

In an increasingly integrated and competitive global economy, raising UK productivity is critical to delivering continued economic growth and sustained increases in standards of living. Raising productivity requires the openness and flexibility to seize new opportunities in the global economy, while making the essential long-term investments needed to support business growth – including in vital infrastructure and skills. In the last decade, significant progress has been made to strengthen UK productivity growth, through investment in infrastructure, a more highly skilled workforce, and increasing the attractiveness and openness of the UK as a place to invest. This 2006 Pre-Budget Report sets out how the Government is building on this success to lay the foundations for sustained long-term productivity growth, through further measures to increase flexibility and openness, reduce regulatory burdens on business, alongside increased long-term investment:

- **investing in a new ambition for world-class skills**, increasing adult skills across all levels and strengthening employer voice in their provision – by taking forward the recommendations of the Leitch Review;
- **investing in the growth of the UK’s science and innovation system** – through a single health research fund of at least £1 billion, taking forward the recommendations of the Cooksey Review, and ensuring a more balanced, coherent and flexible regime for intellectual property, as set out in the Gowers Review;
- **enabling greater flexibility in the land use planning system** to ensure it contributes to economic growth while delivering its wider sustainable development goals – by taking forward the Barker Review;
- **investing in transport infrastructure** to maximise the return on investment in transport – by taking forward the recommendations of the Eddington Transport Study;
- **investing in the growth of sustainable housing supply** – including further acceleration of the release of surplus public sector land and greater ambitions for assisted home ownership through shared equity schemes; and
- **increasing business flexibility by reducing unnecessary burdens on business** – by creating certainty for business, by implementing the recommendations of the Varney Review of HMRC Links with Large Business, and driving forward implementation of the Hampton Review’s risk-based approach to regulation, and the Davidson Review’s recommendations to reduce any gold plating of EU legislation.

Globalisation and productivity

3.1 In an increasingly integrated global economy, raising UK productivity is critical to delivering continued economic growth and sustained increases in standards of living. The UK’s success will depend on building a flexible, open economy with a highly skilled workforce and well developed infrastructure, able to take advantage of accelerating changes in technology, production and trading patterns. In the last decade, significant progress has been made to strengthen UK productivity growth, through investment in infrastructure, a more highly skilled workforce supporting an increasingly knowledge-based economy, and increasing the attractiveness of the UK as a place to invest. This 2006 Pre-Budget Report sets out how the Government is building on this success to lay the foundations for sustained long-term productivity growth, through increased flexibility and openness and increased investment in infrastructure. This strategy is guided by the analysis the Government has set out in *Long-term opportunities and challenges for the UK: analysis for the 2007 Comprehensive Spending Review*, published on 27 November this year.

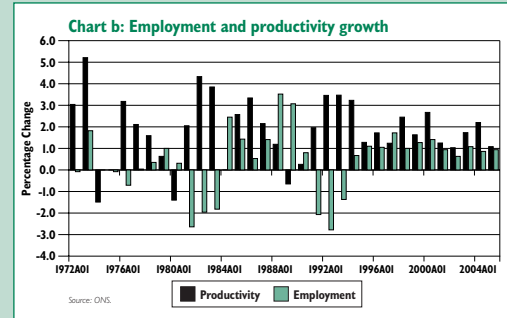
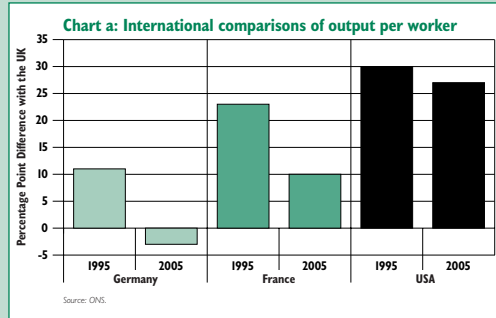
The five driver framework 3.2 The Government's approach to improving the UK's long-term productivity performance has two broad strands: maintaining macroeconomic stability to enable firms and individuals to plan for the future, and implementing microeconomic reforms to remove the barriers which prevent markets from functioning efficiently. This Pre-Budget Report sets out the Government's next stage of reforms to raise productivity growth, through the five key drivers of productivity:

- improving competition, to enable the adoption of innovative business practices and increased business efficiency;
- promoting enterprise, to support entrepreneurship and the strengthening of the UK's enterprise culture;
- supporting science and innovation, to ensure that the UK capitalises on the creation of new knowledge and its translation into new goods and services;
- raising skills levels, to support the development of a more flexible, responsive and productive workforce; and
- encouraging investment, to enhance the stock of physical capital and ensure its efficient utilisation.

UK productivity performance 3.3 Productivity and employment growth are key determinants of higher standards of living and enhanced quality of life. As discussed in *Productivity in the UK 6: Progress and new evidence*, published alongside Budget 2006, historically, UK productivity has lagged behind that of other major industrialised countries. However, the recent data shows that the UK is making significant progress towards closing the productivity gap with its main competitors. The UK has significantly improved its position since 1995 on both key measures of productivity – output per worker and output per hour. On an output per worker basis, the UK closed the gap with Germany, halved the gap with France, and is the only G7 country to have kept pace with impressive US performance. On an output per hour basis, since 1995, the UK has narrowed the gap with France by 10 percentage points, narrowed the gap with Germany by 13 percentage points and kept pace with US performance. Further detail is set out in Box 3.1.

Box 3.1: UK productivity performance

Chart (a) shows the reduction in the UK's output per worker gap with France, Germany and the US. The UK is now experiencing its longest period of combined productivity and employment growth since the 1950s. This achievement is significant, as strong employment growth is usually associated with lower productivity growth, since new workers are initially less productive while they learn job specific skills. Chart (b) shows the UK's enhancement of both its productivity and employment performance.



There are encouraging signs that the UK is on course to raise productivity performance over the current economic cycle, compared with previous cycles. Trend productivity growth over the first half of the economic cycle (1997H1 – 2001Q3) was 2.6 per cent per year compared with 1.9 per cent in the previous economic cycle. Moreover, recent upward revisions to output growth, coupled with robust growth in 2006, show that actual productivity growth has so far averaged 2.4 per cent between 2001Q3 and 2006Q3, clearly above HM Treasury's forecast of 2.15 per cent. Recent outturns significantly increase confidence in the post-2001 productivity projection.^a However, as discussed in *Productivity in the UK 6: progress and new evidence*, actual productivity growth is influenced by cyclical factors. Therefore HM Treasury's approach is to assess the UK's trend productivity performance once the cycle has come to an end or between two on-trend points.

^a For further details, refer to: *Trend Growth: new evidence and prospects* – published alongside this Pre-Budget Report.

Product and capital market flexibility

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

European economic reform

3.5 Strengthening economic reform in Europe remains a key priority for the UK. Following the progress made during the UK Presidency of the European Union (EU) in 2005, the Government has continued to press the case for improvements in the European regulatory environment, as well as for open markets and more pro-active use of competition policy. Box 3.3 sets out the principles that should guide Single Market policy, reflecting the new challenges presented by globalisation. The UK has also outlined how governments can help individuals meet these challenges by providing 'social bridges' to future jobs,¹ enabling individuals to increase their employability and take advantage of changes in the labour market. Further structural reform in the EU is still needed to create more competitive, open

¹ For a discussion of this approach, see: *Social Bridges – meeting the challenges of globalisation*, HM Treasury and the Swedish Ministry of Finance, April 2006. Available at www.hm-treasury.gov.uk

and flexible economies necessary for Europe to compete in the global market. In this context, the UK welcomes the recent updates by Member States reporting on their progress in implementing their 2005 National Reform Programmes to promote growth, employment creation and productivity.

Productivity in the regions

3.6 The Government's goal is to make sustainable improvements in the economic performance of all English regions by 2008, and over the long-term reduce the persistent gap in growth rates between the regions.² The progress made by the Government in meeting this target is set out in Box 3.2. The Regional Development Agencies (RDAs) were established by the Government with a statutory remit to lead the strategic economic development of their regions. As set out most recently in the Devolving Decision Making Review, economic performance can best be improved, and regional disparities overcome, by investing in the drivers of productivity and encouraging greater regional and local flexibility.³

Box 3.2: Regional economic performance

HM Treasury, the Department of Trade and Industry (DTI) and the Department for Communities and Local Government (DCLG) have joint responsibility for delivering the Government's Public Service Agreement (PSA) target to:

'make sustainable improvements in the economic performance of all English regions by 2008 and over the long term reduce the persistent gap in growth rates between the regions, demonstrating progress by 2006.'

The primary indicator used is a measure of nominal Gross Value Added per head, for which only 2003-04 data has been collected. However, measurement of this PSA target is only meaningful when taken over a complete economic cycle. While this data suggests some evidence of positive progress in narrowing the gap in growth rates between regions, it would be premature to reach conclusions about the effectiveness of long-term interventions. More detailed evidence of progress is available in a technical note accompanying this Pre-Budget Report.^a

^a *Regional Economic Performance: Progress to date*, HM Treasury, DTI, DCLG, December 2006

Sub-national economic development and regeneration

3.7 The Government recognises that more needs to be done to release the economic potential of England's regions, cities and localities, and to respond more effectively to the ongoing challenge of tackling pockets of deprivation, in order to maximise the productivity growth of the country as a whole. To address this, in Budget 2006 the Government announced a Review of Sub-National Economic Development and Regeneration to consider the efficiency and effectiveness of regional and local interventions. It is based on an analysis of the drivers of growth at the sub-national levels, and the potential impacts of globalisation and technological change.

Regional Development Agencies

3.8 As part of the Sub-National Review, the Government is undertaking an assessment of the impact, efficiency and accountability of sub-national delivery agencies, including RDAs. This work will assess the outcomes of RDA spending and will consider the long-term delivery challenges facing the network. It will help RDAs identify further opportunities for efficiency savings and ensure a robust prioritisation of their activities in a way that will promote regional competitiveness in a national context and a global marketplace.

² The Devolved Administrations in Scotland, Wales and Northern Ireland work in partnership with the UK Government to promote economic development in their territories.

³ See for example *Devolving Decision Making: 3 – Meeting the regional economic challenge: The importance of cities to regional growth*, HM Treasury, ODPM, and DTI, March 2006

3.9 Building on their role as strategic leaders of economic growth in each region, the RDAs will contribute to the development of regional policy in Budget 2007 in three key areas: the role of the private sector in regional economic development; regional economic strategies and their impact on competitiveness in a global context; and improving RDA evaluation. In addition, to help develop the regional evidence base on the sub-national drivers of economic growth, the Government is supporting a new centre for spatial economics research, which will be established in 2007.

3.10 In line with HM Treasury's series of Devolved Decision Making Reports and the Local Government White Paper, the Sub-National Review is considering how to deliver further devolution to regions and localities and to achieve greater cooperation between regions, sub-regions (including city regions) and local authorities.⁴ The Review is also considering how to improve the accountability, governance and funding arrangements that underpin sub-national economic development. This includes ensuring the effectiveness of regional and local business support interventions, as described in more detail later in this chapter. The Sub-National Review's conclusion will feed into the 2007 Comprehensive Spending Review (CSR), taking account of the Leitch Review of Skills, the Eddington Transport Study, the Barker Review of Land Use Planning, (all discussed later in this chapter), and the Lyons Inquiry into Local Government (discussed in Chapter 6).

COMPETITION

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

Promoting competition

Creating the framework

3.12 The Government has instituted a number of reforms aimed at developing a UK competition regime rated as among the world's best. The Enterprise Act 2002, which developed from the Government's 2001 White Paper: *A World Class Competition Regime*,⁵ aimed at establishing:

- strong, proactive, and independent competition authorities;
- a modernised merger regime;
- stronger market study and investigation powers;
- stronger deterrence of cartels; and
- a stronger mechanism for real redress for third parties.

