



House of Commons
Treasury Committee

**The 2005 Pre-Budget
Report: Government
Response to the
Committee's Second
Report of Session
2005–06**

**Third Special Report of Session
2005–06**

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury and its associated public bodies.

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The following Members were also members of the Committee during the 2005 Pre-Budget Inquiry

Mr Damian Green MP (*Conservative, Ashford*)
Mr David Ruffley MP (*Conservative, Bury St Edmunds*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via www.parliament.uk. The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997–98 onwards are available on the Internet at www.parliament.uk/parliamentary_committees/treasury_committee.

Committee staff

The current staff of the Committee are Colin Lee (Clerk), Fiona McLean (Second Clerk and Clerk of the Sub-Committee), Dominic Lindley, Andrew Staines and Adam Wales (Committee Specialists), Lis McCracken (Committee Assistant), Mandy Sullivan (Secretary) and James Clarke (Senior Office Clerk).

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Third Special Report

The Treasury Committee published its Second Report of Session 2005–06, *The 2005 Pre-Budget Report*, on 25 January 2006, as House of Commons Paper No. 739. The Government response to this Report was received on 22 March 2006, and is appended below.

Appendix: Government response

The Government notes the conclusions of the Treasury Committee's Report on the 2005 Pre-Budget Report.

Scrutiny of the Pre-Budget Report

1. We will continue the practice of our predecessors of examining and reporting upon Budgets and Pre-Budget Reports. (Paragraph 1)
2. Although the Treasury was faced with unusual circumstances in 2005, the House of Commons is entitled to reasonable notice of the date of the Pre-Budget Report. We recommend that the Treasury should announce the date of the Pre-Budget Report at least four weeks before the statement is due to be made and, in any case where this target is not met, give an account of the reasons. (Paragraph 3)

For Budget 2006, the Government gave more than four weeks notice by announcing the date 34 days before the statement. However, it may not always be possible to give four weeks notice. As the Government has previously set out in its responses to the Treasury Committee's reports, it will announce the date of the Pre-Budget Report (and the Budget) at the earliest convenient opportunity.

The United Kingdom Presidency of the G7/8

3. We welcome action taken during the United Kingdom's G8 Presidency to tackle global poverty, including the increases in aid and the provision of debt relief. It is important that there is clarity about the level of aid and debt relief commitments and clear monitoring to ensure that the G8 delivers on commitment at Gleneagles. We recommend accordingly that the Treasury include reports on G8 progress on the Gleneagles commitments in each Budget and Pre-Budget Report, as well as seeking to strengthen international mechanisms for tracking and delivery such as the Africa Partnership Forum. We also welcome the launch of the International Finance Facility for Immunisation and encourage the Government to continue to explore how innovative financing mechanisms such as the broader International Finance Facility can be used to provide the additional aid necessary to meet the Millennium Development Goals. It is disappointing that the Hong Kong trade talks failed to deliver the hoped-for trade deal; progress in 2006 will be important if world

economic growth is to be supported and market access for developing countries is to be increased. (Paragraph 7)

The Government welcomes the support of the Treasury Select Committee for its development objectives, and particularly the achievements made in 2005 on aid and debt relief.

The Government undertakes to report regularly on G8 progress in implementing Gleneagles commitments, through monthly updates to Parliament in 2006 on the implementation of Gleneagles commitments, in the Pre-Budget Report and in the Budget. This information will be drawn from respected international sources, such as the reports of the Development Assistance Committee of the Organisation for Economic Co-operation and Development. The government is also currently supporting a Private Members Bill—The International Development (Reporting and Transparency) Bill—which, should it become law, would establish a clear framework for reporting on UK international development expenditure and policy, including progress towards the Millennium Development Goals and the UN target of 0.7 per cent for official development assistance as a proportion of gross national income.

Progress will also be monitored within other institutions and processes, such as the G8, the EU and the African Partnership Forum (APF). The UK is committed to strengthening the APF so that it can monitor, review and report on progress towards delivery of the respective commitments by Africa and its development partners (not just the G8), on the basis of a Joint Action Plan. The Government hopes the Plan will be approved at the next APF on 4–5 May. As one of the 2005 APF Co-Chairs, the Department for International Development, on behalf of the UK, has been closely involved in the development of this Plan and the Government remains fully committed to this process.

However, the monitoring of progress alone will not ensure the delivery of commitments. The priority now is to translate high-level political commitment into strengthened delivery on the ground, which will require developing countries to develop detailed, ambitious and costed plans. The UK will continue to encourage countries to produce these plans, and is committed to provide full funding for them, alongside other donors. The International Finance Facility for Immunisation will play an important part in the increased vaccination of children. As more developing countries produce ambitious and fully costed MDG plans, the case for the full International Finance Facility will be ever more compelling for those donor countries who cannot afford to meet their aid commitments in any other way.

Trade reform remains vital, and the UK government remains committed to ensuring that the Doha Trade Round delivers concrete benefits to the world's poorest countries. Progress made at the Sixth WTO Ministerial Conference in Hong Kong was limited and did not meet the UK's level of ambition; agreement was reached to end all agricultural export subsidies by 2013, to grant duty-free and quota-free market access to Least Developed Countries on 97 per cent of tariff lines by 2008 and on committing to trade

related capacity building for developing countries, yet the overall outcome of the Ministerial Conference was disappointing.

The UK will continue to work with EU and WTO Member States towards an ambitious and pro-development conclusion to the Round. Action is needed to deliver significant increases in market access for developing countries, to end export subsidies, to substantially reduce all trade-distorting domestic support, and to provide effective special and differential treatment to enable developing countries to capture the gains from trade. All WTO members need to maintain commitment to the Round so that we can deliver on the promises of Doha without lowering the level of ambition.

The recent past

4. After above trend growth in 2004, growth has moderated during 2005. A number of reasons for lower growth were put forward by witnesses, including high and volatile oil prices, rising interest rates, weak eurozone growth, slower growth in real government consumption, increasing tax revenues and weak earnings growth, as well as national accounts revisions. Overall GDP growth for 2005 is now estimated by the Treasury at 1.75 per cent, significantly below the Treasury's forecast of 3 to 3.5 per cent at the time of the Budget. We note evidence from the labour market and business surveys suggesting growth might be revised upwards and that non-oil output growth has strengthened from the trough at the start of 2005. We also note that, despite its relatively large forecast error in 2005, overall the Treasury has had a good forecasting record for GDP growth in previous years. (Paragraph 10)

The 2005 Pre-Budget Report stated that, last year, the UK economy faced: sharply higher oil prices; further weak growth in the euro-area, the UK's main export market; and weaker than expected average earnings. At the time of the 2005 Pre-Budget Report, these were some of the main identifiable economic factors explaining why GDP grew more slowly in 2005 than forecast at the time of the 2004 Budget. In addition, GDP data revisions for 2004 arithmetically deducted from forecast growth in 2005.

