The Treasury Committee

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

Current membership

Rt Hon John McFall MP (Labour, West Dunbartonshire) (Chairman)
Nick Ainger MP (Labour, Carmarthen West & South Pembrokeshire)
Mr Graham Brady MP (Conservative, Altrincham and Sale West)
Mr Colin Breed MP (Liberal Democrat, South East Cornwall)
Jim Cousins MP (Labour, Newcastle upon Tyne Central)
Mr Michael Fallon MP (Conservative, Sevenoaks) (Chairman, Sub-Committee)
Ms Sally Keeble MP (Labour, Northampton North)
Mr Andrew Love MP (Labour, Edmonton)
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Mr George Mudie MP (Labour, Leeds East)
John Thurso MP (Liberal Democrat, Caithness, Sutherland and Easter Ross)
Mr Mark Todd MP (Labour, South Derbyshire)
Mr Andrew Tyrie MP (Conservative, Chichester)
Sir Peter Viggers MP (Conservative, Gosport)

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.

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) are on the Internet at www.parliament.uk/treascom.

A list of Reports of the Committee in the current Parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Dr John Benger (Clerk), Sian Woodward (Second Clerk and Clerk of the Sub-Committee), Adam Wales, Jon Young, and Jay Sheth (Committee Specialists), Phil Jones (Senior Committee Assistant), Caroline McElwee (Committee Assistant), Gabrielle Henderson (Committee Support Assistant), Laura Warren and Laura Humble (Media Officer).

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Witnesses

Monday 27 April 2009

Robert Chote, Institute for Fiscal Studies, Roger Bootle, Managing Director, Capital Economics, John Whiting, PricewaterhouseCoopers, and Martin Weale, NIESR

Tuesday 28 April 2009

Dave Ramsden, Chief Economic Adviser, Edward Troup, Director, Business and Indirect Tax, Mike Williams, Director, Personal Tax and Welfare Reform, Peter Schofield, Director, Enterprise and Growth Unit, and James Richardson, Director, Public Spending, HM Treasury

Wednesday 29 April 2009

Rt Hon Alistair Darling, MP, Chancellor of the Exchequer, Dave Ramsden, Chief Economic Adviser, and Mark Bowman, Director, Budget and Tax, HM Treasury

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Oral evidence

Taken before the Treasury Committee

on Monday 27 April 2009

Members present
John McFall, in the Chair
Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins
Mr Michael Fallon
Ms Sally Keeble
Mr Andrew Love
Mr Andrew Tyrie
Sir Peter Viggers

Witnesses: Mr Robert Chote, Institute for Fiscal Studies, Mr Roger Bootle, Managing Director, Capital Economics, Mr John Whiting, PricewaterhouseCoopers, and Mr Martin Weale, NIESR, gave evidence.

Q1 Chairman: Good afternoon and welcome to this session on the Budget 2009. Can you introduce yourselves for the shorthand writer, please?

Mr Weale: Martin Weale from the National Institute of Economic and Social Research.

Mr Bootle: Roger Bootle, Capital Economics.

Mr Chote: Robert Chote, the Institute of Fiscal Studies.

Mr Whiting: John Whiting, Chartered Institute of Taxation and PricewaterhouseCoopers.

Q2 Chairman: Welcome. We have got plenty to talk about today. The Government estimates that the UK economy will begin to grow again towards the end of 2009, registering growth of 1.25% in 2010. Sheer fantasy, Robert Chote?

Mr Chote: My macro forecasting colleagues are better qualified to judge that than I am.

Q3 Chairman: You can tell they never do that at the weekend.

Mr Chote: My macro forecasting colleagues are better qualified to judge that than I am.

Q4 Chairman: Martin and Roger, give us your views on that.

Mr Weale: I suppose I am thinking more about whether this year will turn out to be worse than 1931, which is now looking possible.

Q5 Chairman: Shall we just go home?

Mr Weale: I am only describing it as it is. I would not be surprised to see an element of recovery next year but I do not expect it to lead to growth of 1%, 1.25% or anything like that.

Mr Bootle: I would not totally discount the official forecasts as being impossible but the uncertainties are enormous and we do know that the forecasting community in general has been absolutely dreadful, so my suspicion is that the consensus figure will be wrong one way or the other and it is possible, I suppose, that it will actually be underestimating how strong the recovery will be, but I have to say that is not my first guess. In particular I am struck by the way that in the Budget forecast consumer expenditure is seen as rising. I find that difficult to accept, given that unemployment is going to be rising very sharply and people will be rebuilding their balance sheets, so I think it is optimistic, decidedly so.

Q6 Mr Fallon: Can I just be clear about the effect of the change that has already come out on the contraction in the last quarter of 2008? Is it the case that that now means that to meet the forecast in this year of a contraction of 3.5% there can be no growth at all in any quarter?

Mr Weale: What it means is that to meet the forecast of the contraction of 3.5% we need essentially no or only a very small further contraction. We had the contraction of 1.9% in the first quarter of this year. That needs to slow to something like 0.1% in the next quarter and then output needs to stop falling for the forecast to be met. Obviously, you could have more of a “V” shape. We could have a further fairly sharp fall in output in the current quarter and then a fairly sharp recovery in the fourth quarter, but on average it means we have very little room for a further output fall this year.

Q7 Mr Fallon: Is a recovery in the fourth quarter actually possible, Roger Bootle?

Mr Bootle: It certainly is possible.

Q8 Mr Fallon: Yes.

Mr Bootle: Yes, the fourth quarter of this year?

Q9 Mr Fallon: What, to deliver a contraction of only 3.5%?

Mr Bootle: As Martin was saying, you can get 3.5% if there is flat output for the rest of the year. You can just about get to the Chancellor’s forecast, but if in the present quarter output contracts then, obviously, to get to that same result, you have to have a recovery by the end of the year. It is possible but I think that is going some.
Q10 Mr Fallon: Why do you think the IMF forecast was so different?

Mr Weale: I think a part of the factor was that the IMF and others had done quite a lot of work on the effects of housing-related recessions and recessions connected with financial crises. Their work has shown that those tend to be longer than the other types of recession. I am not sure that that is true in the UK. The pre-war depression lasted for four years. The 1980 depression lasted for four years. The 1990 depression, which was more obviously housing-related, was shorter, but I think that is where the IMF is coming from.

Q11 Mr Brady: Is there any evidence in your view that the temporary VAT cut has worked?

Mr Weale: Could I say there that, as always, it depends what you mean by “worked”. One of the intentions of it was that it would encourage people to buy in anticipation of future price rises. Inevitably, if that effect is there, it will be observed at the end of this year rather than at the moment, so a lot of the effects that I am sure the Treasury were hoping for we would not expect to see yet and that indeed might question whether a reduction was a sensible thing to do if we wanted the stimulus now. Beyond that I do not think you would expect it to have a large effect and my guess is that even with the benefit of hindsight we will not be able to see whether it has actually worked or not. In that sense I think it was probably a mistake in that it was quite a big thing to do, but not so large as to have a clear and visible impact in the data and, as we have seen, it has been swamped by continuing macroeconomic decline.

Q12 Mr Brady: Does anybody take a different view?

Mr Chote: I would be inclined to think that it was probably a more sensible policy to be going in with, but I think the difficulty is discerning what would have happened to the path of consumer spending in the absence of it, and so the idea that one can demonstrate say that this has succeeded or failed on the basis of the evidence we have at the moment seems to me implausible and I am sure PhD students will be failing to resolve this question in 20 years’ time.

Q13 Mr Brady: What is going to happen at the end of the period? There is the possibility that it might stimulate demand leading up to the end once the rate goes back up again. What is the effect of that?

Mr Chote: One of the objectives of the policy would be to try to bring forward spending in anticipation of the increases Martin was mentioning, which would imply that consumer spending will be softer than it otherwise would be the other side of the return to the previous level. Of course, if we end up having VAT rising to different rates as time moves on, then the story could get more complicated yet.

Mr Whiting: If I could add a word from a general business point of view, one side effect is undoubtedly, particularly for small and medium sized businesses, that a number have simply absorbed the cut to offset other cuts that they were making. So, moving aside from the economic impact, it has certainly given a lot of businesses a bit more flexibility as to what to do. It has helped some, and, of course, it has also given them a headache in managing the sheer logistics of the changes, as has been well documented.

Q14 Mr Brady: With a general fiscal tightening anticipated by the Budget, there are various specific industries, and I am thinking of aviation, beer, pubs, bingo, which have seen taxes increase. Have we reached the point for those industries in particular where the tax increases are going to do more damage rather than an increase in revenue coming in?

Mr Weale: Could I say that with beer and, I suspect, gambling, that seems to me rather unlikely. All the evidence is that those are not terribly price sensitive. With aviation we may see a bit more price sensitivity, but, after all, one of the things that presumably we want to do, or at least I infer the Government wants to do, is to discourage carbon dioxide emissions, and a tax that led to a reduction in revenue could have a justification on those grounds.

Mr Whiting: I do a deal of work in the hospitality industry and certainly the economy generally has hurt them, obviously. The extra duty rises are not helpful, so I think they are seeing a bit of a squeeze coming in from all directions.

Q15 Mr Brady: So there may be tax increases that do not yield any increased revenue?

Mr Whiting: It would be hard to disentangle whether it is the effect of the economy that has, of course, cut demand for hotel bedrooms and for meals out, or whether it is the extra rise, but you put them all together and I think you have to recognise that, certainly from what I see of the hospitality industry, business is going down. A bit like the financial sector, it is simply not going to deliver the amount of tax that it has done over the last few years.

Q16 Chairman: Martin, am I correct in saying your organisation was suggesting a second fiscal stimulus, possibly about 2% of GDP? Given the borrowing figures, would you have changed your mind immediately after the Chancellor’s statement last week?

Mr Weale: No, I did not change my mind. The key behind what we were advocating was something which was very visibly one-off, such as a one-off rebate to taxpayers and pension recipients and so on. The argument for it is the same as the argument for the first fiscal stimulus, that in normal circumstances if governments borrow money it has to be repaid in the future and the short-term gains you might think are more or less exactly offset by the long-term losses, but in a recession, when you have people who would like to work and cannot work, that is no longer true, so the argument remains even despite the very large borrowing figures.

Q17 Chairman: Would you say Martin has been very bold in that suggestion?

Mr Chote: The other point to make is that any plausible size of fiscal stimulus along the magnitude that you are talking about there or the one that we
had last time, of course, pales into insignificance in its impact on the path of public sector debt compared to the underlying deterioration. We are looking at a deterioration that is effectively costing us an extra 6% of GDP or more in terms of a structural deficit year in, year out. To then pile on top of that a one-off give-away of 2% of GDP is very small, obviously, by comparison. You can look at this in two ways. One is that you would not even notice it given the rest of the deterioration. The other view that Mervyn King has expressed is that, given how high debt is going to be, it is dangerous to even push it very modestly further.

Q18 Chairman: You would lean towards Martin then?
Mr Chote: I would lean to Martin’s view, yes.