3.13 Good progress has been made in achieving these aims, with the UK competition regime maintaining its position among the top three globally while improving its overall rating and expanding its lead over the EU and other competition regimes.⁶

⁴ *Strong and Prosperous Communities*, DCLG, October 2006. Available at www.communities.gov.uk

⁵ *A World Class Competition Regime*, DTI White paper, 2001. Available at www.dti.gov.uk

⁶ *Peer Review of Competition Policy*, KPMG and DTI, May 2004. Available at www.dti.gov.uk

Competition authorities 3.14 The Enterprise Act provided the two UK competition authorities – the Office of Fair Trading (OFT) and the Competition Commission (CC) – with:

- independence, by removing ministerial involvement from almost all cases;
- stronger powers to punish anti-competitive behaviour and identify, investigate and remedy markets; and
- a more proactive approach, establishing an OFT Board able to determine its strategic direction and priorities for public enforcement.

3.15 As a result of the Enterprise Act and other reforms, both the UK competition authorities are now independently rated among the top five globally.⁷ Between 2000 and 2005, they launched investigations into 800 mergers (remedying 24 considered anti-competitive) and 150 potential abuses of dominance or cartel cases (making formal decisions on 39 of these), generating consumer savings of at least £750 million.

A modernised merger regime 3.16 The Enterprise Act gave the OFT the power to investigate mergers and a duty to refer those anticipated to result in a ‘substantial lessening of competition’ to the CC for in-depth investigation and possible remedial action. A 2004 survey of experts rated the UK merger regime as 6.4 out of 7, well above the rating before the Enterprise Act.⁸ Since the Act came into effect in 2003, over 550 mergers have been investigated by the OFT (compared with under 400 investigations in the previous three years) with almost 40 referred to the CC. Conservative estimates by the OFT suggest that between 2000 and 2005, the competition authorities’ merger work led to £640 million in consumer savings.

Investigating markets 3.17 The Enterprise Act strengthened the OFT’s powers to study markets not working and to refer those with features that may adversely affect competition to the CC for further investigation and possible remedy. Market inquiries have proved to be an important tool in securing consumer welfare. Recent examples include:

- an OFT study into car warranties, leading to between £60 million and £85 million in annual savings to car owners and fleet operators; and
- CC remedies following a market investigation into store cards earlier this year, resulting in consumer savings of at least £55 million a year.

3.18 This year, the OFT has launched studies into the online shopping market and UK airports, used last year by an estimated 40 percent of consumers and over 200 million passengers respectively.⁹ The OFT has also announced its intention to refer a third market, the payment protection insurance market, to the CC for further investigation, which could lead to consumer savings of around £1 billion.¹⁰

Deterring cartels 3.19 The Enterprise Act gave the OFT new surveillance and information gathering powers for identifying groups of producers fixing prices or limiting supply through cartel activity and introduced criminal penalties, including up to five years imprisonment, for individuals involved in such activities. Since 2003, the OFT has identified numerous cartels and has imposed over £25.5 million in fines. In the past year alone, the OFT has begun informal inquiries into 20 potential cartel cases and launched formal investigations into four.

⁷ With the OFT and the CC ranked 5th and joint 1st (with the EU and the two US competition authorities) respectively. *Competition Authorities Annual Ranking*, Global Competition Review, 2006. Available at: www.globalcompetitionreview.com

⁸ In 2001 the UK merger regime received a rating of 6.0. *Peer Review of Competition Policy*, Ibid.

⁹ *Internet Shopping – Some Key Data*, OFT, 2006. Available at: www.of.gov.uk; Summary of activity at UK airports, CCA, 2005. Available at www.caa.co.uk

¹⁰ *Payment protection insurance: Report on the market study and proposed decision to make a market reference*, OFT, 2005

Private enforcement 3.20 The Enterprise Act strengthened the legal framework for private redress cases, allowing a wider range of cases to be investigated, and providing those affected by anti-competitive activities with the possibility of obtaining direct compensation. Work continues to ensure the advantages of private enforcement are fully realised.

3.21 The Government recognises the need for continued monitoring and improvement of the competition framework, in line with the target of creating the world's best competition regime. Over the coming year, the Government intends to:

- work with the competition authorities and the European Commission to identify and eliminate any barriers to real redress for parties injured by anti-competitive behaviour; and
- support the European Commission in reforms aimed at achieving a proactive and independent EU competition regime, able to open the Single Market to further competition.

European competition policy

3.22 The Government strongly believes that Europe must continue to strengthen and deepen the Single Market. Amid growing protectionist sentiment in some Member States, the Government welcomes the Commission's decision to undertake a fundamental review of the Single Market, and believes it is a timely opportunity to look at how Europe should respond to the new challenges it faces. Consolidating the Single Market requires the ongoing promotion and maintenance of competitive markets to ensure that Europe's economy maintains the flexibility to develop in response to the changing global environment. Box 3.3 sets out the principles that the Government believes should guide Europe's approach to the Single Market.

Box 3.3: Review of the Single Market

The European Commission's Review of the Single Market, which will report next year, provides an opportunity to look again at the core principles that guide policy on the Single Market. The Government believes that a new approach is necessary to equip Europe to compete in the 21st century global economy. It is advocating a more outward-looking, reforming and pro-competition approach. The UK Government's report, to be published early next year to feed into the Commission's Review, will set out the following principles, which it believes should guide Single Market policy:

- be clear about the purpose – recognising the Single Market as a means of achieving prosperity for Europe's citizens, policies should focus on outcomes, enhancing competition and promoting enterprise and innovation, to deliver jobs and growth;
- be focussed on priorities – a more systematic approach, with policy priorities based on sound analysis of where benefits are greatest, using robust impact assessments and greater use of market investigations and targeted enforcement of EU law. Action should focus on key markets such as energy and financial services, which impact on the wider European economy;
- take action at the right level – there must be greater clarity of the respective roles of Member States and the Commission, including identifying appropriate areas for Commission action, and emphasising where cooperation, coordination and mutual recognition between Member States should be improved; and
- deliver a modern and flexible framework – Single Market objectives should be achieved using all the available policy tools, including pro-active competition policy, better regulation principles, and proportionate, more flexible legislation, to enable Europe to adapt to the pace of global change. For example, consideration should be given of extension of the Lamfalussy process^a in Financial Services to other sectors.

^a As set out in the *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets*, 2001. Available at: www.europa.eu

ENTERPRISE

3.23 Enterprise is a key driver of a modern, dynamic economy. A healthy business sector creates wealth and employment, generates competitive pressure that drives innovative activity, and improves the range, quality and prices of goods and services for consumers. The Government is committed to ensuring a flexible, open economy that can allow business to respond to the pressures of globalisation, while prioritising the necessary investment that firms need to be successful. The Government will continue to drive forward regulatory reform to free up businesses' productive time, modernise and simplify tax administration, and lay the foundations for a vibrant entrepreneurial culture in the UK.

Delivering better regulation

3.24 Globalisation increases competition and places a premium on a strong and flexible business environment. As markets become more competitive, it is important to do more to ensure the right conditions are in place so that businesses and individuals can respond to new opportunities and incentives. Key to achieving this is the removal of the burden of unnecessary regulation and traditional routine inspection and enforcement. Regulations need to be fit for purpose and their enforcement risk-based, with resources focused on areas where the risks to society are greatest, so that businesses are enabled to compete effectively in the global economy.

3.25 It is no longer the case that most businesses, if unregulated, will act irresponsibly. Well-informed consumers, responsible companies, organised labour, pressure and interest groups have all encouraged businesses to take measures to reduce risk to society. In this context, it is clear that regulatory regimes need to adapt to the changing world of the 21st century. To this end, Philip Hampton reported, in March 2005,¹¹ on the scope for promoting more efficient approaches to regulatory inspection and enforcement while continuing to deliver excellent regulatory outcomes. The Hampton Review argues for the creation of a regulatory system, at national and local level, in which risk assessment is the basis for all regulators' enforcement programmes. The Hampton principles outline a risk-based approach to regulation, appropriate for a world of increasing competition.

3.26 The UK Government has taken several important steps to ensure that the domestic regulatory framework adjusts to this new environment, and details are provided in this chapter on:

- the legislative framework;
- progress on implementing the Hampton Review recommendations;
- better regulation at local authority level;
- a proportionate and fair penalty regime; and
- targets for reducing administrative burdens.

Legislative and Regulatory Reform Act

3.27 The Legislative and Regulatory Reform Act received Royal Assent on 8 November 2006. The Act provides for a statutory Code of Practice, which will oblige all listed regulators to have regard to the Hampton principles. A new draft of this Hampton Code will be consulted on and the Government intends that it should be enacted by autumn 2007, before coming into force on 1 April 2008. This will legally oblige listed regulators to have regard to the Hampton principles when forming policy, rules, codes and guidance. Any business that believes a regulator is failing to have regard to the Code in relation to these functions will be able to seek redress through the relevant regulator or the Parliamentary Ombudsman. It may also be possible to apply for judicial review of the regulator's actions.

3.28 The Act replaces the Regulatory Reform Act 2001, and will:

- provide ministers with order-making powers that, subject to stringent substantive and procedural safeguards, will allow government departments to deliver their ambitious plans for removing unnecessary burdens on the public, private and voluntary sectors;
- encourage regulators to be more transparent, accountable, proportionate, consistent and targeted in their approach to regulation, by putting these five principles of good regulation, developed by the Better Regulation Commission, on a statutory footing; and
- make the transposition of European Community obligations into domestic law more straightforward, while also making it easier for individuals and organisations to understand and work with this legislation.

Implementing Hampton

3.29 To outline early progress in delivering the recommendations of the Hampton Review, the Government published *Implementing Hampton: from enforcement to compliance*, in November this year. A summary is set out in Box 3.4 below.

¹¹ *Reducing Administrative Burdens*, Philip Hampton, March 2005

Box 3.4: Implementing Hampton: from enforcement to compliance

The Government has undertaken a review of the progress made in implementing the Hampton Review. The key finding was that, while regulators have begun to make progress, more work will be needed to ensure that they are compliant with the Hampton principles. The report shows that:

- regulators are beginning to make progress in cutting forms. Six regulators have either carried out, or are in the process of carrying out, full reviews of all their existing forms.^a Technological developments, including online forms and e-returns, have also decreased the time spent form filling. For example, the Health and Safety Executive is cutting 54 per cent of forms and Companies House online returns save business £11.5 million annually;
- all regulators with inspection functions are applying a risk-based approach to some areas of enforcement, while progress is being made towards full implementation of the risk-based approach;
- regulators are increasingly providing more easily accessible and better-targeted advice through websites with personalised information, e-newsletters, sector specific publications, seminars and workshops. However, regulators need to start monitoring the effectiveness of their advice more regularly and consider consolidating advice; and
- good progress is being made on the Hampton recommendation to merge 31 bodies into seven by 2009. Twelve have already been merged, agreement has been reached to merge a further twelve, and departments are deliberating on another twelve (potentially more mergers in total than originally envisaged). This will reduce the number of interfaces with which businesses have to deal.

The Government has set in place further measures, outlined in this chapter, to ensure compliance by regulators, at both local and national level, with the Hampton principles.

^a The Health and Safety Executive, the Environment Agency, the Civil Aviation Authority, the Human Fertilisation and Embryology Authority, the Patent Office, and the Food Standards Agency.

Local Better Regulation Office 3.30 Eighty per cent of inspections are carried out by local authorities and, while initiatives like the Retail Enforcement Pilot demonstrate good practice, there is little evidence of the risk-based approach being applied consistently. To encourage the implementation of the Hampton principles at a local level, the Government:

- has brought forward the timetable for establishing the Local Better Regulation Office (LBRO) from 2009 to 2007;
- will detail local authority regulatory services, including trading standards, environmental health, and licensing, in the scope of the Hampton Code of Practice;
- will give the LBRO powers to issue statutory guidance to which local authorities must have regard, for example to ensure that a vigorous adoption of the risk-based approach reduces inspections and information requirements. In the meantime, the LBRO will spread good practice on risk-based enforcement at the local level;
- will give the LBRO powers to tackle inconsistencies in enforcement between local authorities; and

- will legislate to place the principle of home and lead authority on a statutory footing so that firms operating in more than one local authority will face a consistent and risk-based approach across their business.