Treasury economic forecasts have, on average, outperformed the independent consensus since 1997 and the Treasury was not the only forecaster to downgrade its projections for GDP growth since Budget 2005. At the time of Budget 2005, the independent consensus was forecasting growth of 2.5 per cent for this year—by the time of the 2005 Pre-Budget Report this had been revised down to 1.7 per cent. Growth for 2005 as a whole was 1¾ per cent, exactly in line with the 2005 Pre-Budget Report projection. However, business surveys have persistently suggested stronger growth over the past year than shown by current ONS estimates and there is uncertainty about the degree to which the UK economy has slowed since early 2004.

Macroeconomic stability

5. We note the confirmation that over the past six years the United Kingdom has been the most stable economy in the OECD and G7, a record that international

institutions have described as “impressive”. We note evidence that the institutional arrangements for monetary and fiscal policy have played an important role in delivering this stability. (Paragraph 11)

The Government welcomes the Committee's comments on the stability of the UK economy in recent years.

Monetary policy

6. In a period of high and volatile oil prices, the Monetary Policy Committee of the Bank of England has so far managed to keep inflation close to the target. So far there is little indication that inflation expectations have become dislodged or that there are significant second round effects stemming from the rise in CPI inflation. However, this is a risk that will require close examination by the MPC in coming months, particularly as the results of pay rounds filter through in the early months of 2006. (Paragraph 15)

We welcome the Committee's comments on the performance of monetary policy.

Measuring service sector output

7. Measuring output in the service sector is inherently more complex than in the manufacturing sector. We recommend that the ONS make it a priority to review the measurement of service sector output, and devote more resources to improving measures of service sector output. Any such change should be accomplished as far as practicable within existing budgets and without increasing overall compliance costs on business, by rebalancing coverage away from sectors of the economy of declining importance. (Paragraph 16)

ONS accepts that it needs to continue shifting the focus of economic statistics towards the service sector, building on the Atkinson Report on public services and the Allsopp Report on services more generally. The service sector, both private and public, accounts for about three quarters of the economy as a whole.

Since the early 1990s, ONS has gradually extended the range and quality of statistics on the service sector. The collection of turnover data and price data from businesses was established during the 1990s and around 30,000 businesses are now surveyed on a regular basis. A programme to develop a monthly Index of Services (IoS) was set up in 1999. The IoS was launched as an experimental statistic in December 2000. The ONS is currently working towards upgrading the IoS from experimental to full National Statistic status by early 2007. A paper summarising progress and future developments will be published shortly.

A strategy for addressing the remaining imbalance between the manufacturing and services sectors was set out in 2004 in the Allsopp Review of Statistics for Economic Policymaking. The Allsopp Review identified the remaining gaps in the collection of

data on the services sector, in particular the lack of a survey of service sector sales by product (SERVCOM) and the imbalance between trade in goods and trade in services. The ONS's ability to shift resources from manufacturing to services is to some extent constrained by EU statistical regulations; the need to reprioritise from manufacturing to services was a major theme of the UK Presidency. In developing service sector statistics ONS will seek fully to exploit administrative data to minimise the impact on business compliance costs.

In parallel, ONS recognised that steps needed to be taken to improve the measurement of public services output. Not only does spending on these represent a fifth of the whole economy, but at the same time citizens and taxpayers need better information on whether they are receiving value for money from these services. Accordingly, in December 2003, the National Statistician asked the then Warden of Nuffield College, Oxford, Sir Tony Atkinson, to conduct an independent review of the way public services output and productivity were measured in the National Accounts. Sir Tony's final report was published in January 2005 and set out a range of recommendations. The National Statistician broadly accepted Sir Tony's recommendations and announced he was setting up the UK Centre for the Measurement of Government Activity, increasing resources in this area, to respond to the challenges set out by the Atkinson Report.

As a result of the Atkinson Review and follow up work, significant improvements to the National Accounts were introduced at the time of the 2004 and 2005 Blue Books. Further development work is ongoing. In addition, ONS now publishes a series of 'Productivity Articles' intended to discuss the measurement of productivity of the key public services in detail. The first article, relating to the Health Service, was published in October 2004. A further article, relating to Education, was published in October 2005 and the second Health article will be published on 27 February. Further articles on Social Protection and the Criminal Justice System will be published later this year

Consumer spending and the housing market

8. Consumer spending growth slowed sharply during late 2004 and early 2005. The evidence we have received indicates that this was due to rising interest payments, lower than expected wage growth, higher petrol and energy prices slowing disposable income growth, and an increase in the ratio of tax to household disposable income. The MPC cut short-term interest rates by 25 basis points in August 2005 and the tax ratio is not expected to continue to increase at recent rates. This may lead to a moderate recovery in consumption growth, but to a rate that is still below its long-term average. (Paragraph 19)

Paragraphs A.85 and A.86 of the 2005 Pre-Budget Report set out the Treasury's assessment of the slowdown in private consumption growth since mid-2004:

“A number of factors have acted to slow private consumption growth. As expected, households have continued to adjust to continued high levels of personal debt and the lagged effects of increases in interest rates between late 2003 and summer 2004. Also, as

expected, house price inflation has moderated to low rates, with house prices broadly flat for much of the past year and a half, which will have curtailed the opportunity afforded by rising house prices for householders to liquidate funds through mortgage equity withdrawal without reducing their proportionate equity in the housing market. Non-householders, though, may have reacted by showing less urge to increase saving for future house purchase.

In addition, unforeseen increases in oil prices have contributed to unexpectedly weak growth in real household disposable income, with the direct effects of increases in fuel bills and petrol prices estimated to have cut real income by up to ½ percentage point in the year to mid-2005. Earnings growth has also remained unexpectedly subdued over the past year.”

9. We note that the Treasury's forecasts for consumption growth are based on an assumption that the savings ratio will stabilise at 4¾ per cent, which is around its current level. (Paragraph 20)

As paragraph A.89 of Pre-Budget Report 2005 states “Despite household consumption slightly outpacing disposable income, the saving ratio is expected to be broadly stable over the forecast horizon at just above its average over the recent past, reflecting the assumption that households net equity in pension funds continues to increase at recent rates.”

The Treasury will produce an updated forecast and assessment in the 2006 Budget.

The Government is committed to promoting saving and asset ownership for all, across the income spectrum and throughout the life cycle. The Government's plan is based on: the Child Trust Fund, Individual Savings Accounts, the Saving Gateway, Stakeholder savings and investment products, and improving incentives in the benefit system. The Government is also promoting financial inclusion and education.

10. The recent signs that the housing market is cooling, with house price growth slower than earnings, are welcome and this, so far, has come without the abrupt adjustment predicted by some forecasters. In the longer term, the implementation of the recommendations from the Barker and Miles reviews should improve the stability of the United Kingdom housing market. We note evidence that, while the majority of households can manage their debt repayments, there is a small, but significant, minority of households with problems with increased mortgage arrears and unsecured debt on credit and store cards. (Paragraph 22)

(i) Housing

Through its response to the Barker Review, the Government signalled its commitment to build more homes for future generations by bringing forward an ambitious package of measures to reform the planning system and deliver increased investment in infrastructure to support sustainable housing growth. The Government's response announced:

- its ambition over the next decade to increase new housing supply in England to 200,000 net additions per year, compared to around 150,000 now;
- reforms to the planning system to make local and regional plans more responsive to housing markets and increase land supply;
- a cross-cutting review in the run-up to the 2007 Comprehensive Spending Review (CSR) to co-ordinate infrastructure provision across departments;
- consultation on the Government's response to Kate Barker's recommendation for a Planning-Gain Supplement (PGS) to help finance infrastructure and ensure that local authorities share in the benefits growth brings;
- a commitment to set out ambitious plans for increasing social housing supply at CSR07, with new investment alongside efficiencies and innovation in provision; and
- further measures to ensure the environmental sustainability of new housing.

