainability.

Decent minimum income in retirement

5.72 The Government is committed to providing a decent minimum income to pensioners in the future as well as those today. As set out above, the guarantee element of the Pension Credit will be uprated by earnings until 2008. The Government reformed the State Earnings Related Pension (SERPS) by introducing the State Second Pension in April 2002 to strengthen the foundation in retirement for 14.6 million working age people on low and moderate earnings. For example, someone on around half median earnings, £12,000, will be able to accrue a weekly State Second Pension of around £70 in 2050, in today's earnings terms; roughly double what would have been built up under SERPS. A further innovation of the State Second Pension is that over 4 million of those making non-remunerated contributions to society, such as carers and the disabled, are for the first time able to build up rights to an additional pension. Of the 18.7 million in total gaining from the 2002 reform, around 55 per cent are women.

Transparency

5.73 Beyond the foundation provided by the state, individuals and families make decisions as to what income they wish to receive in retirement. The Government is playing its role in assisting people to make informed choices about working and saving, issuing over 4.5 million pension forecasts in 2004-05 and developing a web-based retirement planner for launch in 2006. Currently, around 4.7 million individuals have access to an occupational scheme but are not members of it. *Informed Choices for working and saving* set out a number of options for

[29] *Simplicity, security and choice: Informed choices for working and saving*, Department for Work and Pensions, February 2004; *Principles for reform: The national pensions debate*, Department for Work and Pensions, February 2005.

[30] *Pensions: Challenges and Choices*, Pensions Commission, October 2004.

maximising employee participation in these schemes. Both the CBI and the Employer Task Force have recommended that firms adopt automatic enrolment in order to increase employee participation.[31] The Government is keen to discuss with employers how to increase the number of schemes that operate this joining mechanism.

Simplification

5.74 To make informed choices, individuals need clarity around the tax treatment of their pension saving. The numerous existing taxation regimes, each with its own set of rules, create complexity. The Finance Act 2004 legislated for a single universal regime for tax-privileged pension savings, to come into effect in April 2006. As well as providing individuals with greater flexibility and choice over their retirement savings, tax simplification will also benefit employers and pension providers through a reduction in administrative costs. In response to representations made on the legislation, the Government will **introduce a package of supplementary measures, which will come into effect from April 2006, to provide additional flexibility for schemes and individuals, clarify aspects of the legislation, smooth the transition from the current to the new regime, and introduce further anti-abuse and compliance rules.**

5.75 Individuals need access to simple, good value products. The introduction of Stakeholder pensions has ensured that value-for-money, flexible private pension arrangements are accessible to all. These products form part of the Stakeholder suite of products described earlier in this chapter.

Pension Protection Fund

5.76 The Pensions Act 2004 legislated for the Pension Protection Fund (PPF), which will come into being from April 2005. This is the UK's first scheme for ensuring that individuals in defined benefit pension schemes receive a meaningful proportion of their expected pension income if their sponsoring employer becomes insolvent. The Government will legislate to ensure that the PPF has the same tax privileges as the pension schemes that it protects – so that if the PPF takes over a scheme there will be no adverse tax consequences for members of that scheme. Employers who fund the statutory levies payable to the PPF will be able to claim tax relief on those payments. The Government is also establishing a Financial Assistance Scheme to provide support covering the period before the PPF becomes operational.

Enabling longer working lives

5.77 The Pensions Commission analysis confirmed that enabling longer working lives will be an important part of the response to increased life expectancy. Chapter 4 sets out the Government's employment strategy, which contains measures to further improve employment opportunities for older workers. The Government does not believe it is right to force people to work longer and has no plans for a crude increase in the state pension age, but it is providing greater choice and flexibility for those who wish to do so. From April 2005, those who choose to defer taking their state pension will be better rewarded, including the option of a taxable lump sum. From April 2006 it will be possible to draw an occupational pension while remaining with the same employer; and in the same year the Government will also implement the age discrimination strand of the European Employment Directive. Legislation coming into force in autumn 2006 will provide for a national default retirement age of 65. Employees who wish to continue to work will have to have their request considered seriously by their employer.

SUPPORTING COMMUNITIES, CHARITIES AND GIVING

5.78 The third sector plays a key role in creating a fair and enterprising society with a culture of volunteering and giving. To create a framework in which voluntary and community activity can flourish, the Government is providing support for charitable giving, support to

[31] *Securing our future: developing sustainable pension provision in the UK*, CBI, July 2004; *Report to the Secretary of State for Work and Pensions*, The Employer Task Force on Pensions, December 2004.

charities through the tax system and other provisions, and support for community programmes and involvement. Tax reliefs and other measures are now worth more than £2.4 billion a year to charities. Following the success of the Giving Campaign, the Government will continue to work with the sector to identify new ways to promote charitable giving.

Modernising tax administration for charities

5.79 The integration of HM Customs and Excise and the Inland Revenue into Her Majesty's Revenue and Customs (HMRC) provides an opportunity to deliver significant improvements for charities in the administration of the tax system.[32] It will take sustained effort to ensure that the new department meets the diverse needs of charities and their donors. The first key steps by the new department include:

- setting up a single unit for all activity with respect to charitable organisations and charitable donations, including repaying tax to charities and ensuring that charitable reliefs are sufficiently protected against abuse;
- researching the experience and needs of the sector and inviting representatives onto an advisory group to contribute on the initial development of the unit; and
- creating a one-stop shop for charities, including improved website guidance and enhanced dedicated helpline support covering direct and indirect taxation.