3.31 To drive up performance at the local level, the Government will consider how best to measure progress in implementing the Hampton Review's recommendations, including developing, with business, performance indicators to ensure compliance with the Hampton principles. In the context of the 2007 CSR work on the performance framework, and in keeping with the Government's commitments in the recent Local Government White Paper, the Better Regulation Executive (BRE) and the LBRO will work with business over coming months to consider suitable measures.

3.32 In order to ensure that local authorities and businesses focus their attention on high-risk areas of enforcement, **Peter Rogers, Chief Executive of Westminster City Council, has agreed to examine approximately 60 areas of legislation that local authorities enforce, and recommend, by Budget 2007, around five specific high-risk national priorities.** Local authorities would then be free to add local priorities to the areas of national concern identified. Together with a LBRO that will work with the local services inspection gatekeeping proposals, as set out in the recent Local Government White Paper, these proposals should result in a substantially rationalised burden around regulatory services for local authorities.

Retail Enforcement Pilot **3.33** As noted earlier in this chapter, early delivery of the Hampton principles is being achieved through the Retail Enforcement Pilot. The pilot has developed a new, co-ordinated and risk-based planning system to reduce the burden of unnecessary inspections by up to 33 percent for compliant retail businesses. The pilot has covered trading standards, environmental health, food safety, health and safety, fire, and licensing inspections.

3.34 After successful testing in Warwickshire and the London borough of Bexley, the Cabinet Office will now extend the Retail Enforcement Pilot to 70 local authorities to establish the viability and net benefits of a possible national roll-out. The Government is also looking at extending the pilot to cover animal health and welfare, fruit and vegetables, veterinary medicines, and rural payments inspections. If rolled out nationally, it is estimated that, for Trading Standards alone, the initiative could save business an estimated £10 million a year from reduced inspections and £7 million from reduced form filling.¹²

Implementing Hampton nationally **3.35** At the national level, the Government is now speeding up implementation of the Hampton recommendations and ensuring that good practice is shared. To achieve this, the National Audit Office (NAO) will work with the BRE, regulators and business to develop a process of external review of regulatory performance. The assessment process will focus on a regulator's adherence to the Hampton principles and encourage continuous improvement. All major regulators will be assessed by the end of 2007 (including the Health and Safety Executive, the Food Standards Agency, the Financial Services Authority, the Environment Agency and the Office of Fair Trading). Publication of the assessment reports will increase accountability and transparency.

3.36 At Budget 2007, the BRE will also publish guidance on how regulators will pass the external review of regulatory performance. This will clearly set out the best practice on complying with the Hampton principles.

Data-sharing **3.37** The Hampton Review outlined the importance of data-sharing in order to reduce burdens on business. The BRE is leading work to outline the costs and benefits of different approaches to data sharing and to overcome the legal and technological barriers. This work complements Sir David Varney's review of service transformation discussed in Chapter 6.

¹² These costs have been calculated using the Standard Cost Method (SCM), which the Government has introduced as a way of breaking down individual regulations into a range of manageable components and activities that can be consistently measured internationally. For more details, see www.cabinetoffice.gov.uk

Macrory Review of Penalties 3.38 Fundamental to a risk-based approach is the certainty that the majority of businesses, which are compliant, will receive a lighter touch with fewer inspections and forms. Meanwhile, rogue businesses, which repeatedly flout the law, will face quick, meaningful and proportionate penalties. Following the Hampton Review's recommendation that a comprehensive review of regulators' penalty regimes be undertaken, Professor Richard Macrory began his work in September 2005. The Review,¹³ published in November, sets out a vision for a fit-for-purpose penalty regime, with a renewed focus on advice and education. The recommendations have been accepted in full by the Government and will create a level playing field for all businesses and ensure that there is no financial incentive for non-compliance. Regulators will only have access to the new toolkit of penalties when they have demonstrated to the satisfaction of the Prime Minister's Panel for Regulatory Accountability that they are compliant with the Hampton and Macrory principles.

3.39 The NAO and BRE external review of regulatory performance (outlined earlier in this chapter) will also assess regulators against the Macrory principles.

Measuring and reducing administrative burdens 3.40 The Government has been carrying out work to measure the total administrative burden on business in complying with government regulations, as a basis on which to set targets to reduce this burden. Eighteen government departments and regulators will publish their first simplification plans in December this year, in which they will outline simplification measures to reform and remove existing legislation, and will commit to reducing by 25 per cent the administrative burden from their regulations.

3.41 In early 2006, the Government established an online Better Regulation Portal. This provides business and others with an easy way to communicate their ideas on the reduction of red tape, with the assurance that they will receive a considered response within 90 working days. Over 300 suggestions have been received. To strengthen the transparency of the Portal, in early 2007 the Government will start making public all the ideas it receives and the government responses, unless the sender has made a request to the contrary.

Regulation of financial services 3.42 At the 2005 Pre-Budget Report, the Government announced a ten-point action plan for reforming wholesale and retail financial markets, which reflected the greatest concerns of businesses in relation to the burden of financial services regulation. Substantial progress has been made in enhancing the Financial Services Authority's (FSA) risk-based approach to regulation, including:

- broadening exemptions for employees: a response to the consultation on facilitating financial promotions in the workplace will be published shortly;
- introducing a Regulatory Reform Order to amend sections of the Financial Services and Markets Act 2000 relating to the regulatory functions of the FSA by removing restrictions, requirements, inconsistencies and anomalies that relate to how the FSA operates and thereby reduce burdens on industry: the draft Order will be laid before Parliament by the end of the year; and
- conducting a value-for-money review into the FSA, to be undertaken by the NAO. HM Treasury plans to lay a report before Parliament in the first half of next year.

¹³ *Regulatory justice: sanctioning in a post-Hampton world*, Professor Richard Macrory, November 2006

European regulatory reform

3.43 The Government continues to address unnecessary regulation in Europe. The UK played a key role in the call by finance ministers in October 2006 for the European Commission decisively to reduce EU administrative burdens by immediately identifying specific pieces of legislation and taking prompt action to cut the burden they cause. The European Commission has now come forward with plans to measure and reduce administrative burdens in the EU and has proposed a Europe-wide reduction target of 25 per cent.

3.44 The UK will continue to work closely with the European Commission and the German Presidency to develop an action plan containing concrete proposals to tackle regulation in identified priority areas, and to ensure that the EU adopts an administrative burdens reduction target to match the UK's own ambition in this area. Additionally, the UK will make the case for regulations to be made and enforced with regard to risk, in line with the Hampton principles.

Davidson Review 3.45 The Government also needs to ensure that regulations stemming from Europe are implemented proportionately. In the 2005 Pre-Budget Report, the Chancellor asked Lord Neil Davidson QC to review the stock of EU-sourced legislation in the UK and identify measures where unnecessary regulatory burdens could be reduced or the system simplified. The Davidson Review found that unnecessary over-implementation was not extensive, but made some specific recommendations in its final report in November this year, as outlined in Box 3.5.

Box 3.5: The Davidson Review on implementation of EU legislation

Lord Davidson QC's report found that, while unnecessary over-implementation of European legislation may not be widespread in the UK, there are some areas of legislation where burdens could be reduced or the system simplified. Following consultation with government departments, regulators and external stakeholders, the Review has made specific simplification proposals in a range of areas including consumer sales, financial services, food hygiene training, transport and waste legislation. The simplification recommendations will benefit public UK businesses and the wider public by up to £240 million and £430 million a year respectively.

The Review has also identified factors – at the EU level and in the UK – that can contribute to over-implementation of European legislation. Building on recent and ongoing government reforms, the report makes recommendations further to improve the implementation process in the future, by updating the Cabinet Office's Transposition Guide, conducting regular post-implementation reviews, and changing the culture of implementing EU legislation, for instance, by improving communication between negotiating and implementing teams and between the Government and stakeholders. These reforms will help to ensure that the UK economy remains one of the most competitive in the world while maintaining necessary regulatory protections.

3.46 The Government welcomes the final report of the Davidson Review and accepts its recommendations in full. Government departments and regulators will work with their external stakeholders to ensure successful delivery of the recommendations, and the BRE will monitor progress on a regular basis. Government departments will provide an update on the delivery of the Davidson Review's specific simplification proposals in their 2007 simplification plans. HM Treasury has already committed to a consultation on reducing the scope of activity caught by the Insurance Mediation Directive to exclude freight forwarders.

Simplifying tax administration

3.47 To deliver faster productivity growth, which supports higher living standards, the Government will continue to modernise the tax system (as set out in Chapter 5) and reduce administrative burdens. This requires a strong, constructive relationship with business, so that all businesses contribute fairly, through the tax system, towards public services.

Review of HMRC links with large business

3.48 HM Revenues and Customs (HMRC) will continue to respond to the evolving needs of the corporate sector and will implement in full the proposals of Sir David Varney's *2006 Review of Links with Large Business*, published in November 2006.¹⁴ The key proposals, outlined in Box 3.6, will deliver modern, responsive tax administration and an improved relationship between business and HMRC built on greater trust and transparency. Large business will benefit from a more cost-effective use of HMRC resources through the implementation of a risk-based audit approach, which is focussed on key risks to give business greater speed and certainty over the tax implications of commercial decisions.

Box 3.6: Review of HMRC Links with Large Business

The Review of HMRC Links with Large Business consulted extensively with business, representative and professional bodies. The outcomes that business and HMRC want to see are greater certainty, an efficient risk-based approach to dealing with tax matters, rapid resolution of issues, and clarity through effective consultation and dialogue. To deliver these outcomes, the review makes the following key recommendations:

- introducing an advance rulings process, by the 2007 Pre-Budget Report, giving UK and international business earlier certainty on the tax implications of significant investment and corporate reconstruction projects;
- extending the existing clearances process, so that, by Budget 2008, HMRC will provide business with its view of the tax consequences of significant commercial issues within 28 days;
- implementing a risk-based approach to enquiries, by the end of 2007, making HMRC more responsive, as resources will be focussed on resolving contentious issues more efficiently and quickly;
- a comprehensive approach, implemented by the end of 2007, to the settlement of transfer-pricing enquiries within 18 months; and
- with effect from Budget 2007, making HMRC accountable for taking the business perspective into consideration in everything it does from implementing policy decisions to designing systems and processes.

A Large Business Advisory Board, including senior business representatives, will be established to oversee delivery and HMRC will publish a detailed delivery plan by 31 March 2007.

Reducing administrative burdens

3.49 At Budget 2007, HMRC will report on progress towards meeting its stretching targets announced at Budget 2006 to: reduce the administrative burden on business in dealing with HMRC forms and returns by at least 10 per cent over five years; and reduce the administrative burden on compliant businesses in dealing with HMRC audits and inspections by 10 per cent over three years, and at least 15 per cent over five years.

¹⁴ 2006 *Review of Links with Large Business*, HM Revenue & Customs, November 2006

3.50 All businesses can benefit from simplified tax administration, but the gains to smaller businesses can be particularly significant because they can find the costs of compliance the most difficult to absorb. In November this year, HMRC published *Delivering a new relationship with business: HMRC's plans to deliver a better service for business by 2010-2011*. This demonstrates progress made since the creation of a single tax department in 2005; for instance, the short self assessment tax return for the smallest businesses has already reduced from 16 to 4 pages, the new form P46 (a form used when taking on a new employee who cannot produce their latest pay details) has been introduced as well as a new style self assessment statement. Box 3.7 provides an overview of the paper and HMRC's package of reforms designed to transform its relationship with business, and reduce further the administrative burden the tax system places on business.