Q19 Chairman: Would you, Roger, because you were advocating the first stimulus in your admirable Daily Telegraph column previously?
Mr Bootle: Thank you. Yes, I was in favour of the stimulus that was announced last November in the PBR. In principle for a time after that I was of the view that it would be right to increase that stimulus come the Budget. In fact, I changed my mind, and I changed my mind because of the emerging news about the sheer scale of the deficit, and I reached a position, which I think is very similar to Mervyn King’s, which is the second interpretation that Robert was putting forward, that is to say, that these numbers are so huge that to attempt to do some good by stimulating the economy now with an extra 1% or 2% or 3% of GDP would actually be quite dangerous in terms of the way the markets would perceive this, and so I reached the conclusion that the best thing was probably to do very little.

Mr Chote: If I can just add to that, I think the key thing is that credibility depends, crucially, on the quality of the plan the Government has in place to repair the underlying problem. I would much rather have a fiscal stimulus and a credible plan to repair the problem than I would have either.

Q20 Nick Ainger: Could we turn to unemployment?
In his statement the Chancellor said that government policy was expected to protect around half a million jobs. Would you agree with that? Is that a valid round figure that you would agree with?
Mr Weale: It depends what you mean by “government policy”, as always. If you compare the situation with what would have been likely to happen if the Government had been trying to balance the budget through this recession then my guess is that more than half a million jobs would have been at risk, so I think it is a perfectly reasonable thing to say that you cannot consider it without saying clearly what the alternative policy was.

Q21 Nick Ainger: The latest figures show that we are just over two million unemployed now. How high do you think unemployment will go before it starts to fall?

Mr Weale: I think it will probably go to above three million now—a gloomier position than I had thought in the autumn. An unknown factor there which will have an impact on unemployment is the extent to which many of the recent immigrants into the country may return home. For example, the Polish economy as far as we can tell seems unlikely to have a slump on the scale of our economy and that may mean that we get significant re-emigration which will reduce unemployment.

Q22 Nick Ainger: We have certainly had information that indicates that at the current level of unemployment about 40% of those that are unemployed are below the age of 25. Do you accept that that is correct, that it is that sort of figure, and that the bulk of the current people who are unemployed are young people rather than those that may be in their thirties, forties or fifties?
Mr Weale: I have not seen the numbers but I find that completely credible. Certainly, the evidence is that the problems occur for the people entering the labour market and also those typically closest to retirement more than for the so-called prime age workers.

Q23 Nick Ainger: So the policies which appear to have been put in place by the Budget are targeted particularly at young people, offering guarantees of jobs and training if they have been unemployed for longer than 12 months, so you would agree, if that is the situation, that that is a sensible policy to follow?
Mr Weale: Yes, I do agree with that.

Q24 Nick Ainger: Finally, do you expect that the measures that have been announced in the Budget will have a real impact on the numbers, either by reducing them so we do not go past the three million or that those policies would be targeted in such a way that young people in particular would be coming off the dole queues a lot sooner than if the policies were not in place?
Mr Weale: My sense is that it would be unlikely that those policies would stop unemployment rising to three million. If you simply think of the time lag involved, that people have to have been unemployed for a year before they qualify, then that in itself allows quite a lot of unemployment momentum to build up as the economy contracts sharply. The policies are a good thing but I do not expect them to keep unemployment below three million.

Q25 Nick Ainger: The largest policy area in terms of cash is of £1.7 billion being made available to Jobcentre Plus. Do you agree that that is the right sort of priority or should it be spent in another way, perhaps supporting businesses or whatever?
Mr Weale: There are questions of what sort of mechanism one wants to use, but I think targeting it at the people who are at high risk of unemployment or have been unemployed for a long time does seem to me a good idea. I think we have a number of other measures in place which in principle should be
helping business, although again it remains to be seen how effective they turn out to be, the various credit schemes and so on.

Nick Ainger: Has anybody else got any comment on the £1.7 billion available for Jobcentre Plus? No?

Q26 Ms Keeble: I wanted to ask about deflation. Would that be you, Robert?

Mr Chote: It would probably be my colleagues here, but fire away.

Q27 Ms Keeble: Do you think it remains the same threat it was at the time of the Pre-Budget Report, that we have a sustained period of deflation?

Mr Bootle: In essence I think the answer is yes. It is true that the recent inflation numbers have been rather disappointing if people were looking for a very sharp fall, the CPI are still only just below three, but all along I think the real deflation danger was misinterpreted by a number of people because what they were focusing on was the chance of the inflation number flipping over to negative territory later on this year, and all along that was going to be a pretty technical thing, that is to say, the effect of the contrast between the falls in the world commodity prices over the last year compared with the rises that had happened before, and in the British case compounded by the temporary VAT cut. The really important issue which had been obscured by all that was in fact always further out in my mind, and it was to do with the behaviour of wages, that is to say, that we might get to a point where average earnings growth got to round about zero or below, and actually our latest numbers were already there, by the way, including bonuses, and at that point with normal productivity growth proceeding, or even slightly less than normal, unit labour costs start to fall. At that point businesses are warranted in cutting their selling prices and the competitive process would deliver that. I have therefore all along thought that the danger was not actually for this year when the recent numbers do not look so good but rather a bit further out, say, in a year or 18 months’ time.

Q28 Ms Keeble: You have not mentioned quantitative easing in that particular equation. Do you see that as having had any role in preventing any sustained period of deflation?

Mr Bootle: No, I do not. I think, as with all the other questions, you have to ask yourself the question what the position would have been without quantitative easing, but so far as one can tell one just looks at the history of bond yield and the behaviour of banks first of all to get clear in what channels is quantitative easing going to work. It seems to me that there are two. One is going to drive up asset prices and the first part of that channel is driving up gilt prices, and it did that for a bit by a bit and then it fell back. It was not spectacular. The second channel is boosting bank lending, that is to say, that all these banks awash with liquidity decide to lend a lot more, or not. There is not a great deal of evidence about either.

Q29 Ms Keeble: I was going to ask a bit more on that, and perhaps, Martin, you would like to come in on this, because it has clearly had an impact on gilts to an extent, which Roger mentioned, but how about the relationship with corporate bonds? There has been quite a lot of discussion in some of the financial press recently about that and I wondered if you feel that the balance of the scheme is right.

Mr Weale: No, I must say that I feel that the balance of the scheme is wrong, that when the policy was set up it was stated that it would focus mainly on buying gilts rather than buying corporate bonds because of the obvious credit risks with corporate bonds that you do not have with gilts. To take a historical analogy, in 1985, admittedly for different reasons, the Bank of England was owning about £15 billion of corporate securities. The economy is now five times as big, so if we multiply by five that would be equivalent to owning £75 billion of corporate securities today, which, of course, is the amount of quantitative easing, so you might reasonably ask if 25 years ago the Bank of England was able to intervene in the corporate debt market on this scale why can it not do it today, and the best answer I can think of, but it is not a very good answer, is that corporate securities are more risky now than they were in the period of recovery after the 1980s recession. I think had the policy focused on the corporate debt market we would have had much more liquidity in that market, the operations of the Bank of England would have to some extent compensated for the unwillingness of the joint stock banks to lend instead of merely creating a bit of extra liquidity and hoping that the joint stock banks would lend, and the corporate bond market might have enjoyed a bit of a revival, businesses might have found that they could issue more corporate bonds and so ease the credit constraints, at least in that part of the corporate sector, so I do think the policy was misapplied.

Q30 Ms Keeble: So what do you think needs to happen from here on in, because what you have put is quite a difficult problem, is it not? On the one hand there is no point the Bank of England purchasing the gilts; it then needs to look at the corporate bonds, and on the other hand the risks of doing that are probably too high, so what do you think should happen? Do you think that the scheme should be extended and, if so, what shape should it take?

Mr Weale: I must say I think the risks are obviously higher than they are with gilts, but how high is too high? After all, we have seen the Government issue all sorts of guarantees to banks and one wonders why they could not extend some of those guarantees to the Bank of England to encourage it to ease up the problems in the corporate debt market.

Q31 Ms Keeble: And that is what you would like to see?

Mr Weale: That is what I would like to see. Everything is a risk for the taxpayer. As Robert mentioned, the numbers are so large that even if the national debt were increased by £75 billion, ie, the whole of it were lost, which, as we have been told
over guarantees to banks, is extremely unlikely, you
would still find that it did not actually have a major
impact on our medium term fiscal problems.

Mr Bootle: On this quantitative easing issue, there is
a very marked contrast between how this policy is
treated in the textbooks and how practitioners,
including central bankers, treat it in practice. In the
textbooks it is, as it were, a pretty much perfect way
out of our difficulties, as a way of avoiding deflation,
anyway, and the reason for that is that there is
apparently no limit to the extent to which a central
bank can go on creating its own money, and so, in
answer to the question, “How much?”, the reply
comes out, “As much as is needed”, potentially
infinity. The practical equivalent in this country to
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Mr Whiting: You allude to a report that our
has produced a report dealing with debt reform in
public services and narrowing the fiscal gap. You
might want to send that to the Committee so it is on
the record, but could you just comment briefly on
cutting tax or completely reconfiguring public
services options? My colleagues are going to ask
about this so I do not want to take all their questions
from them.

Mr Whiting: You allude to a report that our
economics team, which I was slightly involved with
but not a main part of, produced called Dealing with
Debt, and, as much as anything, it was trying to start
a bit of the debate at the beginning of last month on
what is going to be done. I think in summary what
the report was trying to say was that there is clearly
a big deficit. It is of this order. Cutting expenditure
is one option but it seems to be quite difficult to see
how cuts could be made sufficient to close it.
Another option is clearly to raise taxes. It seems
quite difficult to see how taxes could be raised
sufficiently, so, obviously, coupled with a bit of
economic revival, it looks like a combination of the
two, which you may say is not rocket science but that
is perhaps inevitably where we get to.

Q33 Ms Keeble: Thanks. If that goes in then it is on
the record. I wonder who would want to answer
about the impact on developing countries. Robert?
No? Does anybody want to comment in particular
on what the Government should look at doing, given
its commitment both to maintain the total financial
value of our assistance to developing countries and
we also have the commitment on 0.7% of ODI,
which, if you have shrinking output, you can
probably reach quite cheerfully.

Mr Chote: Yes, the Government has made the target
easier to achieve by shrinking the economy; I will
give them that. Obviously, an important issue here is
that when we get to the question of how much of a
squeeze on non-investment spending there is, we
know nothing yet about how that is going to be
divided up amongst departments. If you look at
what we reckon to be a plausible estimate of what the
overall envelope will be for departmental spending in
the next spending review, and if you were to apply
that evenly across all departments, DFID and the
overseas aid department will be the only ones still
seeing a real increase. In terms of savings, obviously,
whether a future government would still think that
was a sensible priority is up to them. It is, albeit
rapidly growing, a relatively small budget and you
cannot make enormous savings from it.

Q34 Sir Peter Viggers: Robert, a sizeable chunk of
the huge public sector borrowing, almost 80%, is
persistent. What should be done to reduce this
structural deficiency in the public finances?