Gift Aid

5.80 Gift Aid has provided a significant boost to donations to charities. Around 56,000 charities reclaimed tax of £586 million on Gift Aid donations in 2003-04, including around 6,000 claiming for the first time. Charities using Gift Aid range from the largest to the very smallest and tax has been claimed on donations of all sizes, demonstrating that taxpayers of all income levels can use the scheme.

Tsunami Appeal

5.81 The Tsunami Appeal highlighted the generosity of the British public and demonstrated increasing awareness of tax-effective ways to give. The Disasters Emergency Committee (DEC) raised £300 million and estimates from charities and others involved in the appeal suggest that 60 per cent of donors used Gift Aid, which is twice normal take up rates. Tax reclaimed could add over £50 million to donations. In light of the unprecedented generosity of the UK public, the Government announced in January 2005 that a special one-off donation would be made to DEC equivalent to the VAT collected on charity concerts, charity records and other fundraising activities for tsunami relief.

Payroll Giving

5.82 The Government is keen to encourage greater use of Payroll Giving, which enables employees to make regular, tax effective, donations to charity. In January 2005, the Home Office launched the Government's £8.3 million scheme to improve access to Payroll Giving and encourage more of the UK's 12 million employees in small and medium sized enterprises to give to charity. The scheme, administered and promoted by the Institute of Fundraising and Business in the Community (BITC), offers a cash incentive to employers who set up a scheme and matches employee donations. Initial take-up has been encouraging. Through BITC, its regional networks and its key corporate members, the scheme will be promoted to 500,000 small and medium sized enterprises. In addition, over 20,000 copies of the Government's *Guide to Tax Incentives for Corporate Giving*, launched in January, are being disseminated to businesses and charities.

Gift Aid admissions

5.83 In the 2004 Pre-Budget Report, the Government announced changes to the special exemption in relation to Gift Aid and admission charges. Charities have been consulted on how the broader scope of the exemption will be applied and on draft legislation, which reflects their comments. Legislation will be introduced in the next Finance Bill and changes will take effect from April 2006.

[32] The Commissioners for Revenue and Customs Bill which provides the legislative framework for integration has nearly completed its parliamentary passage and the Government expects the new department to be launched shortly.

Support for charities

5.84 In addition to encouraging charitable giving, the Government is committed to supporting the role the third sector plays in the reform of public services, as outlined in Chapter 6. **Building on this the Government will introduce a new reduced rate of VAT for certain supplies of advice or information connected with or intended to promote the welfare of elderly or disabled people or children.**

5.85 The Government recognises that charities increasingly want to enter into joint trading ventures but that the existing rules on company Gift Aid may be a barrier to such arrangements. **The Inland Revenue will examine with the sector whether an approach can be found to allow companies owned by more than one charity to donate their profits to the parent charities using Gift Aid**.

Unclaimed assets

5.86 The Government continues to believe that it is right in principle that more should be done to reunite assets with their owners. Where assets and their owners cannot be reunited, the Government believes that the assets should be reinvested in society, as long as the original owners' entitlements to reclaim are preserved. Therefore in Budget 2004, the Government asked the industry to expand the scope of voluntary action to achieve this beyond investment banking into retail banking and the wider financial sector.

5.87 The Government is engaged in constructive discussions with the industry to take this forward. Looking ahead, the Government expects to agree with industry a common definition of an unclaimed asset, and for the industry to search their records and to set out the full value of their assets so defined, by the time of the 2005 Pre-Budget Report. The Government also expects the industry to explore what more could be done to reunite owners and assets, including the possibility of a National Register, and to set out how they will achieve this by the time of the 2005 Pre-Budget Report.

VAT grant scheme for memorials

5.88 The Government recognises the social value of memorials as a means of commemoration, especially this year, which marks the sixtieth anniversary of the end of the Second World War. It will therefore seek agreement at European level on a reduced rate of VAT for the construction, renovation and maintenance of memorials. In the meantime, **an interim grant scheme will be introduced to cover the VAT costs incurred by charities in the construction , renovation and maintenance of memorials**. This scheme will apply alongside the existing VAT relief for memorial buildings.

Listed places of worship

5.89 The Government is also seeking agreement at European level on a reduced rate of VAT for repairs and maintenance to listed places of worship. **The Government remains committed to this objective and, in the meantime, will extend the period for which funding will be available for the listed places of worship scheme for three years until 2007-08 unless a permanent reduced rate is achieved earlier.**

Queen Mother memorial

5.90 HM Queen Elizabeth the Queen Mother passed away in 2002. To create a fitting memorial to celebrate her life and her contribution to the nation the **Government will make available up to £2 million from sales of a commemorative coin to be issued to celebrate HM the Queen's eightieth birthday,** to be allocated in accordance with the wishes of HM the Queen and HRH Prince of Wales.