Box 3.7: Simplifying tax administration for business

Delivering a new relationship with business: HMRC's plans to deliver a better service for business by 2010-2011 set out milestones for the introduction of new and improved services that will deliver the stretching targets, announced at Budget 2006, to reduce administrative burdens. Over the next four years, HMRC will:

- further reduce the burden of forms and returns: for instance, by introducing a redesigned VAT registration form from December 2006 to make registration easier and quicker for 225,000 businesses each year, and a new self assessment return in April 2008, halving the number of self-employment pages for 500,000 businesses;
- develop a single customer record, which will underpin single registration for all business taxes and enable the creation of a single business customer account, with consultation starting in 2007;
- link the enquiry window with the submission of the tax return, so that businesses can have their tax affairs settled sooner, with effect from 2008;
- provide a streamlined online environment for businesses to submit forms and returns and make payments, with delivery planned from 2008-09; and
- enhance services for agents and tax advisers, so that they can better support their clients and enable HMRC to target its activities more accurately on higher risk areas, with the first pilots starting in December 2006.

Supporting small businesses

3.51 Macroeconomic stability, fair and progressive tax administration and a risk-based regulatory framework are important preconditions for enterprise and job creation. These create the environment for new and growing businesses to raise their productivity and contribute to economic growth. However, small and medium-sized enterprises (SMEs) – particularly in disadvantaged areas – face disproportionate barriers in accessing finance and information. The Government is committed to addressing these market failures in the most effective and targeted way. The Government has already set out its reforms to finance support, introducing Enterprise Capital Funds (ECFs) and reforming the Small Firms Loan Guarantee. The policy priority now is to focus on delivery.

Enterprise Capital Funds 3.52 In order to support firms in accessing finance for growth, the Government has selected six ECFs since Budget 2006, with the second of these, the IQ Capital Fund, formally launched in November this year. This first round of ECFs will invest in: sustainable technology, life sciences, and high technology firms; firms at an early stage of development; and more generally in SMEs with high growth potential. **The Government has now invited**

bids for the selection of the second round of ECFs by 28 February 2007. The bidding process for this second round has been streamlined, making application to run the funds easier and cheaper for potential fund managers.

Small Firms Loan Guarantee scheme 3.53 The Small Firms Loan Guarantee scheme (SFLG) is an important means by which many small businesses access debt finance. Implementation of the Graham Review's recommendations has streamlined the operation of the SFLG, making it easier for lending institutions to use, and a more effective instrument.¹⁵ Participating lenders now take full responsibility for the administration of the guarantee, speeding processes and providing a better service to their customers. The revised scheme is better aligned with market practice, and more focused on innovative products and those businesses facing the greatest difficulties in raising debt finance.

Rationalising business support 3.54 The Government recognises that the plethora of business support schemes available at local, regional and national levels can be hard for firms to navigate. Budget 2006 announced plans to rationalise business support by reducing the existing 3,000 schemes to no more than 100 by 2010, and, in doing so, ensure that they are complementary with private provision and targeted effectively at market failures. A strategy for meeting this 2010 target is being developed in time to inform the 2007 CSR.

3.55 The Department of Trade and Industry reviewed its business support products, taking their portfolio down from around 200 to just 10 larger and higher-impact products in 2004. Further changes include:

- the Department for Education and Skills' has simplified access to many of its workforce products within Train to Gain and will bring in services such as Investors in People to create an employer-focussed and employer-driven skills system;
- the Leitch Review, published on 5 December (and discussed later in this chapter), recommends that employer coalitions and regional skills partnership are merged into a series of employer-led Employment and Skills Boards – giving employers a single contact point to scrutinise local services;
- partnerships will also act as the focal point for mainstreaming the current range of local initiatives to improve employment and skills outcomes for disadvantaged groups, such as the Ambition pilots and Fair Cities, as they come to an end – providing a single point of reference for employers.

3.56 Box 3.8 sets out the progress RDAs have made in simplifying, and increasing the impact of, regional business support.

¹⁵ *The Graham Review of the Small Firms Loan Guarantee*, HM Treasury, September 2004. Available at www.hm-treasury.gov.uk

Box 3.8: Regional development agencies and business support simplification

Responsibility for delivery of business support was devolved to the RDAs in March 2005, and regional government is responsible for around 40 per cent of business support schemes. RDA's commitment to delivering the 3,000 to 100 target in their regions is strong and they have already made significant progress in a number of areas. Specific achievements so far include:

- positioning of Business Link as the primary access channel for publicly funded business support – RDAs including East of England Development Agency, East Midlands Development Agency and One NorthEast are integrating existing access channels into the existing Business Link offer, and are taking the opportunity to streamline delivery arrangements;
- rationalising initiatives – Yorkshire Forward is reducing all current business support products into six programmes – Enterprise, Best Practice, Innovation, International Business, Skills and Access to Finance. A number of RDAs, including South East of England Development Agency and Advantage West Midlands, will consolidate a number of duplicative regional access to finance schemes into a single customer-facing offer;
- rationalising new firm schemes – London Development Agency's new pan-London start-up and micro programme, Business London, replaces a number of previous separate schemes and at least 13 access channels. The North West Development Agency is also developing a new, better coordinated, start-up offer; and
- building on the strength of the national brands such as the Manufacturing Advisory Service (MAS) programme – the South West RDA is proposing to merge sector specific business improvement initiatives with the MAS programme.

Local Authority Business Growth Incentive scheme

3.57 To create a direct financial incentive for local authorities to promote local business growth the Government introduced the Local Authority Business Growth Incentive (LABGI) scheme in April 2005. Local authorities receive a proportion of the increases in local business rate revenues to spend on their own priorities, in addition to the grant that they have already received in the local government finance settlement. In England, 278 local authorities received LABGI grants for 2005-06, totalling £127 million. Following its first year, the Government announced changes in September 2006 to simplify the scheme and increase the level of reward available to local authorities. With up to £1 billion to be spent over the three years to 2007-08, the Government anticipates that up to three times as much non-ring-fenced LABGI grant will be awarded to local authorities to spend on local priorities this year and next year. However, if business rate growth is significantly above or below forecast, the Government may have to scale LABGI payments up or down accordingly.

Enterprise in disadvantaged areas

3.58 Disadvantaged areas suffer from disproportionate barriers to business creation and growth. Markets in these communities tend to be smaller, more fragmented and less efficient, providing fewer opportunities for businesses to create wealth and employment. The Government is committed to tackling these market failures and creating a vibrant enterprise environment within disadvantaged areas.

Community Investment Tax Relief 3.59 In the *Social enterprise action plan*, the Government invited evidence from all interested parties on how the operation of the Community Investment Tax Relief and other incentives might be improved.¹⁶ Details of how to submit evidence can be found on the Small Business Service's website.¹⁷

Local Enterprise Growth Initiative 3.60 The Local Enterprise Growth Initiative (LEGI), announced at Budget 2005, provides flexible, devolved investment in some of the most deprived areas to support enterprise and productivity. The second round of LEGI was launched in March this year. Regional and central government have undertaken a rigorous process of scrutiny to determine the bids most capable of making a targeted, sustainable difference in their communities. **Ten bids from fourteen local authorities in England have today been awarded £157 million over three years, subject to confirmation in the 2007 CSR.** This will boost the economies of some of the most deprived areas in England, through locally targeted, private sector supported solutions.¹⁸ The Government will continue to work closely with local authorities with the highest levels of deprivation and lowest rates of enterprise formation to improve their capacity to bid in future LEGI rounds.

Creating an enterprise culture

Enterprise education 3.61 The continued growth and productivity of the UK economy will increasingly depend on the capacity of enterprising individuals and businesses to identify opportunities, develop innovative approaches to wealth creation and adapt to changing market circumstances. The Government is committed to building a stronger enterprise culture in the UK and is working to promote greater enterprise capability among young people in education. **To support meaningful business engagement with teaching and learning, the Government, in partnership with the British Chambers of Commerce, is creating 50 Young Chambers of commerce.** Young Chambers provide a framework that brings together local Chambers of Commerce, business, schools and pupils, to develop and take forward enterprise initiatives within individual schools. They will facilitate active business leadership and participation from local SMEs in enterprise education for pupils aged 14-19.

3.62 The 23 UK enterprise summer school pathfinders, announced in Budget 2006, have now been delivered by Young Enterprise. Their innovative approaches to extra-curricular learning have received good initial feedback from participants. Oxford University's evaluation of the scheme, to be published later this month, will examine the case for future investment.

Women and enterprise 3.63 US female entrepreneurial activity is two and half times higher than that of the UK, suggesting that there is significant untapped potential in the UK workforce. The Government recently appointed Glenda Stone, Chief Executive of Aurora, and Pam Alexander, Chief Executive of South East England Development Agency, as co-chairs of the Women's Enterprise Taskforce. The Taskforce will report in 2007 on the priorities for developing women's enterprise in the UK, including the evaluation of the regional Women's Enterprise Unit pilots.

¹⁶ *Social enterprise action plan: scaling new heights*, Cabinet Office, November 2006. Available at www.cabinetoffice.gov.uk

¹⁷ Available at www.sbs.gov.uk

¹⁸ The successful bids are: Blackpool; Doncaster, Liverpool and Sefton, North East Lincolnshire, Norwich, Leeds, Pennine Lancashire (Blackburn, Darwen, Pendle, Burnley, Hyndburn), Redcar and Cleveland, Sheffield, Wansbeck.

SCIENCE AND INNOVATION

3.64 In a competitive global economy, innovation and the successful exploitation of creative ideas is increasingly important to business success, productivity and long term economic growth. The Government has an important role to play enabling an innovation system to thrive, so that creative ideas can be carried through to new products and services. The Government has taken action to invest in the science base, strengthen links between business and the research base, incentivise research and development (R&D), and ensure an attractive regulatory and investment environment.

3.65 In July 2004, the Government set out its ambition to increase public and private investment in R&D, so that it reaches 2.5 per cent of Gross Domestic Product (GDP) by 2014. The *Science and Innovation Investment Framework 2004-2014* sets out the Government's framework for achieving this target, and its long-term vision for UK science and innovation policy.¹⁹ The second annual report, published in July 2006, showed that good progress has been made on key indicators for implementing the framework.²⁰ The Government is committed to ensuring the UK remains at the forefront of research globally and remains a location of choice for research-intensive firms. The Government therefore welcomes the Cooksey Review of Health Research and the Gowers Review of Intellectual Property (IP), detailed in this chapter, which identify areas where the UK can capitalise on its strengths, setting out a strategic vision for health research and an IP system fit for the 21st century.

Excellent Research

Cooksey Review of Health Research **3.66** At Budget 2006, the Government announced its intention to create a single fund of at least £1 billion and more effective structures to support world-class health research in the UK, aligning research priorities more closely with wider health objectives, building on scientific progress to date, and translating the results of research into economic and patient benefit. It appointed Sir David Cooksey to lead a review of health research.

3.67 The Cooksey Review, published today, recommends a more strategic approach to the planning, funding and delivery of health research. Amongst its recommendations, set out in Box 3.9, the Review proposes establishing an Office for Strategic Coordination of Health Research (OSCHR) to enhance the coordination of health research in the UK and ensure more coherent funding arrangements.

¹⁹ Available at www.hm-treasury.gov.uk

²⁰ Available at www.dti.gov.uk

Box 3.9: The Cooksey Review of Health Research

The Cooksey Review recommends that a new Office for Strategic Coordination of Health Research (OSCHR) be established to create a more strategic approach to health research. This will bring together the health research budgets of the Medical Research Council (MRC) and the Department of Health (DH), while retaining two separate organisations, in order to:

- set the Government's health research strategy, taking into account the advice, priorities and needs set out by the National Institute of Health Research (NIHR), the MRC and the National Health Service (NHS);
- set the budget required to deliver the health research strategy and the objectives for the DH and the MRC, including the distribution of the research budget between the NIHR and the MRC;
- monitor the delivery of the health research strategy against objectives, to report to ministers and Parliament on its progress, and to advise ministers on the effectiveness of maintaining two separate public bodies; and
- encourage a stronger partnership with the health industries and charities.