Mr Chote: As you say, roughly speaking, 20% of the
budget deficit of 12.5% of GDP is structural. The
other way to look at it is, if you compare how the
public finances have moved since the Treasury's
forecast in Budget 2008 and now, we have effectively
discovered that we have an additional structural
budget deficit of about 6.5% of national income or
about £90 billion in today’s money. What the
Chancellor did in laying out the projections for
taxation and public spending was effectively a plan
that over eight years you would have a structural
tightening that at the end of those eight years is
roughly the same magnitude, about 6.5% of national
income. That is made up of a number of
components. About 10% of that is achieved by the
tax increases that have already been announced, so
a combination of the income tax increases on the
relatively well off, national insurance increases, the
return of the fuel duty escalator, for example, and
then in addition the Government is anticipating
getting about 15% of that gap filled by cuts in capital
spending over the duration of the next Parliament,
effectively speaking, and about 25% from squeezing
current spending, ie, non-investment spending,
compared to the forecasts in the Budget of last year.
That then leaves about half, which the Treasury is
presuming will come either from as yet unannounced
tax increases or as yet unannounced squeezes on
non-investment spending. They seem to be implying
that the cut in investment that they have in place
over the first four years is as far as you want to go
with that, and thereafter you want to be doing it
either with taxes or with current spending, but
clearly those are broad orders of magnitude divided
into two or three blocks. There is an awful lot of
detail that needs to be filled in there. Most important
of all, of course, is where the pain falls within current spending and within capital spending department by department.

Q35 Sir Peter Viggers: John Whiting, the forecast is very considerably worse than it was in the Pre-Budget Report. To what is the downgrading of the outlook attributable and to what extent do you think it is excusable?

Mr Whiting: I think a lot of decline in the tax revenues is simply a contraction in the economy. It is most marked, as I think many of us predicted, in corporation tax which is showing the follow-through of a real slump in activity in the financial sector, many of the businesses slumping into losses and generating therefore not only no tax but also a negative tax with repayment, and also, of course, a lack of bonuses just feeding through into much lower income tax and national insurance receipts. They are all coming through. Could it have been foreseen earlier? It was all estimates and I think, as with the general economic figures, the figures are growing as time goes on and some of us might say there is still worse to come, certainly on corporation tax receipts.

Q36 Sir Peter Viggers: May I put it to Roger Bootle, you have predicted a peak of borrowing of £230 billion, significantly worse than the Chancellor’s forecast of £175 billion. Why are you so pessimistic and what is Plan B if investors do not respond to the gilt auctions?

Mr Bootle: On that forecast the source of the difference is primarily the more pessimistic view of the economy that I was talking about earlier on. If I believed the Chancellor’s economic forecast, I suspect my fiscal forecast would be largely the same. In my company’s forecast for next year we have the economy continuing to decline by 1% in contrast to the Chancellor’s recovery, and, of course, the year after next he has got the economy growing by 3.5% which I think is much too strong.

Q37 Sir Peter Viggers: What would the effect on public finances be if growth was on your projection, not the Chancellor’s?

Mr Bootle: The difference is £175 billion this year, in our numbers £200 billion, and his £175 billion next year is £230 billion on ours.

Q38 Sir Peter Viggers: Martin?

Mr Weale: Could I say that I think in many ways more of the worry is about the medium to long term, what the normal growth rate of the economy is and where the trend path is than whether we have horrifying figures this year or next year, which we know we are going to get. My concern is that the Treasury is still overestimating the trend rate of growth of the economy. They are assuming 2.75%. Now for the fiscal forecasts they prudently take that down to 2.5%. My sense is that between 2.3% and 2.4% is more realistic. I think the Treasury is still expecting immigration to do rather more to support the economy than I do. I also think their view of the overall level of normal output is a bit higher than mine, and that essentially comes from them seeing the economy being less above trend in 2007 than I do. If you add on to that that some of the assumptions they make, for example, about the recovery in revenue from the financial sector, seem to me grossly optimistic, then when you put all that together you have slightly slower growth stretching out to 2017 but you have a rather large budget deficit persisting even in 2017 and a fairly sharp current account deficit. I think you can quite easily tell a rather worse medium term story and that is more of a worry from than next year.

Q39 Sir Peter Viggers: Finally, the cost of financial sector interventions. The Budget estimated these at between 1.3 and 3.5 of GDP, Goldman Sachs has a central forecast of 6% of GDP and the IMF is even more pessimistic predicting losses of 9.1% of GDP. If the economics forecasts prove to be wrong, what effect will this have on the cost to the Government of the obligations it has undertaken through its takeover of banks and building societies?

Mr Bootle: I think this is one of a number of additional factors that make one feel rather concerned about these figures. The figures are, of course, gargantuan but they do not include what could be some enormous numbers to come from that source, amongst others. I think I am right in saying, and this is somewhat opaque, that what the Treasury has done is it has added its own allowance for losses from its nearest financial market interventions to the borrowing and debt numbers for last year, but I do not think they are included in the tables of fiscal numbers going forward so even on the Treasury’s own estimates of the cost the implications for borrowing could be a fair bit higher.

Q40 Sir Peter Viggers: You did not answer the question about Plan B if the gilt auction fails.

Mr Bootle: I do not think that the gilt auction failing is particularly significant. We had one fail not long ago and it is perfectly possible to have a situation in which a gilt auction fails for whatever reason and yet the demand for gilts is still very strong over a prolonged period. After all, the particular characteristics of both the moment and the stock on offer are relevant here. The bigger question, as it were, is what happens if not just one auction fails but the demand for gilts really does dry up and bond yields shoot up very considerably. Then, of course, the cost of financing this stuff goes up enormously. Ghastly though these borrowing numbers are, we should not forget that it is projected, and on the basis of recent form that is a reasonable projection, that the cost of financing all this borrowing is going to be relatively low. If the costs were to shoot up, and plausibly they could do, then we are in serious trouble.

Mr Weale: Could I just add to that that if markets were concerned about this I would expect to see long-term interest rates rising, the yield on Consols, the yield on War Loan, and so far there is no evidence that long-term investors who would be frightened by it are ditching their War Loan, ditching their Consols because they are expecting 10 year yields to be quite a lot higher in two or three
years’ time. Obviously the market can be wrong, but at the moment the market does not appear to be frightened.

Q41 Mr Breed: Can we just return to this fiscal tightening through the forecast period. From what you have just said, I think you have said you do not believe we have got sufficient detail on what the Chancellor is proposing or what his forecasts are and everything else to give any rational view as to whether he has got the mix right between raising tax, cutting spending, the period of time and everything else. Is that right? Have we got insufficient detail to give some sort of credible commentary on whether the Chancellor in his Budget has actually got his figures right? We can all obviously forecast the forecasts but do you actually believe that we have got sufficient detail to give some reasonable commentary on it?

Mr Weale: I think what is missing from this Budget Statement is the same thing as has been missing from all Budget Statements I have seen: what will be done if things turn out worse than expected. Obviously we all accept the point that the future is uncertain, that is characteristic, and therefore it could seem to me that prudent planning would indicate some sort of way of dealing with things turning out worse. You might say nevertheless, and I can see that point, that it would be wrong for the Chancellor to say now what the balance between taxation and spending is going to be in five years’ time, after all we could have had two general elections between now and then, but some sense of how things might turn out and how the gap could be remedied purely as a guide would be quite helpful.

Mr Chote: The illustrative judgment the Chancellor has taken is that given the size of the hole with which we find ourselves confronted he thinks that trying to fill it over eight years is a sensible time horizon. That is one judgment where we could take a view as to whether that is sensible or not and it is one where I am sure the verdict of the financial markets as reflected in the interest rate at which the Government borrows will be quite important in deciding whether this or a future government feels that timetable needs to be accelerated. If you take the eight year time horizon as it is then specifying precisely now whether an incoming government in 2014 ought to be relying more or less on tax increases versus spending cuts it is understandable that there is a degree of vagueness at this stage and you have to ask if there was a fully detailed plan whether that would be any more credible at that time horizon than leaving the broad orders of magnitude as we have at the moment.

Mr Bootle: In general, usually in normal circumstances I do not think for macro purposes most economists would think it makes a great deal of difference what the precise detail is, certainly within these broad categories—government spending or taxation—and even to some extent between them, that largely it can be left to the politicians to make a choice as to what the appropriate balance is. But, of course, we are not in normal times and I think there is a difference between these policies in the sense that if the public believed that the gap was going to be closed through much higher taxation I could see this having a much greater downward effect, serious effect, on confidence and, therefore, on spending than if the public in general and businesses believed it was going to be closed through expenditure restraint. That is not a particularly orthodox answer and in different circumstances I think it could be proved wrong, but I suspect in the current conjuncture that is the balance of it.

Mr Weale: Could I simply make the point that if we were to move to an economy with 38/39% of national income collected in taxation, that was what we managed with in the early 1980s during the recovery period and no-one could say it was harmful for confidence or harmful for the economy then. Obviously the situation could be different this time round, but my sense is there is scope for further increase in taxation without the economy falling apart should that be needed.

Q42 Mr Breed: Without frightening the horses. Can I just ask have any of you done any study on the impact of PFI commitments in respect of how is going to play within the overall spending of departments and such who have now got pretty substantial stacked up commitments under PFI at the present time?

Mr Weale: I think PFI commitments are a part of the sort of long-term commitments which are starting to get closer to the short-term. My worries are rather more to do with the effects of an ageing population and the implications of that on pensions and so on over the PFI. In 10 or 15 years’ time I think we will be in a situation where we wished our predecessors or at least we had saved more when we were young to cover what are then the government’s commitments.

Q43 Mr Breed: So you do not believe that current commitments are unduly high in terms of what spending plans in the next eight years might be?

Mr Weale: I think looking beyond that there is a risk that current commitments are particularly highly or at least unaffordable given current tax structures.

Q44 Mr Brady: I think Roger has written that he thinks on the current figures it could take 30 or 40 years to go back to the 40% debt to GDP ratio. Do others here feel the same? Are those figures about right?

Mr Weale: Could I say trying to answer that question in some sense focuses on what has been wrong with the fiscal structure. We do not know when recessions come but this is the second time in a 20 year period that we have had a recession that has knocked a hole in the Government’s budget. Over the next 30–40 years you might think it is quite likely that there will be another recession, maybe it will be a 10% add-on to the national debt, maybe it will be a 40–50% add-on to the national debt, maybe our friends at Lloyds’ would say, “Let’s assume it’s between the two”, but what it does mean is once we get back to what we call “normal times” fiscal
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policies should be run with the aim of saving up for the next disaster instead of on the assumption that there will not be any more disasters.

Q45 Mr Brady: Do you think Roger is being optimistic?
Mr Weale: I think Roger is being optimistic because I think there will probably be another fiscal disaster within the next 30 or 40 years. I may even be around to see it!
Mr Chote: The estimate we have done on this is simply to say if you take the sorts of assumptions the Treasury makes about the growth rates of the nominal or cash value of the economy, the interest rates at which the Government can borrow and you assume that other elements of spending and revenue remain the same then you can basically say if the Treasury did extend its own forecasts over this sort of time horizon illustratively you are talking about another 20 years or so to get debt back down again. The key point is obviously I would not put any faith in exactly what year that is going to happen, but it is obviously quite a useful exercise in then confronting different interest rates that the Government might have to borrow and how that can make quite a dramatic difference to the broad shape and how urgent it is to get a grip on the situation before it becomes out of hand.
Mr Bootle: I think the more interesting and important issue here is what the objectives should be and what the speeds should be. I very much hope that we are going to have an effective national debate about this issue because the fiscal rules, as we have seen recently, have done an enormous amount of harm in this country. In many ways they were misconceived, misapplied and they provided a smokescreen for a very destabilising policy. The 40% number that applied to one of the fiscal rules came out of the blue without very much rationale. There is a major policy issue here which needs to be seriously debated, that is to say what is the appropriate destination for that debt ratio, is it again 40% ultimately in 40 years’ time, a generation’s time or whatever, and what is the appropriate speed at which we should be moving towards it.