These proposals will help extend home ownership to another 1 million people in the next 5 years and help move towards the Government's aspiration of 75 per cent home ownership.

(ii) Consumer debt:

The Government aims to provide a framework of macroeconomic stability and awareness of financial issues within which people can make informed, responsible decisions about how much debt it is prudent to incur.

Although there was a rise in the number of mortgages in arrears in 2005, those in arrears as a proportion of all mortgages outstanding remains close to historic lows. Indeed, only 0.28 per cent of mortgages are in arrears, below the average of 0.63 per cent, since 1970.

Unsecured consumer credit is now growing at its slowest rate for 11 years. Although the level of personal insolvencies has risen, the majority of individuals use credit effectively, with only 1 person in every 1,000 affected each year. The insolvency rate for England and Wales is less than a fifth of that in the US. Much of the rise has been due to 'Individual Voluntary Arrangements' as opposed to Bankruptcy orders, which enable debtors to come to agreement with their creditors.

Moreover, 'Tackling Over-indebtedness—Annual Report 2005', published by the Department for Trade and Industry in August 2005, provided an update on the large amount of work which has been undertaken by Government, independent regulators, the credit industry, academia and consumer groups to tackle the issue of problem debt, and set out strategic objectives and policy priorities for the future.

Business development and pension funds deficits

11. The growth of business investment has been modest in recent times compared with previous periods of economic recovery. The need for companies to devote additional resources to pension funds may have been a factor in this. Initial evidence from the Bank of England indicates that, in the years leading up to 2002, companies mainly adjusted to these financial pressures by reducing dividends rather than cutting investment. The Pensions Regulator and the Treasury need to assess carefully the impact of the new regulations on pension funding and of other requirements arising from the Pensions Act 2004 and the effect they could have on investment by and the solvency of companies affected and place a copy of their assessments in the Libraries of both Houses. (Paragraph 24)

As set out in Annex A of the 2005 Pre-Budget Report, recent muted business investment growth is likely to reflect a number of factors. One example given was “Weak growth in private consumption and continued weakness in the UK’s key European export market has probably encouraged companies to adopt a cautious approach to capital expenditure.” Another was

“The impact of high oil prices on potential profitability is also likely to have been a factor discouraging stronger growth of private investment, especially within industries where the production process is particularly oil-intensive.”

These factors are likely to continue to have a dampening effect on firms’ capital expenditure in the near term. However, with corporate profitability strong and the cost of capital and credit conditions supportive, underlying conditions remain in place for growth to pick up on the back of stronger domestic and external demand later in 2006 and into 2007.

It is also important to note that business investment estimates are often subject to considerable revision over time, reflecting both regular revisions (e.g. as a result of ONS receiving late survey results) and more fundamental improvements to data collection and measurement. Indeed, as the ONS’s recent press release on software investment shows, such revisions can significantly alter our understanding of the economy—in this case implying higher levels and growth rates of investment and GDP than previously thought.¹

In terms of ‘assessing carefully the impact of the new regulations on pension funding and of other requirements arising from the Pensions Act 2004,’ it should be recognised that the new scheme specific funding regime has yet to bed in. As it does, the Government will continue to take a close interest in its operation and the wider effects on business and the economy in general. The Government will also continue to monitor and assess the implications of pension fund deficits and associated regulation for business investment and solvency.

It should also be remembered that the regulation of the scheme specific funding regime is the responsibility of The Pension Regulator (TPR) which is an independent body operating within the policy framework developed by the Department for Work and Pensions and

¹ Available on the ONS website, www.statistics.gov.uk/pdfdir/newec0206.pdf

enacted by the 2004 Pensions Act. Last year TPR commissioned PricewaterhouseCoopers to look at possible impacts on business, including on company cashflows and solvency, to help inform TPR's proposals for its regulatory approach to the scheme specific funding regime.

Subsequently TPR engaged in extensive consultation with business and others in developing a Code of Practice and guidance on the funding regime and TPR's approach to regulating it. Copies of the full PwC Report together with a note on the context of the work have been placed in the libraries of both Houses of Parliament.

Of course, there are a range of factors that may influence levels of contributions to pension schemes including movements in underlying global asset prices, the extent to which past contribution holidays have been taken by sponsoring employers, increasing transparency and standardisation of pension fund accounting by professional bodies through the adoption of FRS17 (now IAS 19) as well as the approach taken by regulatory bodies.

The TSC noted the up to date robust analytical work on pensions deficits (published in October 2005) by the Bank of England.² The authors of this paper state that the econometric evidence (that goes up to 2002) of adjustment primarily by dividends is 'consistent with most of the literature.' This was consistent with simple theory where new investment opportunities are affected primarily by expected future rates of return and the cost of capital.

This is however a complex area and other work—takes a different perspective.³ The Government will continue to watch the evidence closely.

Oil and gas prices

12. We recommend that the Treasury investigate the extent to which the negative effects on growth of higher oil prices were greater in the United Kingdom than in the other major G7 economies and report on the outcome of those investigations at the time of the 2006 Budget. (Paragraph 25)

As set out in the 2005 Pre-Budget Report, one of the key developments for the UK economy last year was the sharply higher oil price. Budget 2006 will include an updated assessment of the impact of sustained higher oil prices on UK and world prospects.

13. Ensuring adequate energy supplies, without unnecessary volatility in prices, is essential to the health and strength of the United Kingdom economy. We look forward to learning of the outcome of OFGEM's call for an investigation into the use of import capacity for gas and consider that the Government should accelerate its work with the European Commission and other Member States to encourage liberalisation of continental energy markets. (Paragraph 27)

2 Available on the Bank of England's website, www.bankofengland.co.uk/publications/workingpapers/wp276.pdf

3 Available on the CBI website, www.cbi.org.uk/ndbs/press.nsf/0/7b266168c876364380256d6d0026747d?OpenDocument

The Government agrees with the Committee's view that working with the European Commission and other Member States is essential to encourage European energy market liberalisation and deliver secure, reliable and sustainable supplies of energy into the UK. The lack of effective competition in European energy markets was one of the key drivers of the high energy prices in the UK this winter. The Government is pleased that following OFGEM's request, supported by the Chancellor of the Exchequer and the Secretary of State for Trade and Industry, the European Commission has agreed to investigate why more gas has not been flowing from the European continent to the UK.

The Government also welcomes the interim report published recently by the Commission on competition in EU energy markets ('Sector Inquiry under Art 17 Regulation 1/2003 on the gas and electricity markets', Preliminary Report, European Commission 16 February 2006) and stands fully behind the Commission's stated intention to pursue anti-trust actions against firms that have been found to act anti-competitively.