The Government is committed to making the UK the best place in the world to undertake health research and develop new drugs. The review makes recommendations to improve the economics of drug development in the UK by improving speed to market, while allowing more rapid assessment of a drug's safety and efficacy. The OSCHR will use its understanding of the UK's health priorities to improve market signalling to the pharmaceutical and biosciences sectors. It will brand research projects, which could be in the public, private or third sectors, that it believes could address an unmet health need in the UK as "UK Priority Health Research Projects". The Review recommends that the status of "UK Priority Health Research Project" also be included as a criterion in the decision regarding the process by which medicines should be assessed, by the National Institute for Health and Clinical Excellence (NICE) – and its equivalents in the Devolved Administrations. The Review also proposes that the Government, regulators and industry create a new partnership to pilot a new drug development "pathway" for the benefit of all stakeholders: industry, government, the wider economy and patients. This pathway should enable:

- more rapid discrimination between potential new therapies at earlier stages of drug development and earlier 'conditional licensing' of new drugs, enabling patients to access cost effective drugs faster;
- the earlier involvement of the NICE in the process of development to accelerate assessment of clinical trials and ensure their cost-effectiveness, creating more certainty for companies involved in drug development and improving speed to market;
- clearer processes for ensuring the NICE's initial assessments and recommendations for further research are followed-up more systematically; and
- the use of the NHS IT programme to ensure more rapid assessment of any emerging side-effects and efficacy over longer periods, resulting in improved safety for patients.

Government response to Cooksey **3.68** The Government welcomes the Cooksey Review and will take forward its recommendations. The Government has appointed Professor John Bell, as Acting Chair of the OSCHR, to set out the health research strategy for the UK and put forward a joint bid from the NIHR and the MRC to the 2007 CSR to meet the objectives of the strategy. In addition, the

Government will appoint an Independent Adviser in the New Year to implement the Cooksey Review's recommendations for reforming the drug development pathway to improve speed to market for new drugs and enable more rapid assessment of the efficacy and safety of new drugs, and develop a "UK Priority Health Research Project" brand.

Stem cells 3.69 The UK Stem Cell Initiative reported back to the Government, at the 2005 Pre-Budget Report, on a strategy for the next decade of stem cell research in the UK. The first recommendation was for the Government to establish a public-private partnership (PPP) using stem cells to enhance pre-commercial aspects of drug development. Following extensive consultation with the pharmaceutical industry and research community, a task force led by the Association of the British Pharmaceutical Industry has backed the recommendation to establish a PPP. **The Government will work in partnership with industry to establish a consortium, which will develop the use of stem cells in the production of safer medicines and begin work with a series of pilot projects in 2007.**

Research Assessment Exercise 3.70 Building a national innovation system depends on the maintenance of a strong public research base. The UK research base is already highly competitive by international standards. In order to maintain the UK's world-class universities the Government intends that resource allocation should continue to be strongly focused on excellence in research, including curiosity-driven, user-focused, and collaborative research. The Government is strongly committed to the dual support system for university research, which provides institutions with the freedom to set strategic priorities for research, undertake blue skies work, and respond quickly to emerging priorities.

3.71 In recognition of the burden imposed on universities by the Research Assessment Exercise (RAE) the Government has consulted on options for reform. In line with the presumption made in Budget 2006, the 2008 RAE will go ahead as planned. However, the consultation made clear that there is overwhelming appetite for reform thereafter.

3.72 This Pre-Budget Report sets out a new framework for research assessment and funding. Further details of the new system are published today.²¹ Responses to the consultation made clear that a single system should apply to all institutions and across all disciplines, but noted differences in the applicability of current metrics across disciplines. The Government agrees with this analysis and is developing an overarching framework within which the current applicability of metrics in different disciplines is accommodated:

- for science, engineering, technology (SET) and medicine a combination of research income, postgraduate research student data and a bibliometric indicator of quality will be used to assess research. The process will be overseen by seven advisory groups with representation from UK academics, research users and international advisors; and
- for all other disciplines, including mathematics and statistics, there will be a significantly reduced, light-touch peer review process informed by a range of discipline-specific indicators. This will be substantially less onerous for universities.

3.73 The outcomes from this process will be adjusted for research volume to produce a funding allocation. Data to support the new system will be collected for SET and medicine in the academic year 2009-10 with a gradually phased change to funding allocations between September 2010 and August 2014. For all other subjects, expert panels will be convened in 2013-14 to inform new funding allocations from September 2014.

²¹ The consultation document, a summary of consultation responses and further details on the new system are available from www.dfes.gov.uk

3.74 In order to optimise the economic impact of research, the new system will provide greater rewards for user-focused research. In advance of the new system coming into effect, **the Higher Education Funding Council for England (HEFCE) will, from 2007-08, allocate £60 million of Quality-Related research funding a year, relative to the amount of research universities undertake with business.** HEFCE will be responsible for refining the details of the new system, including the bibliometric system and the light-touch peer review, in consultation with the university sector. It will report back to the Government in time for the 2007 Pre-Budget Report.

Building an innovation system

Supporting knowledge transfer 3.75 The Department of Trade and Industry (DTI) is today publishing a booklet of case studies, *Making the Most of UK Science*, highlighting examples of excellent research collaboration and knowledge transfer.²² The case studies illustrate how the academic community and business in the UK have engaged with each other, risen to new challenges, and built upon their respective strengths, to produce innovative products and services that have had significant social and economic impact in the UK.

Public engagement 3.76 The Government's goal is for the UK public to be confident about the governance, regulation and use of science and technology – by both government and business – and to be actively engaged in scientific debate. To build on the progress made in this area through the Sciencewise Programme, **the Government will establish an Expert Resource Centre for Public Dialogue on Science and Innovation to assist all parts of government in enabling public debate on science and technology-related topics.** The Centre will develop and disseminate good practice on public dialogue across government and its non-departmental public bodies, resulting in a culture where public dialogue is seen as a fundamental part of science and technology policy development.

Sainsbury Review 3.77 The Chancellor has asked Lord Sainsbury to carry out a review to assess the responsiveness of the science and innovation system to the challenges and opportunities of globalisation, and take a forward look at what more needs to be done to ensure the UK's continued success in wealth creation and scientific policy-making. The Review will build on the Government's existing policy agenda, including the *Science and Innovation Investment Framework 2004-2014*, as well as the *Next Steps* for implementing the framework published alongside Budget 2006.²³ Lord Sainsbury will report to the Chancellor of the Exchequer and the Secretaries of State for Trade and Industry and Education and Skills in time for the 2007 CSR.

Business Research and Development

R&D tax credit 3.78 Strong R&D performance is fundamental to a high performing innovation system. **In November this year, HMRC launched specialist units dedicated to handling all R&D tax credit claims outside the Large Business Service.** These units will build links with the R&D community, and provide small firms with specialist support. The Government has also launched a promotional campaign, aimed at increasing the levels of awareness and understanding of the R&D tax credit. The Government has begun a dialogue with the European Commission over extending additional support to companies with between 250 and 500 employees.

²² *Making the Most of UK Science*, OSI, November 2006. Available at www.dti.gov.uk

²³ Available at: www.dti.gov.uk

Gowers Review 3.79 In 2005, the Government asked Andrew Gowers to conduct a wide-ranging independent review into the UK's intellectual property regime to ensure that it is supporting UK innovation and the creative industries in a time of rapid global economic change and increased global competition. **The Gowers Review of Intellectual Property (IP) reports its recommendations to the Government alongside this Pre-Budget Report, setting out a vision of an IP system that is fit for the 21st century.** The Review has considered the challenges of globalisation and technological change, and sets out a strategic vision of a system that is balanced, coherent and flexible, ensuring that the operations of the system work for businesses and consumers.

3.80 The Gowers Review argues that, faced with the twin challenges of profound global and technological change, innovation has never been more important to economic competitiveness in the UK, and that an effective IP regime is essential to support that innovation and investment. This requires that IP rights must be effectively enforced to protect and promote innovation and ensure that businesses benefit from their own creativity. It also requires that businesses and innovators be appropriately supported in their use of the IP system. IP rights must also be balanced, so that, while ideas are protected, future innovation is not stifled. The Review's recommendations are set out in more detail in Box 3.10.

Box 3.10: Gowers Review of intellectual property

The Gowers Review sets out reforms to ensure the UK's IP system is fit for the digital age. With the music industry losing as much as 20 per cent of annual turnover to piracy and counterfeiting the Review recommends strengthening enforcement through:

- new powers and duties for Trading Standards to take action against copyright infringement;
- the recognition of IP crime as an area for police action in the National Community Safety Plan;
- tougher penalties for online copyright infringement – with a maximum 10 years imprisonment;
- lowering the costs of litigation – by using mediation and consulting on the use of fast-track litigation. The Review acknowledges that prohibitive legal costs affect the ability of many to defend and challenge IP; and
- consulting on the use of civil damages as a deterrent for IP infringement.

To support businesses using IP rights, the Review recommends:

- restructuring the UK Patent Office as the UK Intellectual Property Office to provide greater support and advice for businesses using IP domestically, with business representatives sitting on a new independent Strategic Advisory Board for IP Policy, advising the Government; and
- improving support and advice internationally – including in India and China – to enable UK businesses to protect their investment around the world.

To ensure the correct balance in IP rights, the Review recommends:

- ensuring the IP system focuses resources on tackling genuinely illegitimate activity. The Review recommends introducing a 'private copying' exception to enable users to format-shift content;
- enabling access to content for libraries and education establishments – to ensure that the UK's cultural heritage can be adequately stored for preservation and accessed for learning. The Review recommends clarifying exceptions to make them fit for the digital age; and
- that the European Commission does not change the *status quo* and retains the 50 year term of copyright protection for sound recordings and performers' rights.

Government response to Gowers 3.81 The Government welcomes the Gowers Review and will take forward those recommendations for which it is responsible. The Government firmly believes in the need for strong enforcement of IP rights to support the UK's creative industries. **The Government is therefore today endorsing the full Gowers enforcement package to tackle piracy and other IP infringement and is providing Trading Standards with an additional £5 million in 2007-08 in order to support the implementation of their new powers to tackle copyright infringement.** To ensure that IP policy is strategically formulated in the future, the Government also supports the creation of an independent Strategic Advisory Board for IP policy. This Board will receive £500,000 from the Patent Office to commission research on emerging IP trends. The Government notes the recommendation to the European Commission on copyright term.

Supporting creativity in business 3.82 Creativity is fundamental to innovation. Following the publication of the Cox Review of Creativity in Business in December 2005,²⁴ the Government is taking forward its response to support UK business innovation, in the context of increasingly competitive global markets. The “Designing Demand” programme, which will help firms to use design to drive innovation, has been successfully launched in the South East, West Midlands and South Yorkshire regions, with the programme due to start in North East and South West by spring 2007. Between 2006 and 2010 it is envisaged that over 6,000 companies will access this support in the strategic use of design and creativity to change the direction of their business. A panel of distinguished figures from the arts, science, technology and education has been set up to oversee the planning of a National Centre in London, with the London Development Agency taking responsibility for the London hub.

Higher education centres of excellence 3.83 Higher education institutions (HEIs) also play an important role in nurturing business innovation. Following the call from the Higher Education Funding Council for England (HEFCE) for bids to establish Centres for Excellence for multi-disciplinary courses, HEIs are developing new approaches to teaching and learning to develop creativity and entrepreneurialism. It is expected that HEFCE will fund around six additional developments to explore major new aspects of the Cox agenda. These projects will work across institutions and cover a variety of sectors, including services, health, environment, and communication, and will explore the development of creative leaders, world class designers, engineers, scientists and executives.

Science Forum 3.84 The UK Science Forum is a high-level forum between government, business leaders and academics, set up to support the UK’s R&D and innovation agenda. In July 2006, the Forum presented its findings to the Government on a number of key issues including science, technology, engineering and mathematical (STEM) skills, the role of public procurement, joint programmes and projects between industry and government, and public attitudes to science. The Government has committed to undertake an analysis of the R&D performed by leading R&D businesses in the UK, exploring the factors influencing their location decisions and their plans to invest in the UK in the future. This analysis will contribute to evidence informing future policy decisions.