Q46 Mr Brady: That takes me exactly to the next question that I was going to put. Whether 40% is the right figure or not, if we are taking 40% as the point that we want to get back to, to have a credible path forward for the public finances, how long should we be looking at it taking to get back to 40%?
Mr Chote: Given where we are now, the idea of using the debt limit in the short to medium-term as being a credibility boosting device is unlikely. I think the credibility now focuses very much on whether people believe that the Government or a future government is going to pursue the sort of tightening over the next Parliament, or a bit more than that, that is laid down and deemed to be necessary. At this stage to try to say should we stick in a new debt ceiling at some point and try to establish credibility in that way is doomed to failure. The credibility now is the credibility over the measures and over the response, not over precisely what target you happen to be aiming for.

Q47 Mr Brady: So it is demonstrating the reality of tightening?
Mr Chote: Yes, I think so.
Mr Bootle: I must say I agree with that. The Government describes the temporary fiscal rule as to set policies to improve the current budget each year once the economy emerges from the downturn so that it reaches balance and debt is falling as a proportion of GDP once the global shocks have worked their way through the economy in full. That is a tautology if ever there were one. The rule is to balance the current budget. Once we get around to balancing the current budget I do think, as Robert says, for the policy to be credible we need, I would hope, more of a consensus about how much tightening to have over the next seven or eight years.

Q48 Mr Fallon: Robert Chote, we have to pay interest on all this extra borrowing, what is the interest rate assumption that runs through these borrowing numbers?
Mr Chote: Basically we have seen a sharp fall in the average interest rate at which the Treasury borrows over the last 10 years and it is down to something between 4 and 5% and the Treasury’s assumption is essentially that it stays at the most recent level, so there is no assumption either that the continued flight to quality pushes it further down significantly or there is a loss of confidence which pushes it higher.

Q49 Mr Fallon: Looking ahead for the next four or five years, is that a reasonable assumption? It seems on the low side, does it not?
Mr Chote: You have got these two forces dragging you in opposite directions, one of which David Miles was pointing out earlier in the year in that he assumed there were reasonable grounds for assuming that borrowing costs would remain relatively low largely because he saw buoyant demand from the UK banks for gilts partly for regulatory reasons, partly for the desire for relatively liquid, relatively low-risk assets on the one hand, and then on the other hand you have the concern as to whether there is a loss of credibility pushing it up. His view at the time when we did our Green Budget in January was that there was no reason yet to be alarmed about borrowing costs rising significantly, but clearly there is huge uncertainty either way and this is a classic example of Martin’s case about saying that it is as important to say how you would respond if things turned out differently from the central forecast as it is to whether you believe precisely what the central forecast is.

Q50 Mr Fallon: Would either Roger or Martin like to add to that?
Mr Weale: Could I repeat the point I made earlier that the best forecast I have of future interest rates is what the long-term bond market is telling me and that is saying rates are likely to stay in this 4-5% range, possibly rising very slightly in the distant
future. As I say, the market could turn out to be wrong and if you are selling Consols forward now, if it does turn out to be wrong in that way we will net a nice profit on them.

**Mr Bootle:** I do not think that the Treasury’s assumption is by any means unreasonable or outrageous. Indeed, although there are upside risks there are also some downside risks as well. One of the few optimistic things I think I can say is that I should have thought it was quite unlikely that we would get both a prolonged recession or the absence of recovery which produced even worse borrowing numbers than we have here and, therefore, a vastly increased supply of gilts and lack of demand for gilts at existing interest rates because if we were to get a very, very weak real outturn then that would bring on the deflationary prospect I was talking about earlier on and it would surely underpin a prolonged period of effectively zero short-term interest rates. On that basis I could imagine the demand for gilts being very strong indeed. In fact, historically there are a number of examples of this. It has tended to be when bond issuance has been terribly high that yields have been very low and one particular example of that is Japan in the 1990s, not unlike the position we are currently in—the numbers are slightly different—but at one point, despite the government having a huge deficit, not quite as large as ours but around about 8% of GDP, 10 year Japanese Government bonds fell to a yield of 0.6%.

**Q51 Jim Cousins:** The Bank of England’s view seems to be that we have to tackle the imbalances in the economy and set a course for returning public sector borrowing to a stronger position than the one set out in the Budget, but tax revenues have dependend very heavily on the finance and housing sectors which have been the epicentre of the imbalances. At a macro level, how do we get round that trap?

**Mr Weale:** Could I perhaps try and respond to that by saying that the fundamental problem is that the financial sector was rather good at converting capital gains on housing into things that we thought of as income and the Government was then collecting some of that income in taxation. If the capital gains are not going to be there then the illusory income that can be taxed is not going to be there either and we do have to recognise that future taxation from those sources is going to be much weaker and, equally, people who relied on capital gains on housing prospectively to finance all sorts of things will have to realise that they have to save in the old-fashioned way instead. That is a very substantial change for the economy but the previous trajectory was unsustainable, as we have seen, and aiming to resolve our problems by hoping we get back to it would be a mistake.

**Q52 Jim Cousins:** Where does that leave us at the level of actual tax revenues because if that picture is correct the sectors on which we have disproportionately depended for rising tax yields over the last few years are not going to produce those rising tax yields, in fact they may well be producing a lot less tax? Where does that leave the Government’s tax position?

**Mr Whiting:** As you say, the financial sector in particular is very vulnerable and it is hard to see it getting back to the sorts of yields for the Government that they have done in recent years for many, many years, if at all. The energy sector has been a significant contributor and maybe that will continue, but with the decline in North Sea there is clearly a bit of a risk to the downside in that as well. Housing you have alluded to. The retail sector is depressed. It is difficult to see which sector is going to deliver the increased tax yields that arguably we need.

**Mr Chote:** The assumptions they have made about the long-term hit to the profitability of the financial sector and the revenues that you are going to get from that are clearly part of the set of factors that go together to explain this deterioration in the structural budget deficits of 6½% of GDP. The largest chunk of that is the assumption that Martin mentioned earlier that the Treasury assumes the productive potential of the economy is going to be 5% lower than the Treasury anticipated at the time of the Budget last year, but obviously other factors, such as taking into account the falls in equity prices and house prices and the expectation that they will not bounce back to the levels anticipated at the time of the Budget, and financial sector profitability all help explain that chunk of stuck borrowing that is not going to go away when the economy has returned to normal, whatever normal looks like, in the post-crisis world.

**Mr Weale:** Could I refer you to the graph on page 229, please. This shows what the Treasury identifies as housing and financial sector receipts as a proportion of GDP and, as you will see, the expectation is that after a dip this year they will be 5% lower than the Treasury anticipated at the time of the Budget last year, but obviously other factors, such as taking into account the falls in equity prices and house prices and the expectation that they will not bounce back to the levels anticipated at the time of the Budget, and financial sector profitability all help explain that chunk of stuck borrowing that is not going to go away when the economy has returned to normal, whatever normal looks like, in the post-crisis world.

**Q53 Jim Cousins:** Coming to the housing part of this whole equation about the difficulty with the tax yields, do you think the Government’s £600 million stimulus to the housing market is going to be effective and do you even think it is being spent on the right sorts of things?

**Mr Weale:** I am trying to remember the precise details of the stimulus. The stamp tax—
**Mr Weale:** Yes.

Q55 Mr Love: There is no answer to that!

**Mr Weale:** My worry about some of the measures, such as the extension of the stamp tax holiday, is that they may slow the adjustment of house prices to what many people would regard as a more sustainable level. I think in the same way you can be concerned about measures to facilitate securitisation of mortgages which will presumably facilitate mortgage credit at a time when you can reasonably argue that if people get on the housing ladder now in a year’s time perhaps they are going to be wishing that they had not, that they had waited another year. So I think one can be questionable about those measures as actually being well-targeted. On the other hand, the policy of stimulating building of council housing does seem to be very sensible indeed. You will remember it was a housing boom that helped the economy recover in the 1930s. We have seen a severe housing slump and doing something practical to offset that by encouraging house building is very desirable.

Q56 Jim Cousins: Mr Whiting, do you have views about that?

**Mr Whiting:** I am not sure that the stamp duty holiday helps a great deal given the prices of housing generally. To me, what is more important is the availability of mortgage credit for those who wish to borrow, and as long as interest rates remain low, it can be serviced and the confidence that both will continue. There is the view that what might be worth looking at are some moves towards the longer-term fixed mortgages. My colleagues may have views but for the people I know—I have daughters who are trying to get into the housing market—looking at today’s interest rates they seem reasonable, but the worry is that five or 10 years out they may be going up very considerably. Why do we not have a bigger market of fixed mortgages?

Q57 Jim Cousins: Long term fixes.

**Mr Whiting:** Indeed; whether that would help them, that is going away from my comfort area in pure tax but I just put that in as an observation. I would agree with Martin’s point about stimulating council housing and I just put one tiny matter in my own memorandum which is rent a room relief which would agree with Martin’s point about stimulating the council housing building industry?

Q58 Nick Ainger: Can I turn to the car scrappage scheme. Robert, the IFS has said that only one in seven cars bought in this country are actually manufactured here. Do you think the car scrappage scheme will have the intended effect on the British car manufacturing industry?

**Mr Chote:** One issue as you rightly point out there is the fact that very few cars bought here are produced here. I think what you have to bear in mind though is that there may be UK manufactured content in cars that are imported and, similarly, in terms of cars that are exported from the UK there may be foreign produced components there. I think in those terms actually getting an accurate picture of how much linkage there is and that sort of policy, based on those questions of how much is imported and not, is actually very difficult to do. I think one of the interesting issues with this policy is the fact that the Government has chosen to cap the total cost of the scheme at £300 million so they are, I presume, looking with an eye to what happened with the German scheme and the possibility that this ends up being vastly more popular and potentially vastly more expensive than they originally anticipate. So in effect they are saying there is a maximum of 300,000 subsidies available there and if you do not get it in time you are not necessarily going to get one. If it is hugely popular then obviously that could present some political difficulties when it comes to shutting it down earlier than some people might anticipate.

Q59 Nick Ainger: The understanding is that it will be 50% Government, 50% industry funded, so in fact the total budget available presumably would be £600 million rather than £300 million. Is that your understanding?

**Mr Chote:** Yes, they are talking about the total cost to the Government, you are right, being £300 million.

Q60 Nick Ainger: So it would be a £600 million package if the industry signs up to it?

**Mr Chote:** If the industry signs up to it, yes, that is right. The issue about whether you can identify what is a reduction in terms of the contribution from the private sector is, I guess, easier said than done.

**Mr Whiting:** One observation is that of course the industry is already offering substantial discounts and many of the manufacturers and traders that we talk to are saying, “I am already offering this discount, surely I cannot be expected to offer another £1,000”. Basically, as Robert says, how on earth you judge the industry contribution to this £2,000 scrappage scheme is an interesting question.

**Mr Chote:** The other issue as well is how many people take it up who would actually have scrapped and bought something else instead anyway.

Q61 Nick Ainger: I accept what you say about the German scheme which has grown like Topsy almost, it has been incredibly successful, 40% increase in sales in this March compared with March 2008. That is quite remarkable bearing in mind what is happening in the German economy and the rest of the European and world economy in terms of the big ticket purchasing. You seem not particularly
positive about the idea of coming up with a scheme to focus on a particular industry and help it through what is clearly a very, very difficult time.