Volunteering

5.91 Recognising the important role of voluntary action in developing social capital and creating strong and cohesive communities, 2005 is the Year of the Volunteer.[33] Working with Volunteering England and Community Service Volunteers, the Government is leading a programme to celebrate the work volunteers do and encourage more people to volunteer. The Home Office will invest an extra £4.8 million in the Year of the Volunteer to expand Volunteer Centres to increase opportunities for public sector employees to volunteer; raise awareness of volunteering through voluntary sector partners; and support the Volunteer Films unit to promote volunteering in their joint work with the media industry. This brings total Government investment in the Year of the Volunteer to £6.8 million.

Youth volunteering

5.92 The Russell Commission has shown that there is a large number of young people who are prepared to volunteer their time to serve their communities. **In response to the Russell Commission report, the recommendations of which are set out in Box 5.2, the Government is investing up to £100 million over the next three years in a new national framework for youth action and engagement.** This will include a volunteering opportunities fund rising to £40 million by 2007-08. The Government is making this fund available to match contributions from business. The framework will ensure young people have a choice of a range of opportunities from introductory 'tasters' to a more sustained commitment, covering diverse activities in fields such as health, heritage and culture, community safety, sport, conservation and education. The Heritage Lottery Fund has pledged £5 million through their Young Roots programme in 2005-06 and Sport England has pledged £1 million a year from their programme for young people to volunteer in sports activities.

5.93 The private sector will lead the creation of a new body which will be a partnership between the voluntary and community sector, young people and the private sector working with the Government to achieve the shared ambition of a million new young volunteers within five years. Using the latest technologies, the new body will set up a portal to improve information and advice on volunteering, spearheading a step change in choice and quality of opportunities available to young volunteers while ensuring the needs and goals of individual young volunteers are at the heart of what it does. Furthermore, to ensure a greater diversity of young people volunteering, the framework will include a discretionary hardship fund to support full-time volunteering opportunities and the Government will consider extending the same entitlements to full-time volunteers aged 16 to 19 as those in education and training, as outlined earlier in this chapter. The Government will also publish a rulebook to set out existing rules on volunteering and the benefits system; will assess the interaction between volunteering and Housing Benefit within the context of the ongoing programme of reform; and will examine the issue of national insurance credits for volunteering.

[33] For more information please see: www.yearofthevolunteer.org

Box 5.2: Achieving a step change in youth action and engagement – the findings of the Russell Commission

The Russell Commission, led by Ian Russell, Chief Executive of Scottish Power, was established by the Chancellor and the Home Secretary in May 2004. Its recommendations are a response to the demand from young people to volunteer in their communities, and to the goodwill that exists in the private and voluntary and community sectors to support volunteering.

Published today, the report of the Russell Commission sets out recommendations for a national framework to deliver a step change in the diversity, quality and quantity of young people's volunteering. The Commission calls for a shared purpose in making the framework happen – the voluntary and community sector, business, government and young people themselves all have an essential part to play. The Commission recommends:

- **an ambition of attracting 1 million more young volunteers** – more than half of 16 to 25 year olds should participate, with significant increases in short-term opportunities and part-time roles, and a high profile national programme of full-time youth volunteering, including a weekly allowance;
- **an implementation body, youth led and independent from government** – to provide an accessible portal for young people to get information and advice about volunteering, and maintain a nationwide database of volunteering opportunities;
- **consistently better quality opportunities** - a kitemark guarantee of standards, with young people able to choose between short-term volunteering (such as taster sessions); part-time volunteering (from a few hours to one or two days per week); and full-time programmes;
- **all young people should have the opportunity to volunteer, regardless of background** – a discretionary fund should be created for young people experiencing hardship who wish to undertake full-time volunteering opportunities, and a rulebook should be published on volunteering and the benefits system;
- **recognition of the positive achievements of young volunteers** – accreditation and links to vocational qualifications to amplify the importance of volunteering to personal and skills development, particularly to educational institutions and employers; and
- **measurable community impact** – volunteering should become a common, fun and popular pursuit for young people, establishing a pattern of lifelong engagement.

Almost 6,000 responses were received to the Commission's consultation and key results were announced as part of the Chancellor and the Home Secretary's Volunteering Conference in January 2005. The full report is available at: www.russellcommission.org.

Mentoring

5.94 The new Mentoring and Befriending Foundation, backed by the Government, will support the growth and development of mentoring and befriending within local communities. The Government will work with the Foundation to identify where mentoring can add most value to service delivery, develop an evidence base on the impact of mentoring and encourage more businesses to get involved in mentoring. New regional organisations, working with Volunteering England, Timebank and local partners will run a targeted campaign in June to encourage more people to become mentors and befrienders.

DELIVERING A MODERN AND FAIR TAX SYSTEM

5.95 A modern and fair tax system encourages work and saving, keeps pace with business practices and the global economy and provides the foundation for building world-class public services. The creation of Her Majesty's Revenue and Customs (HMRC) will introduce greater efficiency, effectiveness and better customer focus into this system. Chapter 3 sets out some of the benefits that the new department will bring to business, consistent with the recommendations of the Hampton Review.

Protecting tax revenues

Improving compliance

5.96 For the tax system to be effective, everyone needs to pay their fair share of taxes and receive the tax credits they are entitled to. Tax avoidance and tax or tax credit fraud undermine the ability of the tax system to deliver its objectives, imposing significant costs on society. The Government has always made clear its determination to ensure that the tax system is fair and is seen to be fair.