During the December Energy Council under the UK presidency, European energy ministers confirmed that secure supplies of electricity and gas, delivered on open, transparent and liberalised markets are crucial for Europe's competitiveness and agreed on the need for more work on implementing existing legislation and on releasing more information to the market. The Government will continue to work with Member States and the Commission to ensure that liberalisation of European energy markets remains a priority, in particular during the discussions on the development of a common European energy policy.

The labour market

14. The United Kingdom labour market continues to perform strongly, with employment growing despite the slowing in output growth. We note the anecdotal evidence we have received suggesting that migration into the United Kingdom has played a role in relieving skills shortages and moderating wage pressure. We recommend that the Government consider commissioning research into the economic effects of migration and the extent to which it has relieved skills shortage and moderated wage pressures in individual sectors. We further recommend that the Government report on the initial outcome of such research no later than the 2006 Pre-Budget Report. (Paragraph 31)

The Government continues to conduct research into the economic effects of migration. The Home Office commissioned research on the labour market effects of migration, with a report being published on their website in 2003 and in the Economic Journal. The Department of Work and Pensions (DWP) has also published a report on the effects of increasing migration from the countries that have recently joined the European Union. The DWP has also started a research project with Dr Sara Lemos from Leicester University to build on this earlier work. Initial results are expected to be published soon.

As part of its ongoing assessment of the UK economy, the Treasury closely analyses developments in the UK labour market and their wider economic implications.

15. We note the conclusions of the Leitch Report that, despite improvements in recent years, the "United Kingdom does not have a world class skills base". Evidence suggests that there is particularly room for improvement in the areas of intermediate and vocational skills and we welcome the roll out of the National Employer Training Programme. This is likely to require long-term solutions and we welcome the opportunity offered by the Leitch Report and the Comprehensive Spending Review to examine and take forward those solutions. (Paragraph 32)

Improvements in the UK's skills base are central to improving productivity, employment and delivering a fair society. Despite significant improvements in recent years, the Leitch Review interim report makes clear the scale of the challenge posed by global changes and the need for still more ambition. The Government agrees with the Committee that achieving the improvements necessary in the UK's skills base will require long-term solutions. Like the Committee, the Government believes that the Leitch Review offers an excellent opportunity to deliver these. Improvements in the numbers of people with vocational qualifications and the nationwide rollout of the National Employer Training Programme are, as the Committee notes, likely to be critical to meeting this challenge. The Government looks forward to the final report of the Leitch Review, due in 2006.

The degree of spare capacity (the output gap)

16. There is considerable uncertainty about the amount of spare capacity in the United Kingdom economy. This is due to recent developments in a number of areas including international migration, oil prices and the measurement of government output. The Treasury believes that the slow growth during late 2004 and early 2005 has led to the emergence of a sizeable negative output gap. Other forecasters including the IMF and OECD believe that the output gap is smaller. The Treasury should continue to take a cautious view of trend growth. We note that the Treasury has departed from its previous practice of a three year rolling review by delaying the NAO audit of the trend growth assumption until Budget 2006. It is important that, regardless of any future changes to the Treasury's assessment of the timing of the economic cycle, the NAO is invited to audit the trend growth assumption at the time of Budget 2006. This audit should assess whether developments between the fourth quarter of 2001 and 2006 support the Treasury's assessment of trend growth of 2¾ per cent over that period. (Paragraph 36)

The Pre-Budget Report acknowledged the uncertainties surrounding the current output gap estimate. The public finance projections continue to be based on a deliberately cautious annual trend growth assumption that is ¼ percentage point lower than the neutral view, and The NAO has been invited to audit the trend growth assumption at

the time of Budget 2006 (as was stated in paragraph 2.31, page 22 of the 2005 Pre-Budget Report.)

The fiscal policy framework and the fiscal position

17. The sustainable investment rule complements the golden rule in that, at least as far as the current cycle is concerned, it is subject to annual measurement rather than measurement over an economic cycle. (Paragraph 49)

The Government agrees that the Sustainable Investment Rule complements the golden rule. Together they ensure the long-term sustainability of the public finances, and protect capital spending while maintaining net debt at a stable and prudent level.

18. We welcome the decision of the Treasury to invite the NAO to examine the reasonableness and caution of the Treasury's view on the end-date of the last cycle and the Treasury's intention to ask the NAO to conduct a similar exercise when the Treasury has made a firm judgment about the close of the current cycle, but this should be conducted and published alongside the Treasury's announcement of that judgment. We note the view of the IMF that the NAO's involvement puts the United Kingdom "on the frontier of institutional development". However, the limitations of the NAO's involvement must also be recognised in that the scope of the NAO's activities is determined by invitations from the Treasury. (Paragraph 54)

The NAO plays an important role in auditing the key assumptions underpinning the fiscal projections, ensuring transparency. The NAO has a formal role under the Code for Fiscal Stability, which requires the NAO to audit any changes to the key assumptions underlying the fiscal projections. In addition, since Budget 2000 the NAO has been asked to carry out a rolling review of key assumptions before each Budget and Pre-Budget Report to ensure those it audited three years previously remain cautious and reasonable.

In the 2005 Pre-Budget Report the Government made clear the NAO would be invited to audit the end date of the current and future economic cycles once the Treasury had made a firm judgement. It is the Treasury's intention that this would take place as soon as practicable after a firm judgement was reached. The NAO audited the end date of the previous economic cycle alongside the 2005 Pre-Budget Report, the first opportunity following the publication of UK Economic cycles (July 2005) which updated the Treasury's view of the last economic cycle. In this case, the NAO concluded that "though there are many uncertainties, there are reasonable grounds to date the end of the previous cycle to 1997," and that it would "not reduce the extent of caution in making the fiscal projections".

The NAO's role in auditing the assumptions underpinning the fiscal projections ensures transparency and responsibility in the process. It is, however, vital that the Chancellor remains clearly and fully accountable to Parliament for the projections made.

19. The start of the new cycle now seems less imminent than when our predecessors last considered the matter, but a review of the fiscal rules in the near future would be timely. There is strong evidence to suggest that clearly stated and measurable rules assist in the conduct of fiscal policy and help to enhance transparency. Although the golden rule has proved of considerable value to date, there is a risk that, as the final years of the current economic cycle are approached, too much emphasis is placed on immaterial or technical matters rather than the rule being used to assess whether Government policy has been broadly appropriate and fair over the medium term. The golden rule's focus should be on ensuring that fiscal policy is sustainable on a forward-looking basis, rather than encouraging changes to tax levels or spending now as a consequence of data revisions relating to levels of growth several years ago. There may be merit in seeking to supplement the golden rule with a rule or statement of policy that governs fiscal policy during the period when it seems likely that the economy is passing from one cycle to another. (Paragraph 55)

The Government already has both short and medium term fiscal policy objectives set out in the Code for Fiscal Stability. Over the short term, the Government's objectives are for fiscal policy to support monetary policy by allowing the automatic stabilisers to help smooth the path of the economy. Over the medium term, the Government's objectives are to ensure sound public finances and to ensure that spending and taxation impact fairly both within and across generations. The two fiscal rules provide benchmarks against which fiscal policy can be judged.

The golden rule ensures fairness for future taxpayers, ensuring that current spending is financed by current taxation over the economic cycle. This rule is assessed by the average surplus on the current budget, and along with the sustainable investment rule, is being met in the current cycle.