**Mr Chote:** You can make arguments about a number of industries as to which there are some, I am sure, many people would think we ought to be helping less in the current time as well as helping more of. When people talk about the particular strategic importance of the car industry over other industries, I am not entirely clear exactly on what basis those judgments are made. As I say, the Government has decided that £300 million is the right number in terms of what to spend on this. I think the best estimate is probably about 10 million or so eligible cars for this so we are talking about the money being there for about 3% scrappage but there is probably more than 3% scrapped anyway. So, as I said, the issue about how much of this is going to people who would have scrapped old cars anyway is open to debate, although presumably those people are then more likely to buy new rather than buy second-hand.

**Q63 Nick Ainger:** I think that is the point, is it not, somebody who has got a 10 year old car may well scrap it and buy an 8 year old car rather than a 1 year old or brand new car that is the idea of the scheme?

**Mr Whiting:** Indeed. One observation, if I can put it in those terms, is that there is nothing in here with a green tinge, if I can term it, which quite surprised many of us. I think some sort of stimulus in this area was widely expected and in many ways it is well worth a try but the expectation is there will be a bit of a push to reinvest in more energy efficient cars.

**Q64 Chairman:** If they do buy newer cars then they are more fuel efficient. The argument I have heard against that is if they get a new car they will drive more miles in a year.

**Mr Whiting:** Quite possibly or, of course, it has cost a lot of carbon to make it.

**Q65 Chairman:** I think we are going round in circles here, are we not.

**Mr Chote:** Just to add, the Treasury has made no greater claim than that the environmental impact is “neutral or modestly positive”.

**Q66 Mr Love:** The media has invested considerable credibility in the IMF forecast for the economy this year and next year. Should we, as a Treasury Select Committee, give them similar credibility, especially when compared with the Treasury forecast, Mr Bootle?

**Mr Bootle:** I do not think the IMF’s forecasting record is particularly impressive, I do not see that you should, as it were, put them on a pedestal above other forecasters. In fact traditionally, of course, the IMF has tended to be really rather conservative and out of date. When the radical issues emerge which challenge a forecast they are not among the best people to recognise that in what they are saying about the future. Given that background, when they come out with a forecast which is notably more pessimistic than the Treasury I guess that has rather more weight, as it were, than an equivalent forecast from some other body.

**Q67 Mr Love:** Let me ask Mr Weale, I went to the trouble of looking up what independent forecasters who are forecasting now are suggesting the average was minus 3.7% for this year. Should we look more to the average or should we be ultra-pessimistic as the IMF which has revised its forecast three times, as I understand it, in the last six months?

**Mr Weale:** I think most people have revised their forecasts three times in the last six months and that is in the nature of things if you produce quarterly forecasts and you are just about to produce another one, as we are, then you would have three revisions in six months. I think all forecasters recognise that they had not anticipated, had not grasped how rapidly the situation was developing and deteriorating and if you look at the Chancellor’s experience he falls into that category. You might have thought he would have avoided the risk of producing a Budget Statement two days before some data came out that could, let us say, damage its credibility because of course the data timetable is published well in advance.

**Q68 Mr Love:** Let me ask you about that. I am told that there is a very early estimate from ONS, the 1.9%, should we put much credibility to that and if it is revised, as everybody is suggesting it will be, is it more likely to go up or down?

**Mr Weale:** The long-term history is that ONS early forecasts tend to be revised up slightly but there is always a concern that normally the economy is growing, the upward revisions happen because you do not pick up new businesses and so on in the short-term. During a slump the experience is often that the early estimates are revised downwards slightly, so if I was the Chancellor I would not be relying on an upward revision from the ONS to get him out of this particular hole.

**Q69 Mr Love:** You wanted to say something, Mr Bootle?

**Mr Bootle:** Yes, just to say that I think there is a danger of focusing on the wrong year here. There are some differences of likely outcome forecasts for this year but they are not that big.

**Q70 Mr Love:** I am coming on to 2011.

**Mr Bootle:** The really important issue is 2010 and I think there is a real contrast here between, as it were, the things that the media focus on and the politicians which are often these quite minor changes, as indeed this latest GDP figure for Q1, which was only three or four pips worse than most people were expecting anyway but it has made an enormous impact, conscious of that on the one hand and the really big issue which is, is the economy going to recover next year or not.

**Q71 Mr Love:** Just to take that next year, I do not want to dwell on it but independent forecasters on average recent forecasts are suggesting growth next...
year, not much, certainly not nearly as optimistic as the Treasury have been, but that contrasts with the IMF forecast which was widely trailed at the time. I want to come on to 2011. I want to ask the question really relating to historical experience because people are saying to me that rebounding in the early 1980s, rebounding in the 1990s, growth was higher than trend in those years. Is there any evidence to suggest that? In other words, can we quote a historical example as to why the Treasury might be a little more optimistic than I think most forecasters have suggested?

Mr Weale: I think inevitably you expect growth faster than trend in a recovery period because, after all, the trend is the average of the period of recession and the recovery period, so it is reasonable to expect some sort of recovery.

Q72 Mr Love: Okay. In the circumstances where there is also a significant—I will not call it a fiscal stimulus because that mixes up the Pre-Budget Report—stimulus to the economy continuing, is it so unreasonable? It has been widely ridiculed in the press, 3½%, is it that bad?

Mr Weale: If we are talking about a forecast for 2011, the error margin surrounding all forecasts are inevitably largely two years ahead, so I am expecting something smaller but I do not regard 3½% as a ridiculous number to be forecasting in any sense.

Mr Bootle: It is not ridiculous but it is hardly cautious.

Q73 Mr Love: Can I ask Mr Bootle, you never got a chance to go on and tell us but you suggested, and I think this Committee has heard this many times before, that the 40% arbitrary figure for debt to GDP ratio was plucked out of the air and we ought to give some more serious consideration. I read with growing horror the memorandum from Martin Weale about the consequences up to 2017 of trying to get finances stabilised. What is a more sensible figure for debt to GDP ratio?

Mr Bootle: I do not know the answer to that, I am not sure anyone knows the answer, but I am struck by a number of considerations and not all pointing in the same direction. The first is how extraordinarily high that 40% number proved to be when confronted with the events of the last two years. That is to say if one wanted to establish the debt to GDP ratio at a level which was sufficiently low that it gave governments quite a lot of scope to respond then we had set the objective much too high because here we are with Government quite closely circumscribed and actually in that regard I am very struck by the very fact that on the two previous occasions of course when we had massive public borrowing at 250% of GDP, it came after we had fought two huge wars. What I find concerning about the current situation is that if there were to be an enormous burden on the public finances from that source or perhaps from, God forbid, some ghastly pandemic of the sort that is in the news at the moment, heaven help us, how would we cope. The opposite consideration is the one I was referring to earlier on. It seems to me getting back to anything like that level, let alone getting lower, is so far distant, but it seems to me the more important prior question is the one I posed earlier, namely what speed should you be proceeding at and how do these different considerations weigh up in that judgment as to how fast you should be trying to get the debt ratio down.

Q74 Mr Love: Just one final question. I was interested in reading the FT today which was suggesting there will be a considerable number of wealthy individuals who will be either avoiding or evading the 50% taxation. They were suggesting something like 69%. I wonder, Mr Chote, if you would care to comment on that and whether the Government are being unduly pessimistic about what they are likely to raise from the 50% tax?

Mr Chote: I have seen the reference to the same numbers, I do not know whether that is true or whether that is the sort of figure they are picking up. Obviously the reaction to the higher income tax rate, people could respond to that in a whole variety of ways. There could be a conventional labour supply response in the sense of people simply thinking that it is not worth working as hard or as long or worth taking opportunities to earn more than they could do; there are, as you imply, migration issues, you could have people who decide that this is the last straw and they are not going to be in the UK and be taxed at those sorts of levels; there are also people who might have been thinking of coming here who will not. There are other factors including the opportunity to try to take income in other sources, such as capital gains, whether this changes the incentives to incorporate yourself as a business for example, and then there is the issue of what would have been a temptation, which is to stick more money into a personal pension. Now I think what makes the revenue estimates particularly complicated to judge whether they are right or not is the fact that you have got the 50p income tax rate measure combined with the pension contribution limits which is there in part to close off one of the opportunities that people have to avoid paying that rate. What we do not know is any of the sorts of numbers you would need to know about what the Treasury assumes the pension contributions of those people to be, their likely behavioural response, to be able to judge whether the overall package adds up. In a sense the way in which the Treasury splits the money they expect to get from the 50p tax rate and the pension contribution restriction is arbitrary because if they did a costing in the other direction, doing it assuming the other policy comes first before that one, then the numbers would look different again, so it is very difficult to judge.

Q75 Chairman: John, do you want to add something before we move on? Does the financial sector have sufficient creativity yet to ensure that not all of it is paid?

Mr Whiting: We do our best! I would echo, in all seriousness, a lot of what Robert has said. It will undoubtedly cause some behavioural change because people will look at should I go for capital growth to try and build a business rather than just
take income and maybe that is no bad thing. But it does mean an 18% tax rather than 50% plus national insurance. The issue about whether more people will go or, more subtly, will not come here in the first place is clearly quite an important one. I suspect the 10% rise will not of itself make a huge change, although of course last year we had changes in the non-domiciled rules, and there is this subtle underlying thing of “Is this it, are there going to be more rises to come through?” and the fear that it might get worse. I suspect a lot of people will wait and see what other countries do and see if this is a general raise in tax rates but, to echo phrases from my colleagues to the right, the risks one feels are to the downside.

Q76 Mr Love: It might be they would want to think about this over-complexity and coherence. Have either of the two of you given some thought to raising the same, roughly, amount of money? We could have a much more coherent system than has been suggested by all the chopping and changing over the last 18 months.

Mr Whiting: One simple example is with the pensions restrictions that have come in, with all the incredibly complex anti-forestalling measures. I do wonder why we have not just adjusted the existing annual amount that one can be contributing, which would at least be simple. I am not sure at what level, but logic might say if you want to control the amount that very high earners can contribute, why not cap the amount at that level i.e. £150,000, and have done?

Mr Chote: Adair Turner’s pension commission said the only practical way to limit tax relief to higher earners in order to distribute it to low earners would be to reduce the value of the £1.8 million lifetime limit. This whole issue about how do you value employer contributions to defined benefit schemes means that—as John will know much better than I do—is going to be enormously complicated to operationalise. In terms of could you do things in a simpler way, well, we now no longer have this bizarre situation in which the marginal tax rate spikes to 60% twice on incomes above £100,000, we now have a bizarre situation where it just spikes once to 60% above £100,000. It is hard to see why you design it that way.

Q77 Chairman: We have heard a lot and it is a global recession. How contingent is the recovery of the UK economy then on the resumption of economic growth in other advanced countries?