SKILLS

3.85 Workforce skills are key to the UK’s capacity to respond flexibly to new challenges in a changing global economic environment. A skilled workforce enables firms to increase their productivity by improving working practices and enhancing innovation, as well as driving improvements in social justice. The UK’s skills profile is improving, with more people gaining qualifications at all skill levels. However, the large stock of workers with low or no skills continues to act as a barrier to productivity growth and reinforces inequalities.

Leitch Review of Skills 3.86 In the 2004 Pre-Budget Report, the Government commissioned Lord Leitch to identify the UK’s optimal skills mix in 2020 to maximise economic growth, productivity and social justice, and to consider the policy implications of achieving a world-class skills base. The final report, *Prosperity for all in the global economy – world class skills*, was published on 5 December this year.²⁵ It sets out a compelling vision, recommending that the UK commit to becoming a world leader in skills by 2020, benchmarked against the upper quartile of OECD countries. This requires doubling attainment at most levels. Stretching objectives for 2020

²⁴ *The Cox Review of Creativity in Business: building on the UK’s strengths*, HM Treasury, December 2004. Available at www.hm-treasury.gov.uk

²⁵ The full document is available online at www.hm-treasury.gov.uk

include ensuring that: 95 per cent of adults have basic skills; more than 90 per cent of the workforce are qualified to at least level 2; there is a shift the balance of intermediate skills from level 2 to level 3 qualifications; and that more than 40 per cent of the adult population have qualifications at level 4 and above. More details are set out in Box 3.11.

Box 3.11: The Leitch Review of Skills

The Leitch Review sets out how the UK should raise its ambitions on skills, by committing to stretching objectives for 2020:

- 95 per cent of adults to achieve the basic skills of functional literacy and numeracy, an increase from levels of 85 per cent literacy and 79 per cent numeracy in 2005;
- exceeding 90 per cent of adults qualified to at least level 2, an increase from 69 per cent in 2005. A commitment to go further and achieve 95 per cent as soon as possible;
- shifting the balance of intermediate skills from level 2 to level 3. Improving the esteem, quantity and quality of intermediate skills. This means 1.9 million additional level 3 attainments over the period and boosting the number of Apprentices to 500,000 a year; and
- exceeding 40 per cent of adults qualified to level 4 and above, up from 29 per cent in 2005, with a commitment to continue progression.

The Review makes a number of recommendations to help the UK meet these stretching objectives, including:

- routing all public funding for adult vocational skills in England, apart from community learning, through Train to Gain and Learner Accounts by 2010;
- strengthening the employer's voice, creating a new Commission for Employment and Skills, boosting the role of Sector Skills Councils, and increasing employer engagement and investment in skills;
- launching a new Pledge for employers voluntarily to commit to train all eligible employees up to level 2 in the workplace. In 2010, review progress of employer delivery – if the improvement is insufficient, introduce a statutory entitlement to workplace training at level 2 in consultation with employers and unions;
- increasing people's aspirations and awareness of the value of skills to them and their families, through a high profile, sustained awareness programme including better careers guidance; and
- creating a new integrated employment and skills service, based upon existing structures, to increase sustainable employment and progression with better intergration of jobs and skills.

Government response to Leitch 3.87

The Government welcomes the Leitch report and its analysis of the growing importance of skills in a modern economy. The report identifies worsening employment rates and low social mobility for the poorly qualified, despite the UK's recent strong economic performance and narrowing of the productivity gap with key comparator countries. Improvements in all these areas are increasingly driven by skills. The long-term challenge for the UK is to increase its prosperity through higher productivity and employment at a time when the global economy is changing rapidly. These global changes are increasing the number of high skilled jobs and increasing skills demands within most existing jobs.

3.88 The Government accepts the higher skills ambitions for 2020 set out in the Leitch Review. The Government is already investing heavily in skills to deliver the current set of challenging skills targets. Achieving these targets is a precondition for any higher ambitions. They will set the foundation from which to build. The Government will consider how best to achieve the Leitch ambitions and implement its recommendations, alongside the level of resources it will allocate to them, as part of the 2007 CSR process.

3.89 The Government accepts the principles the Leitch Review recommends to underpin the delivery of the world-class skills ambition. There must be a shared responsibility for delivering the ambition. Employers, individuals and the Government must all improve their efforts and investment. The Government is committed to investing where there are market failures, with employers and individuals making a larger contribution where they gain the greatest private returns. The focus must be on economically valuable skills that deliver returns for employers and individuals. The skills system must be fully demand-led and focused on the needs of employers and individuals. Reforms should also build on existing structures through simplification, rationalisation and better performance management.

Employer engagement in skills

3.90 Employers have an important role to play in securing world-class skills in the UK, raising their investment in skills at all levels and using skills effectively. The Government welcomes the investment in training that employers have made, and their involvement in existing skills initiatives. The Leitch Review sets out recommendations for shared action from the Government and employers – a ‘something for something’ approach – that ties greater rights to increased responsibility. This approach recommends that employers take more responsibility to offer time off, in return for more influence over the type of training available, and that the Government takes more responsibility to reform and invest in training provision. At the heart of this deal is the Government’s commitment, through Train to Gain, to ensure all workers have a basic platform of skills.

Train to Gain

3.91 Since April 2006, the Government has been rolling out a new national service for employers – Train to Gain. This provides firms with free, flexibly delivered training in the workplace for their low-skilled employees. In return, firms give their employees time off to undertake and complete training. This innovative approach is based on the lessons learned from Employer Training Pilots, which were launched in September 2002 and completed recently. Evaluations of the Employer Training Pilots have shown the positive impact of the pilots on both employers and learners in terms of satisfaction and workplace performance improvements. Over 90 per cent of employers were satisfied with the pilots overall. As described in Chapter 4, the Leitch Review makes a number of recommendations for integrating skills and employment services, with Train to Gain playing an important role in helping to increase sustainable employment and progression. The Train to Gain model has clearly been a successfully piloted and provides a solid foundation from which the Government can start work towards the Leitch ambitions.

Government Envoy for Skills

3.92 The Government also accepts the need for a strong, coherent employer voice at the heart of the skills system, delivered through the new Commission for Employment and Skills, recommended by the Leitch Review. In advance of the creation of the Commission, Sir Digby Jones has agreed to take on the role of the Government’s Skills Envoy, working with all employers to help build a national consensus about the need to work together to improve the UK’s skills.

Skills for young people

3.93 The Government has introduced a number of measures to encourage all young people to take part in some form of education or training up to the age of 19. Despite progress in recent years, the UK ranks among the lowest performing OECD countries in terms of post-16 participation.

3.94 The 14-19 Education and Skills White Paper, published in February 2005, set out the next steps the Government is taking to tackle this problem, including the introduction of 14 specialised diplomas in broadly vocational areas by 2013. The content of the first five Specialised Diploma subjects (ICT, health and social care, engineering, creative and media and the built environment) has recently been published.²⁶

²⁶ The content for each of the first five Diploma lines is available on the Diploma Development Partnership websites.

3.95 Since April 2006 the Government has been piloting new Learning Agreements. These are aimed at 16 and 17 year olds who are in work but not receiving accredited training, to ensure they undertake appropriate learning. **The Government will now consider extending these pilots, to enable a greater number of people to benefit.** Building on the existing statutory right to paid time off to train or study for this group, the pilot is testing the effectiveness of formal learning agreements, financial incentives and wage compensation for young people and their employers when engaging in training.

STEM Skills 3.96 To support the UK's ambition to move to a higher level of research and development intensity, it is crucial that the UK has the right stock and flow of skilled scientists, technologists, engineers and mathematicians (STEM). At Budget 2006 the Government announced further measures to improve the skills of science teachers, the quality of science lessons and increase progression to A-level sciences. In October this year, the Government published a report on STEM skills,²⁷ which announced the formation of a new high-level STEM strategy group, led by the Department for Education and Skills with the involvement of external stakeholders, to encourage a more coherent approach for STEM across government. The group will make recommendations to ministers about national STEM priorities and related matters such as delivery arrangements and evaluation. It will meet three times each year, following its first meeting in October. John Holman has been appointed National STEM Director, to drive delivery forward.

INVESTMENT

3.97 Alongside ensuring open and flexible markets, investing in essential infrastructure to support business growth is key to continuing to raise the UK's productivity performance. Evidence suggests the UK has historically had low levels of fixed investment, including in infrastructure such as housing and transport, compared with leading OECD countries.²⁸ The Government has made good progress in tackling this under-investment in recent years. This Pre-Budget Report sets out key measures to build on these recent increases in investment, through important reforms to the planning system, housing supply and transport system.

Investing in infrastructure

Barker Review of Land Use Planning 3.98 In 2005, Kate Barker was asked by the Government to conduct an independent review of the land use planning system in England. The terms of reference asked her to consider how, building on recent reforms, the planning system could better support economic growth in the context of delivering its wider sustainable development goals. An interim report was published in July 2006, highlighting the ways in which the planning system can impact on productivity growth. These included the transaction costs associated with uncertainty and planning delays, and the potential economic impacts of land supply restrictions, including on occupation costs. It welcomed the progress that had been made, but noted that further changes were needed to support competition and encourage sustainable economic growth.

²⁷ The full document is available online at www.dfes.gov.uk

²⁸ For instance, as set out in *Productivity in the UK 6: Progress and new evidence*, HM Treasury, March 2006

Box 3.12: Barker Review of Land Use Planning

The final report of the Barker Review of Land Use Planning was published on 5 December 2006. It set out a range of recommendations for improving the speed, responsiveness and efficiency of the planning system, while ensuring it delivers its economic, social and environmental objectives, including:

- streamlining policy and process through reducing policy guidance, unifying consent regimes and reforming plan-making at local level so that future development plan documents can be delivered in 18-24 months rather than three or more years;
- updating national policy on planning for economic development (PPS4), to ensure that the benefits of development are fully taken into account in plan-making and decision-taking, with a more explicit role for market and price signals;
- introducing a new system for dealing with major infrastructure projects, based around national Statements of Strategic Objectives and an independent Planning Commission to determine applications;
- promoting a positive planning culture within the plan-led system, recommending that when the plan is indeterminate, applications should be approved unless there is good reason to believe that the economic, social and environmental costs will exceed the respective benefits;
- in the context of the Lyons Inquiry into Local Government, to consider enhancing fiscal incentives to ensure a more efficient use of commercial property and the redevelopment of vacant and derelict brownfield land;
- a more risk-based and proportionate approach to regulation, with a reduction in form-filling, including the introduction of new proportionality thresholds;
- removing the need for minor commercial developments that have little wider impact to require planning permission (including commercial micro-generation);
- improving skills, and ensuring sufficient resources for planning, linked to improved performance, including consulting on raising the £50,000 fee cap and allowing firms to pay for additional resources to speed up applications;
- reducing delays at appeals and call-in, with a new planning mediation service to reduce demand for appeal, and a 50 per cent reduction in the volume of Secretary of State call-ins; and
- ensuring that new development beyond towns and cities occurs in the most sustainable way, by encouraging planning bodies to review their greenbelt boundaries and take a more positive approach to applications that will enhance the quality of their greenbelts.

3.99 The final report of Kate Barker's Review of Land Use Planning (see Box 3.12) makes clear that planning is a valued and necessary activity that can deliver positive economic outcomes, alongside important social and environmental objectives. However, it concludes that the context for the planning system is becoming ever more challenging and therefore recommends further wide-ranging reform, building on recent changes and the plan-led approach, to ensure that the planning system supports sustainable economic growth in a global economy.

Planning major infrastructure

3.100 The Eddington Transport Study recommends reform to the process of planning for major transport infrastructure (see Box 3.13). Kate Barker's Review has considered these proposals in a wider planning context and recommends comprehensive reform of the planning of major infrastructure projects in relation to transport, energy, water supply and waste, based on the same principles.