Fiscal policy is made in a forward looking way, as is made clear by the extensive use of projections in the 2005 Pre-Budget Report, covering the five years to 2010–11. For example, the Government reports on whether the golden rule, using cautious assumptions, is set to be met after the current cycle ends on the assumption that the economy is on trend. It reports on projected performance against the golden rule in a cautious case of trend output being lower by 1 percentage point to stress test the projections.

The 2005 Pre-Budget Report showed that the Government is on course to meet the fiscal rules in the next cycle. The current budget is in surplus from 2008–09 until the end of the projection period, and is projected to have an average surplus over that period of $\frac{3}{4}$ per cent of GDP. At this early stage and based on cautious assumptions, the Government is therefore on course to meet the golden rule after the end of this economic cycle. Moreover, caution in NAO-audited assumptions rises over projection period, so the safety margin against unexpected events is larger in the later years of the projection.

20. While criticisms of the arbitrary level of the limit imposed by the sustainable investment rule as interpreted during the current cycle have some merit, these do not outweigh the essential role that the rule plays in ensuring that Government expenditure and investment today do not lead to an unfair or unsustainable burden on future generations. Before the current economic cycle is declared closed, we recommend that the Treasury state whether, during the subsequent economic cycle, it proposes to interpret the sustainable investment rule as requiring that net debt be maintained below 40 per cent of GDP in each and every year of the next economic cycle. (Paragraph 56)

The Government agrees that the sustainable investment rule, alongside the golden rule, is successfully ensuring that fiscal policy remains sustainable and does not leave an unfair burden of debt on future generations.

Revenues

21. The overall shortfall in tax receipts for 2005–06 compared with the level of receipts forecast in Budget 2005 appears moderate given that the Treasury's forecast for GDP growth for 2005 was reduced from 3 per cent to 3½ per cent at the time of the Budget to 1¾ per cent at the time of the 2005 Pre-Budget Report (Paragraph 57)

As noted in the Pre-Budget Report, the receipts shortfall for 2005–06 relative to the Budget 2005 projection was less than would be expected given the slower economic growth. The resilience of receipts growth in part reflects higher North Sea revenues and the strong performance of the financial sector, which has not been affected by the slower economic growth in the same way as the rest of the economy.

22. Given that uncertainties remain in the global economy, we encourage the Treasury to monitor developments closely to ensure that its forecasts of corporation tax remain realistic. (Paragraph 58)

The Government continues to monitor developments in tax receipts, including corporation tax receipts. Table B12 in the Pre-Budget Report indicated that an acceleration in receipts growth of corporation tax was expected in the remaining months of 2005–06, mainly due to North Sea receipts.

The judgment in the Pre-Budget Report was that non-North Sea corporation tax would continue to record strong growth in 2006–07, helped by a healthy financial sector and the impact of anti-avoidance measures announced in recent Pre-Budget Reports and Budgets. Thereafter, growth in non-North Sea corporation tax receipts increase broadly in line with the economy as a whole.

23. Given the uncertainties over oil prices and oil price volatility during 2005, an estimation error of only around £3.7 billion (or 0.8 per cent of current receipts) appears to be an improvement on the Treasury's forecasting record in recent years. However, the Treasury has now over-estimated receipts for five consecutive years. It

is important that official forecasts for tax receipts avoid any systemic bias either to exaggerate or underestimate revenue receipts, particularly towards the end of the economic cycle when forecasts are likely to come under particular scrutiny. (Paragraph 61)

To guard against assuming an over-optimistic trend in receipts, the Treasury bases its forecasts on cautious assumptions, audited by the NAO.

The 2005 End of year fiscal report, published alongside the Pre-Budget Report noted that the year ahead net borrowing forecasts made since the introduction of the new framework have been on average cautious.

Expenditure

24. We note the Government's commitment to a sustained increase in capital spending in the period to 2007–08 and we look forward to examining proposals in the Comprehensive Spending Review to maximise the effectiveness of capital spending. We will continue to monitor how the Government delivers on its plans for increased net investment expenditure. (Paragraph 63)

The Government welcomes the Committee's support for its plans to increase capital spending to 2007–08 and to consider in the CSR how to maximize the effectiveness of this investment. Updated outturn figures for public sector net investment are published at Pre-Budget Reports and Budgets.

25. In terms of ensuring the effective control and use of public expenditure, we think that the maintenance of substantial end-year flexibility stocks by departments is an encouraging development. There seems no reason to believe that these stocks will be used quickly or unexpectedly. However, we share the view of our predecessors that the House of Commons should be kept abreast of the position with regard to such stock more than once a year. We recommend that provisional estimates of end-year flexibility stock held by each department be published as part of each Pre-Budget Report and Budget, taking account of amounts proposed to be drawn down in the Winter and Spring Supplementary Estimates respectively. (Paragraph 66)

The Government agrees that there is no reason to expect departments' stocks of end-year flexibility to be used suddenly or unexpectedly. All drawdown of end-year flexibility must be approved by the Treasury and by Parliament as part of the Supplementary Estimates process. Information on stocks of end-year flexibility is published in July each year in the Public Expenditure Provisional Outturn White Paper. It is not possible to publish estimates of end-year flexibility stocks by department earlier than this because it is only at provisional outturn that departments have a robust figure for underspending carried forward from the previous year. However, estimated outturn against Resource and Capital DEL is published at the Budget and these figures give an indication of likely total underspending against plan and therefore of total end-year flexibility carried forward.

26. Although it would be inappropriate to expect Government commitments on the level of public spending between 2008–09 and 2010–11 at this stage, the overall fiscal situation suggests that the Comprehensive Spending Review may take place at a time when public expenditure is not expected to grow at the same pace as during the current planning period. In this context, we welcome the Government's commitment to a two-stage process, with a report on spending challenges to be published in the summer of 2006. We recommend that this report be framed so as to maximise opportunities for discussion within the House of Commons and consideration by its select committees on the spending options and challenges before final decisions are announced in 2007. (Paragraph 70)

The 2007 Comprehensive Spending Review will assess what further public service investments and reforms are needed to equip the UK to meet the global challenges of the decade ahead, such as demographic and socio-economic change, globalisation, technological innovation, global instability and climate change.

The Government believes it is essential that this assessment is informed by a broad consensus about the nature of these challenges and the steps that government and wider society must take to meet them. As the Chancellor announced in the Budget, the Government therefore plans to initiate a national debate to inform the CSR, providing opportunities for the widest possible consideration of these issues.

Efficiency savings

27. Delivering the efficiency savings identified in the Gershon review represents an integral element in ensuring the effective deployment of public money during the planning period covered by the 2004 Spending Review. The headline figure of savings of £4.7 billion reported by the end of September 2005 presented in the Pre-Budget Report is encouraging, but the information in support of this figure should be enhanced in order to strengthen parliamentary and public confidence in the progress achieved. We recommend that future Budgets and Pre-Budget Reports include a breakdown of reported savings by department and by financial year, as well as an analysis of local authority savings which distinguishes savings by sector and by whether or not they are cashable. We further recommend that departments be required, in future departmental annual reports and autumn performance reports, to set out targets by financial year and by programme or theme for meeting their overall targets and to report on progress in relation to such intermediate targets. (Paragraph 74)

The Government's efficiency programme, delivering over £20 billion of efficiency gains by the end of 2007–08, will release resources to front-line public services and improve use of existing resources. The Government welcomes the Committee's recognition that the achievement of £4.7 billion of efficiency gains is encouraging. The Chancellor has reported on the aggregate progress of efficiency gains in the Budget and the Pre-Budget Report as previously recommended by the Committee. Departments report on their

own progress in their Autumn Performance Reports and in their Annual Performance Reports.