Mr Bootle: It is pretty difficult to imagine a UK recovery, certainly a vigorous one, if the rest of the world is still depressed, after all measures differ, but we export roughly somewhere between 25% and 30% of our GDP and if that sector is going to be very depressed, let alone falling at the rate that it has fallen over the last year, it is difficult to see. Having said that, performances of different countries do differ, particularly when they adopt very different exchange rate policies. In the 1930s we did manage actually, through a variety of ways, to do pretty well. For a start, the fall in output initially was very minor by comparison with the United States and Germany and a whole series of other countries, and then after we changed monetary policy in 1931 we underwent a very vigorous recovery indeed. Martin made reference to house building but a whole series of other sectors were strong as well. You could say that was partly the result of policy. I take an in-between view on this. It seems to me we are most unlikely to have a strong and vigorous recovery without the rest of the world picking up, but that does not mean to say we have to lie back and take whatever is given to us, we have got some ability and some prospect for domestic demand doing either better or worse.

Q78 Chairman: The Budget is predicting a return to growth of the eurozone/US economy in 2010, Martin, so if you can take that into consideration in your answer.

Mr Weale: The point I wanted to make was that although domestic demand could lead to some sort of recovery, for a balanced recovery we do need exports to grow relative to other types of demand because we do have to move to a situation where we are borrowing rather less from abroad. As Roger implied, the exchange rate depreciation puts us in a very good position but the export growth obviously will not materialise until our major trading partners, which are Germany and the United States, do start to recover themselves. I think we will find it difficult to make a lot of progress. Germany’s difficulties come essentially from the fact they are a big producer of investment goods which is why their exports and industrial production have been falling so sharply and I suppose I cannot see international investment demand picking up sharply until the international financial situation is much easier and businesses are more willing to borrow to invest. I think one can hope that there is this recovery next year in the United States and in the euro area, but the fact that we are to a significant extent dependent on that does not help our prospects.

Q79 Chairman: That would have been a bit pessimistic given our friend, Bill Keegan, in The Observer yesterday referred to the Great Depression, which Andy referred to, and said that the Chancellor, then Chamberlain, balanced the budget post that when the interest in the national debt exceeded 41% of Government spending as opposed to less than 10% now. So can you cheer us up with a last answer?

Mr Weale: Sorry what was the question?

Q80 Chairman: There was a balanced budget after the Great Depression, given that the net debt absorbed 41% of Government spending, whereas today that only absorbs less than 10%, so I think Bill was trying to cheer us up.

Mr Weale: I read that and was not sure whether I was supposed to feel cheered up by that or not. It is generally recognised that the balanced budget in the Depression was a mistake which is why policy is so different today. The fact that national debt is less important presumably is meant to cheer us up by indicating that it was easier to cut spending, that
cutting payments on the national debt is something governments tend not to like to do because it is called default; cancelling other types of promises on things like pensions is typically regarded as prudent behaviour rather than default. I am not absolutely sure why they are different. Obviously the scope for economy is much greater than it was in the 1930s but I do not think that means the economies, if and when they come, will pass unnoticed by the man or woman in the street.

Q81 Chairman: Give us a last question for the Chancellor, each of you. What do you think is the burning issue for him when he comes before us on Wednesday, John?

Mr Whiting: In terms of the tax system, which has been alluded to already by Mr Love, the complexities there are within this little bundle of Budget notes, 93 of them. There is a vast range of changes and the challenge is: are they all really going to contribute to a more efficient economy. There are some good things in there but the way that some of the things are being carried through undoubtedly imposes extra burdens, the foreign profits consultation being perhaps one of the key ones. We do need to make sure that does not impose too significant a burden and it would be good to know that the Chancellor has really got that fully in mind, that we are going to have a competitive corporate tax system to make sure—going back to some of the earlier questions—that the corporate tax system does deliver some money for the UK.

Q82 Chairman: Robert?

Mr Chote: I would ask him how does he believe that policy should respond if it becomes more expensive for the Government to borrow?

Q83 Chairman: Roger?

Mr Bootle: Mine is a variant of that, what is the plan B if things turn out to be much, much worse?

Mr Weale: I would like to know what shape he sees the post-recession economy having. The Budget document suggests that the importance of housing and finance will in some sense recover and that seems to underpin his tax forecasts. Does he want us to go back to being not quite as booming as we were in that area but largely with that sort of structure or does he think that rebalancing will involve a very different structure for the economy?

Chairman: Okay, can I thank all of you for helping us dispel the Monday blues. We will see you next time.
Treasury Committee: Evidence  Ev 15

Tuesday 28 April 2009

Members present
John McFall, in the Chair
Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins
Mr Michael Fallon
Ms Sally Keeble
Mr Andrew Love
John Mann
Mr Andrew Tyrie
Mr Mark Todd
Sir Peter Viggers

Witnesses: Mr Dave Ramsden, Chief Economic Adviser, Mr Edward Troup, Director, Business and Indirect Tax, Mr Mike Williams, Director, Personal Tax and Welfare Reform, Mr Peter Schofield, Director, Enterprise and Growth Unit, and Mr James Richardson, Director, Public Spending, HM Treasury Officials, gave evidence.

Q84 Chairman: Good morning, Mr Ramsden, to you and your colleagues. Can you introduce them for the shorthand writer, please?

Mr Ramsden: I can, Chairman. On my far right is Mike Williams, Director of Personal Tax; to my right is James Richardson, Director of Public Spending; to my left is Peter Schofield, Director of Enterprise and—

Mr Schofield: Growth.

Q85 Chairman: Was “Growth” an afterthought?

Mr Ramsden: To my left is Edward Troup, who continues to be the Director of Business Tax. I am Dave Ramsden, the Treasury’s Chief Economic Adviser.

Q86 Chairman: You are all welcome. We have got quite a lot to get through this morning, so I would appreciate it if your answers are brief and cogent. The Government calculates that growth in the UK economy will be around 31/2% from 2011 onwards, but when Martin Weale was before the Committee yesterday he told us that this year growth could be worse than 1931. Why are you so optimistic that the UK economy will emerge strongly from recession after 2010?

Mr Ramsden: If you look at the underlying economics, the balance of supply and demand, although we have made what I think is a cautious assessment that 5% of output is lost during this very deep and sharp recession, that still means that there is significant capacity at the beginning of the recovery. We think that with the UK’s flexible economy, flexible labour and product markets, there is potential for that capacity to be taken up relatively quickly and that has been the experience of previous recovery phases. I worked in the Treasury in the early 1990s during that recession and in the Budgets of the early 1990s we were forecasting these kinds of growth rates then as spare capacity that was used up and the outturn, as we highlight in the Budget Book, was that growth grew at an average of 3½% for five years in the 1990s, so I think it is reasonable both from the economics and from the past experience of the UK to have those kinds of medium-term growth forecasts underpinning our forecasts. Can I just add one final point. Our public finance projections, which is really the reason why we forecast, we forecast in order to frame our public finance projections, are run off the bottom end of our range so we have growth forecasts for those of 1% for next year and then 3½% in the medium-term, which is exactly the same as the growth rates that were experienced over five years in the 1990s.

Q87 Mr Fallon: Mr Ramsden, given that the economy shrank by 1.9% in the first quarter, far worse than the 1.5% that you thought it would, what revision can we expect to consumer demand for 2009 as a whole?

Mr Ramsden: Mr Fallon, you have talked about two different things there. One is the ONS’s first estimate of GDP on the output basis and the other is consumer demand. It is no doubt very challenging at the moment to forecast what is happening in the economy; that is true of us and that is true of other forecasters, but it is also challenging to measure what is happening in the economy. The ONS’s first estimate of GDP is made up of 50% of forecast, it includes no data at all on the output side from March. If you look on the demand side, and that is why I said your question was asking about two different sources of data, the retail sales volume data for Q1, which also came out last Friday, showed growth on the previous quarter. To some extent there are mixed messages coming from different data. As we know, before we publish our next forecast at PBR the ONS will produce at least two, if not three new estimates of what happened in Q1 which will give us a fuller picture.

Q88 Mr Fallon: You are not answering my question. If the economy has contracted much more sharply in the first quarter of this year, what effect do you expect that to have on consumer demand for the year as a whole?

Mr Ramsden: Mr Fallon, you have talked about two different things there. One is the ONS’s first estimate of GDP on the output basis and the other is consumer demand. It is no doubt very challenging at the moment to forecast what is happening in the economy; that is true of us and that is true of other forecasters, but it is also challenging to measure what is happening in the economy. The ONS’s first estimate of GDP is made up of 50% of forecast, it includes no data at all on the output side from March. If you look on the demand side, and that is why I said your question was asking about two different sources of data, the retail sales volume data for Q1, which also came out last Friday, showed growth on the previous quarter. To some extent there are mixed messages coming from different data. As we know, before we publish our next forecast at PBR the ONS will produce at least two, if not three new estimates of what happened in Q1 which will give us a fuller picture.

Q89 Mr Fallon: You are not answering my question. If the economy has contracted much more sharply in the first quarter of this year, what effect do you expect that to have on consumer demand for the year as a whole?

Mr Ramsden: I would not be changing the forecasts that we published last week for consumer demand. I can read them out to you if that would be helpful.

Q89 Mr Fallon: But you are not going to change them?
Mr Ramsden: Certainly not, no.

Q90 Mr Love: We were told yesterday that if the 1.9% figure comes out to be the reality, and it was suggested to us that it is far more likely that any revision would be to make it worse rather than to make it better, reaching your target figure of 3.5% will be extremely difficult for the rest of the year. Do you not think that is something you need to look at?

Mr Ramsden: Maybe this also would help in understanding further my response to Mr Fallon’s question. What we have set out in our forecast is a judgment as to the reasons why we think that growth will resume towards the end of this year. We think that if the global forces which have been driving down GDP output and trade more significantly, more sharply than we thought at the PBR, continued in Q1, we always said we thought Q1 would be a second very challenging quarter, a very sharp fall in output, but we see the rate of decline in output in GDP, in spending, reducing. If the pace of decline slows as we go through the year, and that does not mean that the recession does not continue, it does, we think that the forces which are underpinning eventual recovery are in place to give growth in Q4, and those are the very, very significant macroeconomic policy stimulus from the Bank of England, from the fiscal automatic stabilisers, from discretionary policy, the fall in inflation which will be coming through sharply for the remainder of this year, and the significant depreciation in the exchange rate. We think all those forces will help to lead to a pick-up in GDP towards the end of the year. Two particular factors linking to our policy will also contribute, and I think your experts told you about these yesterday. I mentioned this at the PBR hearings with you. One is that because of the ending of the lower rate of VAT at the end of the year there should be a relative price effect bringing forward consumption into Q4 and also the position on stamp duty should encourage some increase in transactions and consumption related to that in Q4. I would absolutely stand by the judgments that we have made in our forecast. We will update our forecasts at the PBR in view of all the data that has come in.

Q91 Mr Love: Are you expecting any rebalancing of the economy away from consumer expenditure?

Mr Ramsden: We are certainly expecting a significant rebalancing of the economy through the recession. If you look at Table B4 on page 203, which I think I have referred you to at previous hearings, the contribution of private consumption to our GDP growth forecast in 2009 is minus 2 and in 2010 private consumption only contributes a quarter of a percentage point, whereas net trade, the bottom line, contributes half a percentage point in 2009 and half a percentage point in 2010. So there is a quite significant rebalancing there, which is what you would expect in the circumstances.

Q92 Mr Love: Consumer demand will grow by around 3% according to one of your other tables in the Budget Report, which, although it is slightly below the overall growth figure of 3½% for 2011, does not appear to suggest very much rebalancing going on.