3.101 The Government believes that these recommendations on planning for infrastructure could play a significant role in ensuring the UK's competitiveness and delivering the Government's objectives on climate change, the environment, and energy security, through improving the speed, certainty and transparency of the planning process for major infrastructure. Key elements of the proposed reforms are that:

- the primary role of ministers would be to set national policy statements for major infrastructure development, taking full account of economic, social and environmental considerations, following full consultation;
- there would be a presumption in favour of development for major infrastructure proposals so long as they are consistent with national policy statements, and compatible with EU law and the European Convention on Human Rights;
- an Independent Planning Commission would be established to manage inquiries and determine individual applications for major schemes in England;
- local consultation would be carried out by the applicant at the pre-application stage and inquiries and decisions would have regard to local considerations;
- consent regimes would be rationalised to eliminate duplication and overlap and to treat major projects as a whole; and
- there would be a clear framework for statutory rights to challenge at key stages in the process.

3.102 The Government welcomes Kate Barker's report which it will take forward, and agrees with her overall analysis. The Government will set out in a White Paper, in spring 2007, its proposals in response to her recommendations for improving the speed, responsiveness and efficiency in land use planning, and for taking forward Kate Barker's and Rod Eddington's proposals for reform of major infrastructure planning. In the meantime, the Government is interested to hear views including on how the major infrastructure proposals could be implemented and made to work in practice.

3.103 Planning is devolved in Scotland, Wales and Northern Ireland. The Government will continue to work with the Devolved Administrations in developing reforms to ensure that the planning systems in the UK operate effectively alongside each other.

Tax incentives for brownfield land

3.104 Recognizing that previously used land is often more costly to develop than greenfield sites, the Government introduced a 150 per cent corporation tax relief in 2001 to give extra help with the costs of decontamination. Landfill tax also includes an exemption for waste removed from contaminated land. Following the recommendation of the Barker Review of Land Use Planning, the Government intends to review these tax reliefs to ensure they are helping to deliver additional development and will be consulting on possible reforms in spring 2007 to enable any changes to be put in place alongside the proposed introduction of the Planning-gain Supplement, set out later in this chapter.

Business Premises Renovation Allowances

3.105 The Business Premises Renovation Allowances scheme will give 100 per cent capital allowances for the capital costs of bringing empty business properties back into use in disadvantaged areas and was enacted in 2005. The Government is continuing to seek state aid approval and remains committed to introducing the scheme as soon as possible.

Real Estate Investment Trusts **3.106** This Pre-Budget Report announces a change to the Real Estate Investment Trusts (UK-REITs) regime, to be included in Finance Bill 2007, to make it easier for newly-established companies to join the regime. This change will allow companies to enter the UK-REIT regime without meeting the requirement that at least 75 per cent of their business by assets and income consists of property rental activity, provided that they meet this condition within one year of entry. The entry charge of 2 per cent of the gross market value of investment properties will be levied at the end of this first year, on the value of properties held at that point. HMRC will also shortly publish information on a number of technical changes to be made in Finance Bill 2007, to ensure that the regime runs smoothly.

Investing in housing

Investing in housing supply **3.107** Meeting housing need is vital for the UK's future economic prosperity and social success. *The Government's Response to Kate Barker's Review of Housing Supply*, published alongside the 2005 Pre-Budget Report,²⁹ sets out a package of measures to increase housing supply and improve affordability, including a target to raise the number of new houses being built to at least 200,000 net additions per year by 2016. Good progress is being made: data for the year until September 2006 shows 165,000 completions, a 25 per cent increase over the same period in 2001. However, predictions for demographic change indicate that new housing supply will need to rise further over the next decade.

3.108 The Government is therefore bringing forward further measures to increase and speed up the delivery of new, sustainable, housing. The publication of *Planning Policy Statement 3: Housing* (PPS3) will ensure that local and regional plans are more responsive to housing markets and prepare and release more land to meet future housing requirements.³⁰ Reinforcing this policy, 29 areas across the country have now been named as New Growth Points with the potential to contribute around 100,000 additional dwellings by 2016, an increase of around 32 per cent on previous plans for housing supply in these areas.

3.109 To support local authorities in meeting their housing targets, the Government plans to introduce a new Housing and Planning Delivery Grant on which it has recently consulted.³¹ In addition, a new independent National Housing and Planning Advice Unit will begin work early in the new year, providing expert advice to regional planning bodies, allowing them to incorporate a better understanding of the relationship between housing supply and affordability.

Sustainable housing **3.110** To meet future economic, social and environmental challenges, it is vital that the UK builds more sustainable homes. To reduce the carbon impact of new development and to encourage environmentally sound housebuilding, the Department for Communities and Local Government will shortly publish the Code for Sustainable Homes. Building on the higher energy efficiency standards introduced earlier this year through building regulations, the Code will be accompanied by an ambition progressively to incorporate its standards on energy efficiency into future building regulations, thereby ensuring that, within a decade, all new homes are zero carbon. Chapter 7 sets out new measures to help achieve this ambition. Additionally, to ensure that the planning system plays its full role in tackling carbon

²⁹ *The Government's Response to Kate Barker's Review of Housing Supply*, HM Treasury and ODPM, December 2005

³⁰ *Planning Policy Statement 3: Housing (PPS3)*, DCLG, November 2006

³¹ *Housing and Planning Delivery Grant: Consultation Paper*, DCLG, July 2006

emissions, the Government will shortly issue for consultation a new Planning Policy Statement on Climate Change. This will aim to integrate climate change considerations fully into every stage of the planning process.

Housing infrastructure **3.III** The Government is committed to ensuring that its ambitious plans for a step-change in housing supply are supported by the necessary investment in social, transport and environmental infrastructure. To address these issues, the Government has established a 2007 CSR Policy Review into Supporting Housing Growth.³² The review has identified a number of key themes for further work, including:

- identifying the infrastructure implications of housing growth in different spatial forms and locations;
- possible adjustments to departmental priorities and allocation mechanisms to ensure more efficient and timely provision of infrastructure funding; and
- improving infrastructure planning and delivery at the local and regional level, including measures to improve the coordination and timeliness of delivery partners and mechanisms for front-funding the provision of infrastructure.

Shared Equity Task Force **3.II2** Due to the long-term nature of investing in housing supply, the Government set up the Shared Equity Task Force to examine whether there were barriers preventing the development of shared equity products for households wanting to access home-ownership in the shorter-term. In its report, published today, the Task Force found that:

- there is currently a small, fragmented market in the provision of equity loans. Yet there are pension funds and others interested in investing in this market;
- the public-private partnership to develop the expanded Open Market HomeBuy scheme has already tackled a number of informational and regulatory barriers, as well as bringing major financial institutions into this market for the first time; and
- market provision is set to expand and the aspirations of those households closest to homeownership will increasingly be met by the market.

3.II3 In response to the report, the Government will seek to extend the reach of the Open Market HomeBuy scheme to households on lower incomes, and will be launching a competition for lenders to join in a 2008-09 to 2010-11 round of the scheme. Taking together procurement gains, a stronger role for the private sector, and the numbers now expected to be assisted by the market, **the Government now expects over 160,000 households to access homeownership through private or public shared equity products by 2010, double original plans.**³³

Surplus public sector land **3.II4** The Government's response to the Barker Review of Housing Supply established a new, joint HM Treasury-Department for Communities and Local Government taskforce to examine cost-effective options for releasing more surplus public sector land to facilitate housing growth. **The taskforce has recommended a number of actions to accelerate the release of surplus public sector land for housing, including an increased ambition of 130,000 new homes to be delivered from existing and new sites over the next ten years,**

³² See *The Government's Response to Kate Barker's Review of Housing Supply*, HM Treasury and ODPM, December 2005

³³ *Sustainable Communities: Homes for All*, ODPM, January 2005. Available at www.communities.gov.uk

further measures to support the work of English Partnerships in this area, an enhanced Register of Surplus Public Sector Land, and increased incentives for housing delivery. The Government will consider these recommendations as part of the 2007 CSR.

Progress on the Planning-gain Supplement

3.II5 The proposed Planning-gain Supplement (PGS) aims to release increases in land value created by the planning process to help finance the infrastructure needed to support new housing and growth. Kate Barker recommended introducing PGS, alongside a revised planning obligations regime, in her review of housing supply, as an essential part of a package of reforms to incentivise the release of more land for development. The Government responded to Barker's recommendation, publishing a consultation paper on PGS alongside the 2005 Pre-Budget Report.³⁴

Further consultation on PGS **3.II6** **The Government will move forward with the implementation of PGS if, after further consultation, it continues to be deemed workable and effective.** In response to views expressed by consultation respondents on specific policy areas, the Government is today publishing consultation papers on elements of the design of PGS and the new approach to planning obligations:

- *Valuing Planning Gain: a Planning-gain Supplement consultation*, HM Revenue and Customs;
- *Paying PGS: a Planning-gain Supplement technical consultation*, HM Revenue and Customs; and
- *Changes to planning obligations: a Planning-gain Supplement consultation*, Department for Communities and Local Government.

3.II7 Many respondents suggested that the Government consider alternative measures to capture land value, including the Optional Planning Charge and planning tariffs. Kate Barker's review of housing supply examined options for capturing value uplift and the Government has looked closely at these models. **The Government continues to believe that a workable and effective PGS, alongside a scaled-back planning obligations system, represents a fairer and more effective means of releasing land value to help finance infrastructure.**

Timetable **3.II8** Given the need to allow markets sufficient time to adjust to the new regime, **the Government now proposes that a workable and effective PGS would not be introduced earlier than 2009.**

Rate **3.II9** As proposed in 2005, **PGS would be levied at a modest rate across the UK** to generate additional revenue for investment in infrastructure at the local and regional levels while preserving incentives for development to come forward.

PGS and brownfield land **3.II20** The Government consulted on whether a lower rate of PGS should be applied to brownfield land. Many respondents suggested that because lower values associated with brownfield sites would be reflected in PGS valuations, a lower brownfield rate would not

³⁴ Planning-gain Supplement: a consultation, HM Treasury, HM Revenue and Customs and the Office of the Deputy Prime Minister, December 2005

encourage regeneration. The Government agrees with this assessment, but will continue to examine this issue and whether other instruments could better create incentives for regeneration. **The Government intends to review certain tax incentives for the development of brownfield land** (as discussed earlier in this chapter).

Scope 3.121 Maintaining a broad scope with a wide base would enable PGS to be levied at a modest rate with a reduced risk of creating economic distortions or avoidance opportunities. **The 2005 consultation proposed that PGS apply to residential and non-residential development but that home improvements would be exempt from the levy. This remains the proposed scope of the levy. The Government is still considering thresholds for small-scale non-residential development.**

3.122 The application of PGS and a revised planning obligations system to major infrastructure projects, to public sector works, to minerals and waste consents and to non-Town and Country Planning Act consents remains under review.

Revenue allocation 3.123 The Government committed at Budget 2006 to recycle a significant majority of PGS revenues back to the local authority area in which the revenues derived. The Government now proposes that at least 70 per cent of PGS revenues would be hypothecated for local infrastructure priorities and would be returned to the local authority area in which they were generated. **Remaining PGS funds would be returned to the regions to help finance strategic infrastructure projects.**

PGS and the Devolved Administrations 3.124 PGS will apply across the UK but because it is essentially a local measure, **all PGS revenues generated in the Devolved Administrations would be returned to the country in which they were generated. The use of PGS funds in the Devolved Administrations would be determined by the administrations** and would not be subject to many of the conventions prescribed for the use of PGS revenues in England, although it is proposed that PGS revenues should be dedicated to infrastructure throughout the UK. The Government will continue to engage with the Devolved Administrations on this and other interactions with devolved policy areas.

Local infrastructure delivery 3.125 PGS revenue allocation will need to be consistent with the 2007 CSR Review into Supporting Housing Growth (as discussed earlier in this chapter). Robust local planning is critical to the efficient and effective delivery of infrastructure. **The Review is exploring options for improving infrastructure delivery planning at the local and regional level.** PGS revenues would be used, alongside scaled-back planning obligations and other revenue streams, to fund priorities set out in infrastructure plans. At the local level, the use of PGS funds could also be subject to the new performance management framework set out in the recent Local Government White Paper.³⁵

Transitional arrangements 3.126 **Transitional arrangements will aim to ensure that development already formally in the planning process would not be subject to PGS.** The Government proposes that for development where planning permission was granted before an appropriate appointed day in the future, including for outline planning permissions, PGS would not apply. There will be dialogue with stakeholders on transitional arrangements before further announcements are made.