Local authorities produce Annual Efficiency Statements that set out the sectors that efficiency gains are achieved in, including the cashable amount of the gains. They are available on the Office of the Deputy Prime Minister website.

Departments have an efficiency target to achieve by the end of 2007–08. There are no interim targets for departments. The 2007–08 efficiency targets are part of the Spending Review 2004 settlement for departments and the Spending Review sets out agreed efficiency targets for each department. Departments report gains in the five key areas identified by the Gershon Review to the Office for Government Commerce. The Government has provided an aggregate breakdown in these five areas.

28. We recommend that, in Budgets and Pre-Budget Reports, the Treasury report on progress towards the Gershon workforce reduction targets from a single baseline in April 2004 and ensure that information is readily available to enable departmental reductions reported on different baselines to be reconciled with such totals. (Paragraph 75)

The Government has set a target for the gross reduction in Civil Service and military posts in administrative and support functions of 84,150 by 2007–08, including the reallocation of 13,550 posts to the front-line. The baseline for measuring workforce reductions has differed because it would have been illogical to penalise departments who have made early progress in delivering their Gershon efficiency gains and workforce reductions. This is the case in a small minority of departments.

SIPPs and pensions simplification

29. In view of the concern voiced by our predecessors and others about the possible impact on the housing market of the previous proposals to permit investment in individual residential property by SIPPs, the revised policy appears appropriate, but the reversal came very late in the day. We recommend that the Treasury examine this episode to ascertain why the likelihood of misuse was not more apparent to it at an earlier stage and whether any unnecessary costs were incurred by the timing of the change of policy. We further recommend that the Treasury report on the outcome of this examination and any lessons it has learned for the future conduct of tax policy in its reply to this Report. (Paragraph 79)

The Government welcomes the Committee's support for its decision to prevent people claiming tax relief on pension contributions made into Self Invested Personal Pensions (SIPPs) for the purpose of funding purchases of holiday and second homes for their or their family's personal use. The Government acted as soon as it became clear that, despite the checks and balances built into the system, a large groundswell of interest had built up with the intention of using tax relief for purchases of property for personal use.

Ministers had made clear that they keep the pension tax simplification rules under constant review and would take action if required.

The Treasury continually examines all aspects of the policy making process to ensure that it reacts swiftly and proportionately to protect tax revenues from abuse and deliver a modern and fair tax system.

Tax Avoidance

30. We welcome the Government's announcement that the non-corporate distribution and zero rates will be replaced with a new single banding set at the current small companies' rate of 19 per cent. We are pleased that the Government has recognised the need for both certainty and simplicity in this area, although it is unfortunate that it has taken it over three years to do so. We recommend that the Government issue clear guidance on the tax rates applicable to small business as soon as possible. This guidance should provide sufficient information to enable those running small companies to assess whether the cost of continuing to operate as a company will now outweigh the available tax savings. It should also provide clear information about the steps to be taken to wind up a company. We also welcome the Chancellor of the Exchequer's announcement that the zero and non-corporate distribution rates will be replaced with a rise in the investment allowances for smaller businesses to 50 per cent. The Pre-Budget Report indicates that, while abolishing the starting allowance is expected to increase tax revenues by £930 million over the next three tax years, the rise in the investment allowance is expected to benefit companies by only £45 million over the same period and there will be a further benefit of £55 million by 2007–08 from the VAT annual accounting scheme. We urge the Government to assess what further measures it can put in place to encourage small companies to retain and reinvest their profits for growth. (Paragraph 83)

The Government welcomes the Committee's support for the changes to small business taxation announced at the Pre-Budget Report. The Government will clearly set out all proposed tax rates for business, including small business, for the 2006 financial year on Budget Day. The Budget Insert issued to companies when they are sent a notice to deliver a company tax return for accounting periods ending on or after 1 April 2006 will have detail on the rates.

The Government considers that decisions on the legal form a business should take should be based on all relevant commercial factors, not purely tax considerations. Advice on choosing the appropriate form for a business can be found on the Business Link website⁴ at. Should a company's directors/shareholders wish to cease a company's business activity, and to put the activity into unincorporated form, the most appropriate way of achieving this will depend on the facts and circumstances of the individual company. For many businesses, the move from incorporated to unincorporated form

4 www.businesslink.gov.uk

will be relatively simple, and the winding up procedure under the Companies Acts may not be the best way of achieving the desired goal in all cases. Detailed information on how to cease a company is available on the Companies House website.⁵

The Government values the significant contribution that small businesses make to the economy and society, and remains committed to providing an environment in which small businesses can succeed and grow. It is pursuing a programme of reform to ensure that the regulatory environment in the UK is effective and well-focused so that businesses can flourish in fair and competitive markets. The Government is also committed to promoting and strengthening the UK's enterprise culture so that more people consider entrepreneurship as a viable career option and ensuring that those who do decide to start-up a business have access to appropriate advice and support.

31. We look forward to the Government providing further detail about its proposals to extend the tax avoidance disclosure regime to “all of income tax, corporation tax and capital gains tax”. We trust that HM Revenue and Customs will ensure that it consults fully and appropriately on the proposals, to ensure that the optimum balance is struck between protecting tax revenue against inappropriate avoidance schemes and ensuring that the disclosure regime does not place an unreasonable administrative burden on businesses. (Paragraph 84)

In extending the disclosure regime, HMRC will ensure that the appropriate balance is struck between protecting tax revenue and administrative burden and will work with the tax community to achieve that.

32. In view of the broadening of the disclosure regime, we recommend that the Treasury state whether it now has any intention to introduce a general anti-avoidance rule. (Paragraph 85)

The Government has previously consulted on introducing a GAAR and concluded that the current approach to avoidance is sensible, proportionate and fair approach. As with all tax policy matters, the Government keeps this position under review.

Other tax issues

33. We welcome the Government's announcement that they are to consult on the introduction of PGS, which should help to deliver the necessary new housing growth in a sustainable fashion. We trust that the Treasury will ensure that it consults fully and appropriately on the proposals, to ensure that the optimum balance is struck between raising revenues to improve local infrastructure, whilst not deterring landowners from selling their land for housing development or compromising appropriate planning safeguards. In particular, we expect that the Treasury to give full consideration to applying lower rates (or a total exemption) for PGS applied to brownfield sites. We also consider that, regardless of the eventual decision on

5 www.companieshouse.gov.uk

introduction or design of the PGS, Government should continue to accord a high priority to securing improvements to the planning system, which currently inhibits the growth in housing supply necessary to keep house prices at an affordable level. (Paragraph 88)

The Government welcomes the Committee's support for consulting on the introduction of the Planning-gain Supplement (PGS) as part of the wider response to Kate Barker's review of housing supply.