Mr Ramsden: We think that by the time we get into the strong recovery phase in 2011 we are expecting consumption, which is by far the most significant contributor to GDP, to be contributing significantly to growth, but that is after a very significant adjustment through the recession.

Q93 Mr Love: Tell me why you think consumers will be confident enough? You mentioned earlier that consumer expenditure actually increased over the last couple of months, which is perhaps quite surprising considering all of the bad news that is out there. What makes you think that when we have reached the bottom of the recession consumer confidence will be at such a level as to lead to a 3% increase?

Mr Ramsden: Compared to the position we are going through at the moment where, understandably, with unemployment rising very sharply consumers have concerns about their livelihoods, it is quite likely, therefore, that there is an element of precautionary saving and we are forecasting that the saving ratio picks up significantly through this period. By the time we get to 2011 against a backdrop where we see the world growing again at about 4%, not as fast as it did in 2006–07 but still significantly, and where by 2011 on our forecast we are clearly through what will have been a very significant recession but well into the growth phase, it is quite reasonable to assume that savings ratios having got back up to 5% or 6%, the vast majority of people remaining in employment at high employment rates, for consumption to be a significant contributor.

Q94 Mr Love: One of our expert witnesses yesterday suggested that this recession could parallel that of 1931 and, therefore, his view was that there should have been a second fiscal stimulus. Why did we not have a second fiscal stimulus?

Mr Ramsden: If you look at where we have got to as we were preparing this Budget, there is a very, very significant amount of stimulus already in the system. We have interest rates at historic lows. We have the Government having agreed to a policy of asset purchase or quantitative easing with the MPC already having embarked quickly on a three month programme to purchase £75 billion of assets, about 5% of nominal demand. As I have already mentioned, we are already seeing quite sharp falls in inflation from—

Q95 Mr Love: Can I just stop you there. What I wanted to do was press you because all of that is absolutely correct if you agree the figures in relation to 3½% decline, then 1½ and I think it is 3½ which are your growth figures for the next three years, but, of course, we have had IMF figures and it looks likely that the average of forecasting is likely to further decline and in that type of scenario was a second stimulus not necessary?
Mr Ramsden: For a start, I would not agree with the premise of your question. I do not think it is likely that growth is going to come in below our forecast. People always focus on our forecasts but actually when the Bank of England published forecasts in February, arguably at a more uncertain time for the world economy, they had exactly the same growth rate for us next year on their risk-weighted forecast of 1% and then mode forecast, their most likely outcome, was for 2% growth next year. Having said that, your other point is an interesting one. Obviously there are still significant downside risks to our forecasts. In response to feedback that you have given us, recommendations from this Committee, we have tried to outline all those downside risks. That is why within the overall Budget and fiscal judgment there was targeted stimulus in 2009–10 on top of the more macro-wide stimulus that we introduced at the PBR. If I could just say one more thing. In terms of dealing with these downside risks and the risk of deflation, which is highlighted by many forecasters, you also have to think beyond the Government’s immediate balance sheet, as we have discussed with you, and you have to look at interventions such as the Asset Protection Scheme, which is a very significant fiscal intervention potentially designed to head off those, if you like, relatively small probability but high impact downside risks. Against that backdrop, against all those interventions that the Government has been taking on the financial sector and directly on its own balance sheet, we felt that the fiscal judgment at Budget struck the right balance.

Q96 Sir Peter Viggers: How contingent is the recovery of the UK economy on the resumption of economic growth in other advanced economies? 
Mr Ramsden: I think that is a fair question and highlights how much our forecasts are based on assumptions. We are a very open economy particularly reliant on trade with the rest of the EU, over 50% of our trade. We have tried to highlight that a normalisation of credit and lending globally, and it has to be globally, it cannot just be in terms of the UK because of the global linkages that we are all very well aware of in the financial system, and a resumption of world trade and global activity are key conditioning assumptions for our forecasts. The answer to your question is if we do not see that kind of world trade and world growth pick-up then we will be looking to other factors for the UK other than the rebalancing that I have talked about to get the same growth rates. We will assess and reassess this and return to these judgments as we go along.

Q97 Sir Peter Viggers: What factors would you be pondering? What other action would you be pondering if the eurozone and the US economy did not return to positive growth in 2010 as the Budget assumes?
Mr Ramsden: This is why, as I have highlighted to this Committee before and as we have been emphasising through the spring, we attach so much importance to the G20 process and not only to the G20 leaders making commitments to take action but then following through on that action. What we are seeing in this recession, which is unlike previous recessions, is a decline in nominal demand across the world and for the UK that means a decline in money GDP. If you look at the early 1990s recession GDP fell but inflation continued and similarly in the 1980s. What we have at present across the world, and this is something that the Governor has emphasised, is this problem of not enough nominal demand, so we are looking across the G20 for leaders to both commit to action and then take it to deal with that. Finally, at the micro level we are also attaching huge importance to avoiding a return to protectionism because that would be critically damaging to the UK given how open we are. As you might want to come on to, what we have seen in the last few months that we just did not expect at the PBR was this drying up, for example, of trade credit insurance, quite basic things that keep the world trade system moving, and that is why G20 leaders are committing to action on that and also we are in the Budget.

Q99 Chairman: You mentioned the Governor there, but if I refer you to the Red Book at page 203, Table B4, that shows a rebalancing away from the Government, not a rebalancing away from the consumer. How are you going to tackle the paradox of policy discussed by the Governor of the Bank of England who said to us that the economy needs rebalancing and eventually the consumer will have to draw back and save more? What plans do you have for consumers who will have to reduce their growth rate and that stimulus will be withdrawn?
Mr Ramsden: After a shock as significant for the world as this one I think you are going to see that kind of rebalancing taking place over a number of years, and that underpins the judgments that we will no doubt come on to in terms of the fiscal position and the consolidation that we have set out. What the Governor highlighted when he was talking to you in March about the paradox of policy was that in the short-term we cannot afford a situation where every consumer starts to save. Over time we think that there will be a rebalancing back to savings ratios if you look at Table B5 on page 204 where the savings ratio picks up from around 2% in 2007 and 2008 up to 5%. Given the developed capital markets in the UK, given that once we have got through this crisis period we think that the financial sector will normalise, we think those kinds of savings ratios are reasonable and do underpin a rebalancing. As the position plays out we will reassess the degree of rebalancing. For example, I would not be surprised if the euro area does pick up as we are forecasting, given the degree of depreciation we have seen against the euro, if we see more of a net trade contribution, but we will keep that kind of thing under assessment.

Q100 Chairman: I think you could maybe say that the present situation is characterised by uncertainty and on your best estimates and hope this will happen.

Mr Ramsden: No, it is on best estimates. Some of your experts believe that the rebalancing has to go much further than we do. They talk about savings ratios that need to go up to, say, 10% or 12%. We think that 5% or 6% is a reasonable equilibrium place for savings ratios to end up.

Q101 Chairman: But as a Committee we want to see evidence for that, so if you can provide us with a further paper on that, that will help inform our report because it will be a significant part of our report.

Mr Ramsden: We can provide you with more information if that is useful. We have tried to set out a lot of the document. In the data at the end of last year for GDP, at least on the ONS estimates that we currently have, we have seen a significant rebalancing with a very sharp pick-up in the savings ratio.

Q102 Chairman: Just take what I am saying and come back to us with something, okay, further information?

Mr Ramsden: Okay.

Q103 Nick Ainger: In the Budget Statement the Chancellor said that Government policy is expected to protect around half a million jobs. How is that figure calculated?

Mr Ramsden: It was not just about Government policy. As I read the speech it actually referred more generally to—

Q104 Nick Ainger: Let me give you the quote: “Taken together, the total policy support for the UK economy is expected to protect up to half a million jobs”.

Mr Ramsden: The total policy support, that was the point I was trying to get to. That includes the actions by the Bank of England, so it is not just the Government. As we have said consistently—

Q105 Nick Ainger: I just want to know how you have calculated it, how you have got to a figure of half a million jobs.

Mr Ramsden: As your experts said to you yesterday, obviously the counterfactual here is very important. We went back to October last year and looked at the macro-policy interventions since then on interest rates, on quantitative easing, on the Government’s fiscal interventions, and that gave us an estimate compared to what the growth path might have been without those things and what the growth path was with those things and from that we calculated that it could be up to half a million jobs protected or supported. That was the basis for the calculation.

Q106 Nick Ainger: It was more art than science.

Mr Ramsden: These things are always going to be estimates with uncertainties around them, which is why I think the speech said “up to”. Relative to the amount of demand that has been supported by those macroeconomic interventions, for me that was a defensible estimate.

Q107 Nick Ainger: Martin Weale, when I asked him yesterday about the measures in the Budget to address unemployment, felt that it was unlikely that the measures that are there to support employment would actually stop unemployment rising above 3 million. Would you agree with that?

Mr Ramsden: We think that the measures will have an impact and colleagues who lead on the detail of the measures rather than the macroeconomics of them can provide more information on that. As we have discussed with you before, in terms of the way we have put together our fiscal arithmetic we have taken the independent average forecast, which is based on the claimant count estimates, for framing our fiscal numbers. I do not think I can provide any more of an answer than that.

Q108 Nick Ainger: Okay. Martin Weale is saying that he thinks unemployment may rise to over 3 million and Professor Blanchflower’s view is that it could actually go as high as 4 million. Does this Budget really address the threat of those sorts of figures, of 3–4 million people unemployed?

Mr Ramsden: We think that the Budget addresses a particular threat; in fact, two threats. One is that we are very keen to make sure that Jobcentre Plus, which is very effective in contributing to a flexible labour market, has the resources that it needs, so we have contributed very significant additional resources to Jobcentre Plus, the idea there being that what we want to avoid is what we saw in the 1980s,
and to some extent in the 1990s, where a short-term demand shock to the labour market has long-term supply side consequences.

Q109 Nick Ainger: I totally agree with you, but what I am trying to get at is are those measures in the Budget actually sufficient? You have rightly prioritised that and if you look at the numbers the big increase is for Jobcentre Plus, £1.7 billion, nobody is arguing about that, I am just posing the question whether that is sufficient to stop unemployment rising above 3 million.

Mr Ramsden: We think it is sufficient to support this. I cannot comment on other people’s forecasts, whether it is Martin Weale or David Blanchflower, but we think it is a sufficient and serious response to the needs of the labour market, both in terms of Jobcentre Plus as the key delivery mechanism but also in terms of dealing with this particular issue that we recognise which Blanchflower, Gregg and Layard have all highlighted of trying to deal with the youth unemployment consequences of this recession.

Q110 Mr Tyrie: I wanted to ask about the structural deficit. First of all, what is the Treasury’s estimate? I think I have worked it out from the Red Book, but what is the Treasury’s estimate of the size of the structural deficit this year as a proportion of the total deficit? If you could just give me the percentage.

Mr Ramsden: Yes, I can.

Q111 Mr Tyrie: I think it is on page 222, if I have got the right table.

Mr Ramsden: That is very helpful, thank you.

Q112 Mr Tyrie: But there may be others I need to look at.