5.97 The Government has taken a series of steps to prevent abuse of the tax system. These have included structural reforms that make the system less vulnerable, closing loopholes in the law and improving the way HM Customs and Excise and Inland Revenue deliver their compliance functions. Continued vigilance at both a domestic and international level is essential to ensure that action is taken against those who attempt to gain an unfair advantage by avoiding or evading their obligations.

Tackling avoidance schemes

5.98 In Budget 2004, the Government introduced disclosure rules to tackle tax avoidance schemes for both direct taxes and VAT. These rules allow earlier, targeted action against avoidance schemes. To build on this success, the Government is now expanding the rules to include **stamp duty land tax on commercial property** and **two more listed VAT schemes and an additional VAT hallmark.**

Direct tax compliance measures

5.99 The Government is determined to ensure all employers and employees pay the proper amount of tax and national insurance contributions (NICs). Budget 2005 reiterates the Government's intention, announced alongside the 2004 Pre-Budget Report, to close down the ever more complex and contrived attempts at tax and NICs avoidance. Should further arrangements emerge that frustrate this intention, the Government will legislate to close them down where necessary from 2 December 2004.

5.100 The disclosure rules have revealed a number of areas of the tax system at risk from high levels of tax avoidance. International transactions have emerged as a particular concern, with increasing globalisation presenting new opportunities for those attempting to avoid their obligations. Building on the action taken in the 2004 Pre-Budget Report, the Government is introducing two new anti-avoidance rules which will allow the Inland Revenue to issue a notice to counter a tax advantage in specific circumstances where a UK tax avoidance motive is present. These new measures will tackle **arbitrage, where companies seek to gain a tax advantage by exploiting differences within and between tax codes** and **excessive claims for double taxation relief.**

5.101 The Government is providing additional resources to the Inland Revenue to improve compliance in high-risk areas, and will take action, with immediate effect, to close specific loopholes that are currently being exploited. These measures include:

- **preventing arrangements that enable individuals and trustees to avoid tax on capital gains;**

- **preventing avoidance by companies and individuals using financial product based schemes;**
- **blocking a marketed avoidance scheme for the corporate intangible assets regime;** and
- **closing loopholes in the stamp duty land tax rules.**

Film tax avoidance

5.102 As announced in the 2004 Pre-Budget Report and alongside the film tax reform described in Chapter 3, the Government is legislating in the Finance Bill to close a number of avoidance schemes that exploit the tax reliefs for UK film production.

VAT compliance measures

5.103 The Government is continuing to see the benefits of the VAT compliance strategy launched in April 2003. Further measures announced today include:

- **tackling a specific avoidance scheme exploiting Customs warehousing rules;**
- **measures to address VAT losses from partly exempt businesses in relation to their VAT recovery;** and
- **extending the unjust enrichment provisions so that no business can unfairly benefit from charging too much VAT.**

Tackling tobacco smuggling

5.104 Tobacco smuggling involves serious widespread criminality, and costs over £2.5 billion a year in lost tax revenue. Since the launch of the tobacco strategy in 2000, the illicit cigarette market share has fallen to 15 per cent, down by more than a quarter from its peak.[34] The Government will continue to take steps to reduce the smuggled market share still further.

5.105 As part of this effort, the Government will continue to target the increasing numbers of counterfeit cigarettes now being sold by smugglers. More than half of the smuggled cigarettes now being seized are counterfeit, many of which are contaminated with cadmium and arsenic and may pose additional risks to smokers. **The Government is considering further action to tackle the smuggling of hand-rolling tobacco with a view to announcing a package of further measures later in 2005.**

Combating alcohol fraud

5.106 The Government is committed to taking action to tackle alcohol fraud that is both tough and proportionate. The 2004 Pre-Budget Report announced details of the duty stamps scheme to be introduced in 2006. The Government's objective is to tackle spirits fraud while minimising compliance costs. Following close consultation with the industry, the Government has decided:

- that the benefits of duty stamps can be delivered without attaching financial liability to the stamps;
- to provide targeted exemptions from the duty stamps regime for mobile operators and duty-free shops and for spirits of less than 30 per cent alcohol by volume
- not to include a class exemption for liqueurs; and
- to adopt the industry proposal to allow stamps to be incorporated into the bottle labels and to do so in a way that allows them to be printed by the industry's own label printers. Businesses will have the option to use free-standing duty stamps.

[34] *Tackling tobacco smuggling*, HM Customs and Excise, March 2000.

5.107 Compliance costs for the industry will be less than the estimates published at the 2004 Pre-Budget Report, without compromising the effectiveness of the scheme which remains central to the strategy for tackling spirits fraud.

Oils fraud

5.108 The UK Oils Fraud Strategy was announced in Budget 2002 and is targeted specifically at the misuse of rebated oils. Oils fraud cost the Exchequer around £850 million in 2003 in Great Britain alone. The strategy is a combination of new regulatory regimes and enhanced law enforcement activity. It is designed to tackle oils fraud by making it harder to commit the crime successfully, increasing the likelihood of getting caught and increasing penalties.