As the Committee suggested, the Government has conducted a full and appropriate consultation (ended on 27 February 2006), including the views and expertise of a wide range of private and public stakeholders from all regions and countries of the UK. This included seeking views on how PGS can effectively raise revenue and finance additional infrastructure while preserving incentives for landowners to bring land forward for development. Additionally, views were specifically sought on whether a lower rate of PGS should be applied to brownfield land to support regeneration objectives. The Government will thoroughly consider the responses to its consultation on PGS and discussions with stakeholders will continue.

At the same time, the Government will continue to accord a high priority to securing improvements to the planning system. The Government recently consulted on a new draft Planning Policy Statement for Housing (PPS3) to ensure that local and regional plans are more responsive to housing markets and prepare and release more land to meet future housing requirements. More broadly, the Chancellor and the Deputy Prime Minister have asked Kate Barker to conduct a review of land use planning. This will consider how, in the context of globalisation, and building on the reforms already put in place in England, planning policy and procedures can better deliver economic growth and prosperity alongside other sustainable development goals.

34. We welcome the Treasury's promise of no further increases in North Sea Oil taxation during the life of this Parliament, not least because any subsequent increases might increase uncertainty around future taxation of oil companies and might serve as a disincentive to future investment in the North Sea. (Paragraph 89)

The Government is committed to ensuring that oil companies should receive fair post-tax returns for their risk and investment in the North Sea and the Exchequer should get a fair share of North Sea revenues from what is a national resource. The changes announced in the Pre-Budget Report were subject to detailed analysis to ensure that the North Sea tax regime delivers these objectives and strikes the right balance between oil producers and consumers, by promoting investment and ensuring fairness for taxpayers.

The Government recognises the importance of fiscal stability as an influence on companies' investment decisions, hence the announcement that there would be no further increases in North Sea taxation for the lifetime of this parliament. Alongside this the 2005 Pre-Budget Report also announced the introduction of a Ring Fenced

Expenditure Supplement which replaces and extends the Exploration Expenditure Supplement and uplifts all North Sea expenditure to ensure that the economic value is maintained over time. This is principally targeted at new entrants, a small but important sector for the future of the North Sea. The Government is also aware that there are other aspects of the North Sea tax system that potentially have implications for the stability of the regime in the longer term, and that is why the Government has opened discussions with industry on wider structural issues that are of direct concern to oil and gas companies.

Tax Credits

35. We are concerned that the Government has yet to provide clear and detailed information about precisely how it has concluded that its proposed package of reforms to the tax credits system will produce a combined saving of £250 million in 2007–08 and 2008–09. We accept that the more stringent requirements for claimants reporting information to HMRC should save money. However, it would also appear that the ten-fold increase in the disregard for increases in income, from £2,500 to £25,000, will be costly. We recommend that the Government provide us with a detailed breakdown of the calculations involved in reaching the estimated £250 million saving. (Paragraph 92)

Information on the cost of the package announced at the 2005 Pre-Budget Report was provided in a letter to the Chair of the Treasury Select Committee of 7 December 2005 from Mr Orhial, however, it may help to clarify some points further.

This recommendation refers to ‘combined savings of £250 million’. This is based on the figures contained in the Pre-Budget Report document, which estimated the impact on the Exchequer of the Pre-Budget Report package in the three years from 2006–07 to 2008–09 as -£100m, +£200m, +£50m, implying a net yield of £150 million over the period. However, over the five-year period from 2006–07 to 2010–11 the package actually shows a net cost of £50m thanks to costs of £50 million in 2009–10 and £150 million in 2010–2011 balancing out the earlier yield.

This illustrates the point highlighted in the final two paragraphs of Mr Orhial’s letter: that the way that tax credits are scored on a National Accounts basis means that there are significant timing effects.⁶ Some of the measures involve an Exchequer cost and others a yield, but these accrue at different times and some can take several years for their full effect to be shown in the figures.

There are also complicated interactions between elements of the package announced at the 2005 Pre-Budget Report that make the cost of individual elements meaningless. For example, the cost of the disregard in the absence of all the other measures would differ substantially from its cost as part of the package announced. These overlaps in the costs

6 Treasury Committee, Second Report of Session 2005–06, *The 2005 Pre-Budget Report*, HC 739, Ev 84

of the various elements of the package make any attempt to assign a cost to any one element arbitrary.

36. We welcome the fact that the Government is seeking to improve the operation of the tax credits system by introducing a package of reforms. The reforms are intended to redesign the tax credits system so that, where income rises, tax credits entitlements will almost always remain fixed for the remainder of the year and, where income falls, tax credits entitlements should be responsive to such falls. In effect, the Government is seeking to strike a different balance between an income system which is simple and one which is responsive, with the balance leaning a little more towards a fixed awards system than has previously been the case. Most of the planned reforms will take effect between April 2006 and April 2007. We will continue to monitor the operation of the tax credits system during this period, to assess the extent to which the reforms address the significant difficulties associated with the operation of the system to date. We also welcome the Chancellor of the Exchequer's undertaking that he will continue to review the effectiveness of the tax credits system. We note his statement that he is prepared, if necessary, to adopt a fixed awards system in which tax credits awards are based on last year's income. (Paragraph 93)

The Government welcomes the Committee's undertaking to monitor the operation of the tax credits system as the changes announced in the Pre-Budget Report take effect. As was announced on 5 December, the Government will continue to listen to the case for a fixed annual system, but believes that it is preferable to maintain the current system that flexibly responds to changes in circumstances. Any move to a fixed system would take time to implement and could not promptly react to falls in a family's income. This would make tax credits less well targeted on tackling poverty.

The Pensions Commission

37. We recommend that, as part of Budget 2006, the Treasury publishes a table comparable to Table 4.2 of the 2005 Pre-Budget Report but relating to people that are retired. (Paragraph 95)

The Government welcomes the Committee's interest in understanding better how the tax and benefit systems combine to affect incentives to save as well as to work. Marginal deduction rates (MDRs) are one important way of illustrating the impact of the tax and benefit system on pensioners. As a result of introducing Pension Credit in 2003 the number of pensioner benefit units facing 100 per cent MDRs is 1.3m lower than it might otherwise be. However, if considered alone, marginal deduction rates do not fully capture the full range of factors that might influence individuals' decisions to work and save. These include the costs levied on private saving by providers and the effect of generous tax reliefs offered by the Government, both of which impact on decisions prior to retirement. The Government is bringing forward proposals for pension reform in a

White Paper in the spring and will consider as part of that how best to illustrate the effect of the tax and benefit system on incentives to save.

38. We expect to consider the challenges faced in encouraging saving in communities that have not been engaged with financial institutions or savings products and do not have access to basic banking facilities further during our forthcoming inquiry into financial inclusion. (Paragraph 96)

The Government notes the Committee's intention to consider these issues during the inquiry into financial inclusion. Government departments have submitted evidence to the inquiry as requested by the Committee.