³⁵ *Strong and prosperous communities – The Local Government White Paper DCLG (2006)*

Legislation 3.127 The Government will shortly introduce a preparations bill to Parliament providing HMRC with the authority to build the systems necessary to administer PGS, if enacted. Further announcements on PGS are expected in spring 2007.

Investment in transport infrastructure

3.128 Transport infrastructure supports the efficient and flexible functioning of the economy, and plays a vital role in equipping the UK to respond to globalisation. It facilitates the movement of goods and people, encourages business investment, influences individuals' location decisions, supports social objectives and public services, and benefits consumers through lowering the cost of goods and services and increasing the variety available to them.

Eddington Transport Study 3.129 Sir Rod Eddington's Study, published on 1 December this year, examined how long-term transport decisions can impact on the UK's economic growth and concluded that transport has a pivotal role in supporting the UK's future success. A 5 per cent reduction in travel time for all business and freight travel on the roads would generate around £2.5 billion of cost savings – some 0.2 per cent of GDP. The Study reaffirms the importance of investment in transport to the continued success of the UK economy in the global marketplace. The Study finds that the UK is well connected and that much of the transport system works well. The study also demonstrates a changing context and identifies the challenge of the significant and growing strain the UK's economic success places on key points within the transport system, with a serious risk that congestion, crowding and unreliability will reduce future productivity growth. At the same time, the Study recognises the importance of improving the environmental impact of the transport system.

3.130 With long-term guidelines improving the certainty of future funding, and dividends working through from effective spending control (for instance, the progress on delivering Network Rail's 31 per cent efficiency target), new opportunities have been created to meet the challenge. The Study underlines the need for major reforms to the planning, funding and delivery of transport interventions if sustainable returns from any new investment are to be maximised and opportunities exploited. Box 3.13 sets out the Study's recommendations.

Box 3.13: Eddington Transport Study

Based upon new and existing empirical research, the Eddington Transport Study demonstrates a compelling link between transport and economic growth and productivity, and supports a strong case for continued investment in transport. The best schemes offer returns in the region of £5-£10 for each £1 invested. The Study finds that the UK is well-connected and that much of the transport system works well (for example, logistics companies can deliver to over 75 per cent of the UK population for their West Midlands hubs in a half-day truck journey). However, it also finds that sustained economic success and the growth in transport demand has put some parts of the system under strain and that, without action, the situation will worsen. To address these challenges, Sir Rod Eddington has made the following five key recommendations:

- to meet the changing needs of the UK economy, the Government should focus policy and sustained investment in improving the performance of existing transport networks, in those places that are important for the UK's economic success;
- over the next 20 years, the three strategic economic priorities for transport policy should be: congested and growing city catchments, key inter-urban corridors, and the key international gateways that are showing signs of increasing congestion and unreliability. These are the most heavily used and economically significant parts of the network;
- the Government should adopt a sophisticated policy mix to meet both economic and environmental goals. Policy should get the prices right (especially congestion pricing on the roads and environmental pricing across all modes) and make the best use of existing networks. Reflecting the high returns available from some transport investment, based on full appraisal of environmental and social costs and benefits, the Government, together with the private sector, should deliver sustained and targeted infrastructure investment, in those schemes that demonstrate high returns, including smaller schemes tackling pinch points;
- the policy process needs to be rigorous and systematic: start with the three strategic economic priorities, define the problems, consider the full range of modal options using appraisal techniques that include full environmental and social costs and benefits, and ensure that spending is focused on the best policies; and
- the Government needs to ensure the delivery system is ready to meet future challenges, including through reform of sub-national governance arrangements and reforming the planning process for major transport projects, providing greater clarity about government policy through strategic statements of transport objectives, and by introducing a new Independent Planning Commission to take decisions on projects of strategic importance.

3.13I The Government agrees with Rod Eddington's strategic analysis. It will take steps to implement his advice, covering strategy, processes and delivery, while aiming to improve transport's environmental performance and taking account of the Government's social objectives. In this context, the Government is committed to reforming its transport strategy, including:

- reviewing the implications for the 2007 CSR, publishing as outputs a framework and evidence base for decision-making over the medium term; an analysis, to be updated regularly, of the priority areas nationally where transport interventions should focus to unblock constraints to growth; developing and appraising a full range of potential solutions (including better use of existing networks, and targeted investment) and prioritising those options with the best value-for-money returns; and a refreshed research and evaluation strategy;

- developing the strategy on pricing: setting out early plans to enable widespread road pricing to be implemented within the next ten years (i.e. by 2016), if it can be done so in an affordable way which preserves the potential net gains to society; including within this key decision points; timely updating of these plans; and
- developing further the strategy to ensure that transport prices reflect the costs of carbon emissions and other environmental externalities, for instance, through taxation, regulation and trading mechanisms, as recommended by the Stern Review of the Economics of Climate Change.

3.132 The Government is committed to reforming the development of supporting processes, including:

- reviewing processes as part of the 2007 CSR so that resources are allocated taking account of options across modes and giving priority to cost-effectiveness in delivering objectives;
- developing appraisal of transport projects: by April 2007, it will better reflect reliability, freight and agglomeration benefits; by March 2008, it will capture additional economic and environmental benefits; by March 2008, scope for further improvements will be identified, drawing on evaluation studies; and
- adopting immediately a set of planning scenarios which include the significant possibility of widespread road pricing by 2016, and issuing guidance on the implications by April 2007.

3.133 The Government is also committed to reforming delivery, including:

- considering proposals to reform planning for transport infrastructure as part of wider proposals for planning reform following the Barker Review of Land Use (see Box 3.11); and
- taking forward Eddington's analysis of sub-national governance in the 2007 CSR.

3.134 The Department for Transport will report on progress in taking forward the measures, and its further consideration of the new evidence and analysis presented by the Eddington Transport Study, in the course of 2007. As discussed in Chapter 6, the Government has asked Sir Michael Lyons to consider the implications of the Eddington Transport Study, as well as the reviews by Kate Barker and Lord Leitch, for the role and funding of local government, ahead of publishing his final report.

The UK as a competitive centre for global investment

Strategy for promoting the UK

3.135 The Government recognises the importance of marketing the UK as a place to invest, to enable the UK to seize the opportunities presented by globalisation. In July this year, the Government published the new five-year strategy for marketing the UK economy internationally: *Prosperity in a changing world*.³⁶ This strategy sets out the steps that the Government will take to achieve a step-change in its efforts to attract high quality inward investment and promote UK businesses. These efforts will be more focused towards where the greatest opportunities lie, in high growth emerging markets and R&D-intensive sectors.

³⁶ Available at www.ukinvest.gov.uk

UK Trade and Investment **3.136** UK Trade & Investment (UKTI) is responsible for coordinating and driving the strategy. Progress has been made on a number of fronts. Resources have already been reprioritised to reinforce the UK's presence in China, India and 14 other emerging markets. UKTI is rolling out its new R&D programme. In October this year, a cross-Government group on marketing the UK economy was established to improve coordination of the Government's activities. Chaired by UKTI and including the Regional Development Agencies and Devolved Administrations, this group will meet quarterly to agree a coordinated programme of work. UKTI's reorganisation is underway to raise its profile as a skilled, professional and enterprising organisation. In the UK, UKTI's marketing expertise has been reinforced to strengthen its approach to marketing the UK as a place to do business. UKTI will market the UK business proposition as a unique "springboard for global growth", supported in particular by its international connections, creative talent, and business-friendly environment.

International Business Advisory Council **3.137** In March this year, the Chancellor established the International Business Advisory Council (IBAC). The IBAC will advise the Government on how the UK can rise to the challenge of globalisation, promote itself as one of the key locations of choice for international business investment in high value-added activity, and work with international partners to pursue a less protectionist world. Its inaugural meeting took place on 17 November 2006. The Government also hosted a Business Advisory Summit in November with over seventy Chairs and CEOs from many leading UK companies. The Government strongly welcomes this engagement with business on the challenges of globalisation, particularly in the areas of trade, economic flexibility and education.

Financial services **3.138** London is the world's leading international financial centre; its scope, scale and internationalism is unparalleled and the Government's objective is for it to be even more successful in an integrated global economy. The business services and finance sector is the largest sector of the UK economy, accounting for around a third of total activity. As Europe's leading financial centre, London also acts as Europe's gateway to global financial markets. This means the UK is in a strong position to benefit from opportunities presented by continuing global economic growth and integration, particularly in emerging markets such as China and India.

3.139 The Government committed, in Budget 2006, to establishing a High-Level Group, with senior representatives from across the financial sector, to develop a strategy to enhance the UK and the City of London's international competitiveness. Following their inaugural meeting in October this year, the Government agreed to take forward substantive proposals in a number of key areas, as set out in Box 3.14. The High-Level Group will also monitor UKTI's progress in promoting the UK-based financial sector overseas.

Box 3.14: High-Level Group on the City of London's international competitiveness

On the basis of extensive discussions held between HM Treasury and practitioners across six sectors – banking, insurance, capital and derivative markets, asset management, legal services and accountancy – the High-Level Group met for the first time in October to consider how the Government and the financial services sector can continue to work in partnership to ensure the continued global success of the UK-based financial sector. The Government agreed to take forward proposals to:

- maintaining cutting edge principles-based regulation – the Government set out proposals to reduce administration burdens of regulation, to take further action against unnecessary gold-plating and agreed to examine, with the Financial Services Authority, whether the regulatory regime might be lightened for insurance services with lower consumer detriment or systemic risk;
- modernising the wholesale insurance market – Lord Leven, Grahame Millwater and Andres Kendrick will work together to support the timely delivery of the reform stage being set by the Market Reform Group and, in parallel, the Government will examine the business environment for the wholesale insurance sector;
- boosting professional financial skills in London – the Chancellor asked Teresa Sayers and the Financial Services Skills Council to undertake research on financial skills gaps. At the same time, HM Treasury, together with industry, will examine a proposal for a centre for regulatory expertise that would provide teaching and research; and
- promoting, in a new joined up strategy, the UK based financial sector in high growth overseas markets – bringing a more strategic approach and better coordination of the efforts of public and industry bodies. UKTI, which will be responsible for coordinating the strategy, will allocate additional resources to the promotion of financial services, with dedicated diplomatic staff and tailored promotional strategies in key overseas markets, including China and India.

Work is also being taken forward on a number of broader issues affecting the financial and business services sector, including migration, and the findings of the reviews reporting at this Pre-Budget Report, including those by Sir David Varney, Lord Davidson, Sir Rod Eddington, Lord Sandy Leitch, and Kate Barker (all discussed earlier in this chapter). The next meeting of the High-Level Group will be chaired by the Chancellor in May next year, where progress on these issues will be reviewed.

3.140 Modern financial business places great importance on a tax system that is coherent and consistent, delivering both the clarity needed in handling fast moving financial transactions in a global environment, and the necessary flexibility to accommodate innovation that is a hallmark of the financial markets. In meeting these objectives, the Government will ensure that the corporate tax system continues to reflect the commercial and economic realities of the financial sector.

3.141 This Pre-Budget Report announces proposals that take forward this work in the areas of life insurance, general insurance, exchange traded funds, offshore funds and securitisation, with the objectives of modernisation and simplification, and reducing barriers to market developments, set out further in Chapter 5. These measures have been developed in consultation with business, a key theme of *HMRC's 2006 Review of Links with Large Business*, discussed earlier in this chapter. The financial sector contains many of the UK's largest businesses and will therefore be a very important player in taking forward this agenda. Consultation is continuing with business in a number of areas, including insurance and the impact of the Markets in Financial Instruments Directive on Stamp Duty relief.