5.109 At the 2004 Pre-Budget Report the Government increased rebated oils duty rates by 1 penny per litre, narrowing the differential in duty rates between these oils and main road fuels. This helped to reduce incentives for fraud as even a small narrowing can dent fraudsters' profits significantly. As described in Chapter 7, to further support this strategy, and to maintain the differential with main fuel duties, **the Government today announces an increase in duty of 1.22 pence for rebated oils,** to take effect from 1 September 2005.

Modernising information powers

5.110 The Government will shortly begin consulting on the powers that will be available to the new tax department and the appeal rights and other safeguards for taxpayers. This will be a key element in creating a modern organisation with modern tools. The aim will be to provide a framework of law and practices that supports the Government's objectives of a tax system that is fair and better adapted to the needs of customers. The consultation will consider the scope for aligning and rationalising the different powers that currently apply to different taxes to make it easier for taxpayers to comply; and how best to obtain the information needed for better risk assessment and better targeted compliance activities. A key aspect of this process will be a consultative committee to ensure its outcomes fully reflect the priorities of a wide range of stakeholders.

Protecting the UK tax base

5.111 The Government is determined to continue to defend robustly the corporation tax system against legal challenges under EU law. The Government will continue to monitor the impact of international accounting standards on the corporation tax base.

Modernising the tax system

Stamp duty land tax thresholds

5.112 Budget 2003 set out details of a major reform of stamp duty on property to modernise administration and enforcement and remove distortions. To reduce the number of first-time and low-income house buyers paying stamp duty land tax and to improve the efficiency of the housing market, **the Government will double the zero-rate threshold to £120,000 for all residential property transactions with effect from 17 March 2005.** This puts the threshold above the £115,000 median price paid by first-time buyers and will exempt an extra 300,000 home buyers from stamp duty every year. To increase home ownership in deprived areas, the threshold in the 2,000 Enterprise Areas will remain at the higher level of £150,000. As a result, 650,000 residential property transactions will be exempt from stamp duty each year. Over 50 per cent of first-time buyers and 47 per cent of all residential buyers will not now pay stamp duty land tax.

Inheritance tax

5.113 To provide a fair and targeted inheritance tax system, with certainty for families, **the Government will increase the threshold by more than the statutory indexation in each of the next three years to £275,000 in 2005-06, £285,000 in 2006-07 and £300,000 in 2007-08.**

Capital gains tax **5.114** The Government is indexing the capital gains tax annual exempt amount in line with prices. It will therefore increase to £8,500. Gains arising on disposal of a principal private residence will continue to be exempt from capital gains tax.

Modernising the tax system for trusts **5.115** The Government has consulted widely on the modernisation proposals in *Modernising the tax system for trusts* and continues to work with the industry to secure consensus on the best way to simplify trusts taxation further to help people manage their affairs, whilst ensuring that trusts are not used to achieve an unfair tax advantage.[35] The Government will fulfil commitments made in Budget 2004 by introducing:

- **new rules so that tax for certain trusts with vulnerable beneficiaries is charged as if the vulnerable person were receiving the income and gains directly. This will apply from 6 April 2004;** and
- **a standard rate band of £500 which will mean that 25,000 trustees that consistently receive taxed income under this amount will no longer have to submit a self-assessment tax return every year. This will apply from 6 April 2005.**

Residence and domicile **5.116** The Government is continuing to review the residence and domicile rules as they affect the taxation of individuals and will proceed on the basis of evidence and in keeping with its principles. It would welcome further contributions to the debate, which will then be taken forward by the publication of a consultation paper setting out possible approaches to reform.

Shari'a compliant financial products **5.117** The Government is committed to fair tax treatment for Shari'a compliant financial products. Following consultation announced in the 2004 Pre-Budget Report, **legislation will be included in the Finance Bill to amend the tax rules so that the mark-up on a Murabaha transaction and the profit-share on a Mudaraba arrangement are taxed on a level playing field with equivalent banking products.** Stamp duty land tax reliefs for Islamic house purchase schemes will be extended to include a new Shari'a compliant product.

Stamp duty intermediary relief **5.118** **Legislation will be introduced to enable the Government to designate new forms of multilateral trading facilities as 'recognised exchanges'**. This will enable intermediaries operating through those facilities to continue to qualify for intermediary relief. This will give operators more flexibility and will support competition.

Small businesses **5.119** The Government believes that small businesses' decisions on which legal form to use should be made for commercial reasons. *Small companies, the self-employed and the tax system* began a dialogue with small firms and their advisers on the strategic issues associated with these decisions. Final responses are welcome by 29 April 2005.[36]

Construction industry **5.120** There are also issues with legal forms in the construction industry which means there is no clear dividing line between employment and self-employment. The Government is presently discussing with the industry a range of practical options to help clarify this dividing line, and so reduce tax avoidance and resolve any employment rights issues.

North Sea corporation tax: aligning payments more closely with PRT **5.121** To bring the corporation tax payment profile for companies operating within the North Sea ring-fence more into line with the profile for payments of petroleum revenue tax, **the payment dates for instalments of North Sea corporation tax for these companies will be amended so that the bulk of tax is paid within an accounting period or soon after the end of each period.**

[35] *Modernising the tax system for trusts*, Inland Revenue, August 2004.
[36] *Small companies, the self-employed and the tax system: a discussion paper*, HM Treasury, December 2004.