Combating fuel poverty

39. We warmly welcome action taken in the Pre-Budget Report to provide pensioner households with central heating and insulation. While substantial progress has been made in reducing fuel poverty since 1997, the Government needs to assess the impact of recent price rises carefully and take further action where necessary, considering the full range of households that might be in fuel poverty. (Paragraph 97)

The Government takes the issue of rising energy prices, and its potential impact on the number of households in fuel poverty, seriously, and continually monitors the impact of prices on fuel poverty. Government, with other interested parties, has, therefore, taken a range of measures to mitigate the impact of price rises. As welcomed by Committee members, the Government has already announced further assistance to elderly households through the significant additional funding of £300m to tackle fuel poverty across the UK announced in the Pre-Budget Report on 5 December 2005.

We need to tackle fuel poverty across the entire range of vulnerable households. In England, the Government has a target of eradicating fuel poverty amongst vulnerable households by 2010, which, as well as the elderly, includes families with children, and households containing someone who is sick or disabled. Some one million households have now been assisted by Warm Front. Grants under the Scheme are available to elderly households on income support and those on specified disability or income related benefits, enabling them to get a range of central heating and insulation measures. Benefit Entitlement Checks are also available to households if they do not qualify for the Scheme at the time of application or if their dwelling cannot be brought up to a set energy efficiency level.

Energy supply companies also provide a range of assistance to customers as part of their work to deliver their targets under the Energy Efficiency Commitment. In addition, last October they launched the Home Heat Helpline, an industry initiative designed to enable customers to be directed to assistance available to them from their supplier. Customers can also be referred to the Department for Work and Pensions for a Benefit Entitlement Check where appropriate.

Since the Pre-Budget Report all major energy supply companies have announced an increase to their prices. Revised analysis, outlined in the Energy Review consultation, of the overall effects of changes in fuel prices and incomes, excluding consideration of energy efficiency improvements, suggests that the total number of vulnerable households in fuel poverty is likely to rise by around one million households in England between 2003 and 2006. The Energy Review will consider the UK's progress against the medium and long-term Energy White Paper goals, including fuel poverty, and the options for further steps to achieve them and aims to bring forward proposals on energy policy in summer 2006. On fuel poverty, the Review will consider further steps that the government, working with the energy supply industry and other stakeholders, might need to take to meet its fuel poverty goals.

Public sector pensions

40. It is essential that public sector pension schemes ensure value for money for taxpayers. We ask the Treasury to provide more details of the cost savings made under the framework agreement, compared to those projected under the original proposal to increase the pension age to 65 for all public sector workers after 2013. In view of the significance of such schemes and their cost to the economy, we want the Government to provide a summary of progress in each of the sector-by-sector negotiations in its response to this Report. (Paragraph 98)

Following three meetings of the Public Services Forum in 2005, the Government reached agreement with unions on the set of principles that will govern scheme specific negotiations. The UK Government Departments responsible for teachers, civil service and NHS pensions are negotiating on the basis of cost envelopes that will realise the full expected savings from the Government's original proposals (£13bn in total over all three schemes over a 50-year period) and address other long-term pressures. These detailed scheme-specific negotiations and further consultations (which will address issues such as the possibility of switching from a final salary to a career average scheme) should be completed this summer.

i) Ensuring value for money for taxpayers:

The Government agrees that public sector pensions should ensure value for money for taxpayers, which is why it is undertaking one of the most fundamental reviews for decades. Like all employers, the Government is faced with the increasing costs of defined benefit provision as people are living longer. This is the key reason why public sector pensions are undergoing reform.

ii) Summary of progress of sector-by-sector negotiations

It would not be appropriate for the Government to commit to releasing a summary of the position on these negotiations at this point in time as this could undermine the negotiations.

However, the Government will consider whether it will be possible to provide a summary of the position this spring. It is also the intention that Ministers responsible for the particular schemes will produce detailed proposals on which there will be consultation later this year.

iii) Details of cost savings made under the framework agreement

The Public Services Forum principles apply to the reform of teachers', NHS and civil service pension schemes, which currently have a Normal Pension Age of 60. The cost savings made across those schemes will depend on the final decisions made on issues such as pension scheme design for existing and new staff.

The Government secured agreement with the unions that Normal Pension age will increase from 60 to 65 for all new entrants.

- The original proposal was for this change to also apply to the new service for existing staff from 2013.
- The new proposal will effectively exempt existing staff from the pension age changes

The reforms are still expected to save £13billion over 50 years as originally intended. This is perfectly feasible as 85 per cent of the original savings came from new entrants. Even though existing staff will now be exempt from the pension age change, this reform feeds through the schemes quickly due to staff turnover. The Government Actuaries Department has projected that in 8 years time around 1/3 of the workforce will be made up of new entrants and in 20 years around 2/3rds of the workforce will be made up of new entrants.

The Government cannot provide specific details of how spending will be affected at present as this will depend on what is decided about how the schemes should operate in the future. The deal with trade unions did ensure that the original cost envelope will be respected in scheme-level talks, so that if existing staff are exempt from the age 65 change in any of the schemes the savings will be found elsewhere.

The Government are making good progress with the negotiations and expects consultations to conclude in summer 2006. The negotiations are led for the Government by the departments responsible for particular schemes, the Department for Education and Skills, the Department of Health and the Cabinet Office, not HM Treasury.

The Operating and Financial Review

41. We welcome Government measures to reduce the amount of “red tape” faced by business. However part of the Better Regulation agenda relates to consultation with businesses and others, and it does not appear that best practice in this regard has been followed with regard to the recent change of policy on the Operating and Financial Review. We urge the Government to consult widely before changing or

abolishing reporting requirements and, where relevant, the Better Regulation Task Force should be involved in the consultation process. (Paragraph 99)

The Government is committed to ensuring that all regulations are necessary, fair, effective, affordable and enjoy a broad degree of public confidence. By using the BRTF's 5 principles of better regulation—namely proportionality accountability, consistency, transparency, and targeting—as a basis for policy making we are delivering better regulation for business. The Government is also committed to consultation in line with the Cabinet Office Code of Practice on Consultation.

Around the same time that regulations were laid to remove that statutory OFR, the Government asked for comments on the wording of the Business Review to determine whether any changes are needed to clarify its scope and requirements in the Company Law Reform Bill.

In light of the responses to the decision to amend the reporting requirements, the Government has now decided to widen existing consultation to invite views from all stakeholders on the full range of options for narrative reporting. The Department for Trade and Industry is leading this consultation, which closes on 24 March.

Should the Government decide to change reporting requirements, the abridged consultation period will allow for these changes to be reflected in the Company Law Reform Bill, and secondary legislation. For the avoidance of doubt, no such changes would apply to financial reporting periods which had commenced before any new regulations had been passed. This is to ensure that companies have certainty as to their current legal reporting obligations and have adequate time to prepare for any changes. The relevant legal requirement for this financial year remains the Business Review.

The Department for Trade and Industry is leading this consultation.⁷ The DTI engaged with the BRTF during earlier consultation on the Bill and will ensure it does so in developing the narrative reporting requirements in the Bill.

Unclaimed Assets

42. We welcome the announcement of a voluntary scheme for the investment of unclaimed banking assets. We may examine the progress of this scheme in due course. (Paragraph 100)

The Government welcomes the Treasury Committee's support on this issue.

HM Treasury
22 March 2006

⁷ Further details can be found at www.dti.gov.uk/cld/businessreview.htm