Tobacco duties

5.122 Smoking remains the greatest cause of preventable illness and premature death in the UK. Maintaining high levels of tax helps to reduce overall tobacco consumption. **Budget 2005 therefore announces that from 6pm on Budget day tobacco duties will increase in line with inflation, adding 7 pence to the price of a packet of cigarettes.**

Alcohol duties

5.123 The Government is committed to creating a fairer balance of taxation falling on different alcoholic drinks. Budget 2004 announced a spirits duty freeze for the remainder of this Parliament. This means spirits duty has now been frozen for 8 successive Budgets so that by 2005-06 the total tax on a standard bottle will be £1.32 lower than if duty had risen in line with inflation since 1997. In addition, Budget 2005 announces from midnight on 20 March 2005 the following duty changes:

- **duties on beer and wine will increase in line with inflation, adding 1 penny to a pint of beer and 4 pence to a standard 75cl bottle of wine;** and
- **duties on cider and sparkling wine will be frozen.**

Travellers' allowances

5.124 The Government supports the freedom to shop across international borders and is against excessive restrictions being applied to travellers who bring goods into the country for their own use. Travellers may currently bring goods (excluding wine, spirits, tobacco and perfume) up to a total value of £145 from outside the EU into the UK, without being required to pay tax or duty on arrival. This limit is set in EU law and would require unanimous agreement among Member States in order to be changed. The travellers' allowance was last revised by the EU in 1994 and is now out-of-date. The Government believes that the £145 limit should be raised significantly, **and has proposed to the European Commission and other Member States that it now be set at £1,000.**

TACKLING GLOBAL POVERTY

5.125 The UK is committed to eliminating global poverty in the long-term and achieving the internationally agreed Millennium Development Goals (MDGs), which include halving poverty, combating diseases and achieving primary education for every child by 2015. The UN has warned that, although progress is being made globally on reducing poverty, most developing countries are not expected to meet more than three of the seven MDGs by 2015. 2005 is the target year for the first MDG of eliminating gender disparity in primary and secondary education, but this target will be missed.

Priorities for 2005

5.126 2005 represents a unique opportunity for the UK to drive the international development agenda. Box 5.3 sets out the key opportunities for the UK to pursue this agenda. The UK will use its presidencies of the G7/G8 and the EU in the second half of the year to press for real action on aid, trade, debt relief, governance and peace and security for all developing countries, with action on Africa based on the Report of the Commission for Africa:

- more and better aid, with more countries declaring a timetable towards 0.7 per cent of Gross National Income (GNI) in overseas development assistance, a new International Finance Facility (IFF) and consideration of international taxation proposals as possible sources of financing for development;
- deeper and broader debt relief, matching 100 per cent bilateral debt relief with 100 per cent multilateral debt relief; and
- an ambitious outcome to the Doha round of trade negotiations that delivers substantial benefits to poor countries, and allows them to carefully design and sequence their trade policy reforms to take account of broader development and poverty reduction objectives and not be forced to liberalise as a result of external pressure. It will be important to help developing countries build up

the capacity they need to trade, including more funds for infrastructure, so that as rich countries open up markets, developing countries can take advantage of new opportunities.

Box 5.3: 2005 - Key events for international development.

February – G7 Finance Ministers held their first meeting under the UK Presidency in London. They agreed a series of progressive 'conclusions on development,' reaffirming their commitment to help developing countries achieve the MDGs and setting out the steps they plan to take:

- to provide on a case by case basis as much as 100 per cent multilateral debt relief for heavily indebted poor countries;
- a work programme on the IFF and other financing measures for decisions at the G8 Summit in Gleneagles;
- to improve the effectiveness of aid by harmonising operational procedures and aligning aid behind country-owned priorities;
- to ensure that the Doha Round of trade negotiations delivers substantial benefits to developing countries and to ask the IFIs to develop proposals to ease adjustment in these economies, consistent with debt sustainability and country-owned development strategies; and
- a reaffirmed commitment to the Global HIV Vaccine Enterprise to coordinate research on an HIV vaccine; to consider how to increase public research; and to explore the use of advance purchase commitments to drive private sector investment.

The UK Government will press for further action to tackle global poverty at the remaining key events this year:

April – The G7 Finance Ministers will meet for the second time under the UK's presidency. The Spring meetings of the IMF and World Bank will also take place in April.

June – The G8 Finance Ministers pre-summit meeting will be held in advance of Gleneagles.

July – The G8 Summit in Gleneagles and the EU Finance Ministers meeting on development will take place. July also marks the start of the UK's Presidency of the EU.

September – The UN Millennium Declaration Review Summit. The summit will be an opportunity for the world to take stock of the scale of the effort that is needed if the MDGs are to be achieved. Also taking place in September: the third G7 Finance Ministers meeting under the UK's presidency and the annual meetings of the IMF and World Bank.

December – WTO trade negotiations in Hong Kong and the end of the UK Presidency of the G7/8 and EU.

Africa

5.127 On current trends, Sub-Saharan Africa will not meet any of the MDGs by 2015. Therefore, Africa is one of the Government's two priorities for its G8 presidency this year, along with climate change. The Commission for Africa was established by the Prime Minister in February last year to determine which policies have been effective and where more can be done to support Africa's development. The final report, summarised in Box 5.4, was published on 11 March 2005. The report of the Commission for Africa sets out a comprehensive plan of action for the African continent. It demonstrates that with bold concerted action Africa can be set back on track to meet the MDGs. The report contains detailed recommendations for African countries, individual donors, and for the international community. **The Government accepts the detailed recommendations of the Commission for Africa and will work through the UK's G8 and EU presidencies to secure their implementation.**

Box 5.4: The Commission for Africa

The Commission for Africa published its findings in March 2005. Commissioners from across Africa and the world are saying that a comprehensive package of action is required if Africa is to meet the MDGs by 2015. The Commission for Africa's recommendations are informed by the work of the African Union and the New Partnership for Africa's Development. The key recommendations are:

- **finance – an immediate doubling of aid to Africa raised through the International Finance Facility (IFF) providing $25 billion per annum immediately and increasing as rich countries make progress towards spending 0.7 per cent of their annual income on aid. This will provide a substantial increase in resource flows to education, infrastructure and health for the most vulnerable, with strategies for delivery and monitoring, including a global agreement on tackling HIV/AIDs;**
- **trade – improving Africa's capacity to trade, improving access to markets and transitional support from developed countries to help Africa respond to new trade regimes, and ensuring that the EU's Economic Partnership Agreements (EPAs) contributes to growth, poverty reduction and regional integration in poor countries – Africa, the Caribbean and Pacific;**
- **debt – 100 per cent multilateral debt relief for low-income countries and a new compact on debt relief to provide up to 100 per cent cancellation of debt service and debt stock on bilateral and multilateral debt for all low-income countries in Africa;**
- **governance – investment in capacity building, increased accountability and transparency and a call for renewed political will from African governments in tackling corruption; and stronger measures on the repatriation of Africa's stolen assets and on the transparency of payments in natural resource and other industries and greater transparency in export credit industries; and**
- **peace and security – building capacity to prevent and resolve conflict, improved co-ordination of post-conflict peacebuilding and making aid more effective at reducing conflict.**

Aid

5.128 The UK has set a timetable for achieving the UN target for overseas aid of 0.7 per cent of Gross National Investment (GNI). The 2004 Spending Review announced that by 2007-8, total UK aid will rise to nearly £6.5 billion a year, representing 0.47 per cent of GNI, a real terms increase of 140 per cent since 1997. The Government aims to sustain the rate of growth it achieves in 2007-8, which would mean that total UK overseas development assistance would reach 0.7 per cent of GNI by 2013. If the proposal for the IFF is agreed, the equivalent of 0.7 per cent of GNI could be achieved in 2008-9.

5.129 Increasing the volume of aid is vital to achieving the MDGs, but action is also needed to ensure that international aid is provided in the most effective way. The UK will continue to work with other donors to encourage long-term and predictable aid which is: targeted to the poorest countries; harmonised around country-owned poverty reduction strategies; delivered in a way which imposes the minimum burden on developing country systems; and is untied. The UK has also set out a new approach to aid conditionality.[37] While it is important to ensure aid is used for its intended purpose and not lost to corruption, the Government aims to support poor countries in the policy choices that they make themselves.

[37] *Partnerships for Poverty Reduction: Rethinking Conditionality*, UK Policy Paper, March 2005.

Box 5.5: IFF and IFFIm

It is estimated that an additional $50 billion per year is needed ahead of 2015 if the MDGs are to be met. The International Finance Facility (IFF) would frontload donors' existing long-term aid commitments through bond issuances on the international markets to deliver immediately the additional, predictable funding needed to achieve the MDGs. With the IFF, the UK could reach the equivalent of 0.7 per cent as early as 2008-09.

The IMF and World Bank have confirmed that the IFF is the most advanced proposal for raising additional development finance and that it is technically feasible. The IFF now has the support of almost fifty countries.

As the first step, the UK, together with France and Sweden, is finalising a $4 billion IFF for immunisation (IFFIm), which could save the lives of 5 million children ahead of 2015 and a further 5 million lives after 2015. This would make a substantial contribution to the MDGs and demonstrate the significant benefits of frontloading resources. The UK has proposed to provide one-third of the resources required, and it is expected that the IFFIm will be launched in the first half of 2005.

International taxation proposals are complementary to both the IFF and the IFFIm, and the UK is considering these proposals in further detail and will be working with others to take forward technical discussions.

Tsunami

5.130 The UK responded to the devastating impact of the tsunami in the Indian Ocean with £75 million towards the emergency humanitarian relief effort. The G7, chaired by the UK, agreed in February to defer debt payments during 2005 for tsunami affected countries which request it. Indonesia and Sri Lanka requested such a moratorium, which was agreed by the Paris Club group of creditor countries on 10 March 2005. The Government recognises the need for coordinated long-term reconstruction and will consider additional contributions to the international reconstruction effort once the IMF/World Bank needs assessments have been finalised with affected countries.

Debt relief

5.131 The experience of the last five years of the Heavily Indebted Poor Countries (HIPC) Initiative has shown that debt relief can be an extremely effective tool in support of poverty reduction. The debt burden of the world's poorest countries is being reduced by some US$70 billion dollars over time, allowing the savings from debt relief to fund country-owned strategies aimed at reducing poverty. Poverty reducing expenditures in HIPCs have on average increased from 6.4 percent of GDP in 1999 to 7.9 percent of GDP in 2003, a level about three times that spent on debt service.[38] For example, debt relief has helped Tanzania increase the number of children in primary schools by over 50 per cent and build 1,000 new schools.

[38] *Heavily Indebted Poor Countries (HIPC) Initiative: Status of Implementation*, IMF and World Bank, August 2004.

5.132 However, the achievements of the HIPC Initiative must be set against the greater challenges that remain. The UK announced in September 2004 that it will pay its share of the debt service from eligible countries to the World Bank and African Development Bank's concessional financing arms on behalf of eligible countries until 2015. The Secretary of State for International Development has now signed and funded debt relief agreements with 14 countries. The UK has started paying service relief on its share (10 per cent) of World Bank and African Development Bank debt for the eligible countries. This will free up $49 million of additional resources for poverty reducing expenditure such as on health and education, in 2005. Canada has joined this initiative, which if fully financed will provide up to $20 billion of additional financing over the next ten years. The UK is urging G7 and other partners to provide additional resources to finance World Bank and African Development Bank debt relief. The Government continues to call for a revaluation or off-market sale of further IMF gold to fund the IMF's share of further multilateral debt relief.

Trade

5.133 International trade is key to economic growth and poverty reduction. However, in addition to market access for developing countries, more needs to be done to help poor countries build up the capacity to trade. It is also important that developing countries have the policy space to carefully design and sequence trade policy reform to fit in with their broader objectives on development and poverty reduction and are not forced to liberalise through external pressure. The UK believes that the current round of trade negotiations, the Doha Development Agenda, must deliver substantial benefits for poor countries. Agreement must be reached to phase out agricultural protectionism in developed countries, including Europe's Common Agricultural Policy, and improve preference schemes including through reforming rules of origin so that poor countries can maximise their opportunities for improved access to developed market countries, not just in theory but in reality. At the same time, it is important to ensure that product standards, tariff peaks and tariff escalation do not act as barriers to developing country exports.

5.134 The role of aid will be key in helping developing countries realise the benefits of trade. They often lack the basic building blocks to enable growth, trade and private investment such as a healthy and well-skilled population, electricity, transport and communications, as well as the institutions that are needed to manage trade and economic growth. The Commission for Africa has recommended that increasing economic growth in Africa requires scaling up investment in infrastructure, support for local enterprise, and a stronger role for the business community. The UK believes that developed countries must stand ready, through increased aid, to help countries put in place these building blocks for growth, as well as assist with the costs associated with the transition to more open markets. This will be a key priority for additional aid targeted for agreement in 2005.

Health

5.135 The health MDGs on infant mortality, maternal mortality, HIV and AIDS and Malaria are unlikely to be met, especially in many Sub-Saharan African countries. Good health is vital to achieving other MDGs, for example on primary education and to enable a robust economy that is capable of sustaining growth. Underlying this is the need to support the development of health systems that are responsive to the needs of poor people, particularly women and young people, as well as tackling diseases that have a disproportionate impact on poor people. This requires allocations to health systems from within national budgets, supplemented by predictable donor flows.

5.136 Malaria kills one million people a year and AIDS kills three million a year, with significant impacts on the economy and service delivery in developing countries. The UK believes a three-step approach is needed to develop vaccines for malaria and HIV. First, research needs to be coordinated better. Second, publicly funded research needs to increase. This will be an early priority for spending through the IFF as an example of an area where the returns to investment are potentially very high. Third, the UK is already working with international partners to enter into contracts to buy a fixed quantity of vaccines at an agreed price. Such advance purchase agreements, which are only binding if the vaccines are successfully developed, will encourage pharmaceutical companies to invest in research with confidence that there will be a market for their products and can ensure that the vaccines will be affordable.

Peacekeeping

5.137 The Government will continue to support African-led peacekeeping operations, especially efforts to end the current conflict in Darfur, where the UK has provided more than £14 million to the African Union force. Since September 2003, the Government has committed £62.5 million in humanitarian assistance in response to the crisis in Darfur. Outside Darfur, the UK is supporting humanitarian efforts across Sudan, as well as building up a development programme, in conjunction with other donors. Current plans focus on delivery of basic services at the local level, rule of law and access to justice, and reform of the security sector. The Government is leading a group to ensure Sudan's debt is lifted, once progress has been made to end the conflict in Darfur.

Support for reconstruction of Iraq

5.138 The UK continues to work alongside its international partners to support the reconstruction of Iraq. In this context, the UK supported the agreement in September 2004 of a $436 million IMF Emergency Post-Conflict Assistance programme for Iraq. The UK's objective of a fair and sustainable solution to Iraq's external debt problems was achieved in November 2004, when the Paris Club of creditor countries agreed to forgive 80 per cent of Iraq's external debts. The debt reduction will be implemented in stages linked to progress in delivering the economic reforms Iraq agrees with the IMF. The UK's share of this debt relief, once fully implemented, will amount to approximately £960 million. The UK is working to strengthen the capacity of Iraqi government institutions, including fiscal and economic policy-making capacity within the Ministry of Finance.