Mr Ramsden: This comes back to something I mentioned in one of my first answers, which is what we have assumed about the impact on the supply side of this recession. We have taken what the NAO consider to be a cautious approach in assuming that it has a 5% permanent impact. So, as a result of this recession, rather than a level of GDP of 100, you have got a level of GDP of 95 at the end, so we never get back that output, and we have assumed that that comes in over three years from 2007 to 2010. I am saying all this because it is quite important in terms of answering your question. If you assume that level of loss of output over that period, it means that you end up, given our methodology for doing cyclical adjustment, with a large proportion of the deficit in 2009–10 being considered to be structural. I think it is about 75% or 80%, but that is based on our judgment. If there was no impact on the supply side at all, as has often been predicted after previous recessions or as, for example, Roger Bootle and people like Ben Broadbent at Goldman Sachs have described—Ben Broadbent describes this as an aggressive assumption—were the impact on the supply side to be less than 5%, then the percentage of the deficit that was structural would be correspondingly lower. So because we have got a cautious 5% hit in there, it gives us a high percentage that is structural, but that is an estimate. It is a judgment that we have made to frame the fiscal assessment and we will keep it under review as we go forward, because (and this is something that Robert Chote has said before) it is a pretty difficult thing to do while the shock is still playing out, to work out the supply side impact.

Q113 Mr Tyrie: In taking the NAO’s estimate you are trying to work out your central estimate of the deficit structurally and cyclically, are you not? You are not being excessively cautious. You used the word “caution”, but this is your best guess, is it not. Or is this an ultra-cautious number?

Mr Ramsden: No, I would describe our fiscal projections as a kind of realistic central, but then what I would highlight is that they are driven by a number of cautious assumptions, not just the trend output assumption that the NAO have said has an element of caution but something such as VAT, for example.

Q114 Mr Tyrie: We should treat this as your best guess of the size of the structural deficit: 75% to 80% of the total deficit?

Mr Ramsden: No, sorry, I think that the headline numbers are a realistic forecast. If anything, I think that because our cyclical adjustment methodology is quite cautious it is possible that our estimate of the structural deficit is at the cautious end, is possible.

Q115 Mr Tyrie: But it is possible that it is at the optimistic end?

Mr Ramsden: I think it is more likely, given the assumptions—

Q116 Mr Tyrie: It is hard work getting to the point. I just want to establish, before we go any further, what is your best estimate of the structural deficit as a proportion of the total deficit this year?

Mr Ramsden: I apologise if it is hard work. There are a lot of moving parts in our assumptions.

Q117 Mr Tyrie: I understand. When all those parts have moved, what number is your best guess?

Mr Ramsden: I think that our estimates of the structural deficit are cautious because they are based on cautious assumptions.

Q118 Mr Tyrie: If you were not being excessively cautious but you were offering me your best guess, what would it be?

Mr Ramsden: I do not know. Perhaps it is easier to say that from a fiscal perspective, in terms of framing the fiscal judgments, I think it is helpful to have a degree of caution in our forecast of the structural deficit. It would be better to have a degree of caution in there than a degree of optimism.

Q119 Mr Tyrie: Have you supplied the Chancellor with figures that are cautious rather than central in developing this forecast? Are you saying that,
Mr Ramsden: I am saying that if I am right about caution in our assumptions on VAT, on trend output, on equity prices, then that would imply that the structural deficit would be lower, but these numbers reflect the advice given to the Chancellor.

Q120 Mr Tyrie: I have to say that the markets, everybody, will find your advice quite amazing. How many other numbers in this Red Book have this arbitrary extra layer of caution added which nobody knew about until I asked you this question?

Mr Ramsden: No. If you look at C1, it lists all the assumptions audited by the NAO and it refers to them earlier in the document. It says, in paragraph C6: “The use of assumptions audited by the National Audit Office under the three-year rolling review process is designed to add caution into the public finance projections.” This goes back 10 years to this Government’s framing of its approach to the fiscal assumptions. That has not changed over 10 years. I am sorry if I am not making this clear, but we are trying to introduce more and more transparency over the years, explaining our assumption so that people can work out for themselves if they think they are cautious. There is a lot more of that in this document.

Q121 Mr Tyrie: This is taking a very long time. I have not got to my first question. I just thought I would get a straight answer to the first one, which is 75% to 80%, making clear I had understood the table, but that is just the percentage.

Mr Ramsden: 9.8% as a percentage of 12.4.

Q122 Mr Tyrie: Yes, exactly, in that table on page 222. Perhaps you could give us what your central estimate is—not now, but after having reflected on it. What, extracting different layers and levels of caution, is your central estimate? Do not tell us now, but come back to it.

Mr Ramsden: Central estimate for what? I am sorry.

Q123 Mr Tyrie: The degree to which the deficit is structural. That was my question.

Mr Ramsden: No, the estimate on the structural deficit, on the cyclically adjusted deficit, is as set out here. Caution is a qualitative concept which overlays a number of the different assumptions. I am not sure what I can add to the very comprehensive description in here.

Q124 Mr Tyrie: Forecasts are central estimates. This whole document is based on a forecast. There is no earthly point in producing a forecast on your worst case scenario, is there? No Chancellor is going to find that remotely useful and nobody is going to thank you in either the markets or the real economy.

Mr Ramsden: We are producing what I consider to be a realistic set of fiscal forecasts, but they are underpinned by some cautious fiscal forecasting assumptions.

Q125 Mr Tyrie: Of course, you never announce that they are incautious. You never say: “Here are our forecasts. It is all on a wing and a prayer.” Can I get past the basic number of 75% to 80% and ask you what policy implications that figure carries? In other words, what is going to be required to get us back—and I presume the policy is to get us back—to a zero figure for the structural deficit, and in that context could I turn you to page 35, where you set out in Chart 2.2 balancing the cyclically adjusted current account over the planning period and beyond. People turning up that page now will see a series of bar charts which are empty—white boxes—running out for the Parliament after next. What does that series contain in policy terms? What does that mean in plain language?

Mr Ramsden: To be clear on the assumption where you started your question, the objective as set out, as framed by the Temporary Operating Rule that we introduced at PBR, is to get back into a cyclically adjusted current balance. So it is not to get public sector net borrowing back into balance because that includes public sector net investment. That is just a clarification.

Q126 Mr Tyrie: An important one.

Mr Ramsden: Moving to the chart that you highlight, this is a chart that we have been producing since the PBR and since we have moved to this Temporary Operating Rule. What you have is—

Q127 Mr Tyrie: Could I remind you of the question, because I will be in trouble with the Chairman if I am not careful. I just want you to tell me, in plain language, for people who are not economists, in policy terms what is implied by those empty white bars?

Mr Ramsden: I needed to provide the context. I have remembered the question and I will give you the answer.

Q128 Mr Tyrie: I apologise.

Mr Ramsden: We start off from a position where in 2009–10 we think the cyclically adjusted current balance is going to be in deficit to the tune of 6.7%, based on all the assumptions that we were just talking about for how much is structural and cyclical. We have then, in this budget, set out an adjustment path based on policies but also based on the recovery in the economy that gets that cyclically adjusted current balance down to 3.2% by the end of the forecasting period. That is the five years out to 2013–14, and that is using the same approach that we were using in the early 1990s to present the fiscal numbers. You go out five years on the basis of assumptions. Beyond that period the current balance is still in deficit after 2013–14. What we have set out beyond that period is an illustrative or stylised adjustment path of .8% a year—that is the white blocks—that gets the current balance back into balance by 2017–18.

Q129 Mr Tyrie: What in layman’s language does 0.8% of GDP mean for policy?
Mr Ramsden: It depends, because it could be that that improvement—

Q130 Mr Tyrie: Give me a range of suggestions, just so that we can have a rough idea?

Mr Ramsden: To be honest, I cannot, because it depends on what happens at that time. We have set out very detailed and very closely accounted for and transparent policies and assumptions to 2013–14. Beyond that we are using stylised assumptions.

Q131 Mr Tyrie: Higher taxes, lower taxes, higher spending or lower spending?

Mr Ramsden: We are very clear that these are illustrative. That is what the footnote to that chart that you are highlighting says. It says, “Illustrative projections”, Chart 2.2, so I think we have set out clearly what it is.

Q132 John Mann: What went so wrong six months ago?

Mr Ramsden: It really goes back to the answer I was trying to give Peter Viggers. When we did the PBR, we thought that there would be a recession in the G7 economies. We had GDP in the G7 economies falling in 2009, but we and every other forecaster underestimated the intensity, the ferocity of the world recession.

Q133 John Mann: Economic forecasters?

Mr Ramsden: Yes.

Q134 John Mann: But businesses were saying things were going to be worse than being projected at the time; lots of businesses were.

Mr Ramsden: Some businesses were.

Q135 John Mann: Why are you listening to economic forecasters and not businesses?

Mr Ramsden: If you would let me finish answering. In putting together our PBR judgments, like every other forecaster, we tried to take account of the whole range of evidence, what economics was telling you, what the economic data was saying and also business sentiment. We were putting that forecast together in late November when this really sharp set of factors was taking hold. The independent average forecast for 2009, when we did the PBR, was minus .9 for 2009 growth. It is now minus 3.4. So I am quite happy to concede that all economic forecasters are being caught out by this.

Q136 John Mann: It is fascinating. I did a full survey of all the newspapers the weekend before the Budget, and there the business forecasters were far more optimistic than the politicians or the economic forecasters, virtually all of them. So are you listening to business now: because business was saying the forecasters, virtually all of them. So are you listening optimistic than the politicians or the economic and there the business forecasters were far more of all the newspapers the weekend before the Budget,

Q137 John Mann: I have read the Budget; I have read the forecasts. You are projecting the public sector borrowing requirement going up to £175 billion. Some forecasters are saying that it is going to be far more than that. Why should it not be less than that, because that is a huge increase to what was being projected only a few months ago? Are you not being too cautious in your assumptions on what is going to happen?

Mr Ramsden: As I have said, I think our headline fiscal forecasts are realistic. We have set out what the average error on our year-ahead forecasts is. I was quite struck by the fact that when we were putting together the Budget forecast for borrowing the average at the beginning of April of new outside forecasts for borrowing in 2009–10 was £160 billion, and we came in at 175 billion, and I think that is because some of the assumptions underlying our forecasts do build in some caution, but now you have some forecasters who have high borrowing. So I think there is a big range of outcomes around our 175 billion, but I consider it a realistic forecast.

Q138 John Mann: On the bank bail-outs, you are saying 1.5 to 3.5% GDP is the cost. Some forecasters are going up as high as 9.1% GDP. The bank profitability in the previous five years had been hugely and unprecedentedly high. Why should not the banks that have been bailed out in fact move rapidly into profit and why should not your forecast there, in fact, just as likely be too cautious?

Mr Ramsden: There are two points there, and I will take them in turn, if I may. On the question of future bank profitability, we have assumed that the financial sector profitability does return but it does not return to anything like the rate we saw in the earlier years of this decade, and that is why, when you look at box C3 on page 229, we do not have a recovery in receipts from the financial sector going up to anything like previous peaks. Other people like Goldman Sachs are more optimistic about bank profitability, so they have lower borrowing forecasts than us in the medium term. However, I think ours is a sensible assumption. On the question of the estimate that we have made of losses from the current crisis, we have tried to set out (and this in box 2.3 on page 26) the basis of the assumptions that we have made. Unlike some of the other estimates that are out there, this is an assumption which we think is a cautious provision to make of what the actual impact on the UK’s public finances will be given the outlook that we see for the economy and for the banking sector, and what we have factored into our
Q139 John Mann: There is, of course, a danger that one talks oneself into longer recession by being overcautious and painting too gloomy a scenario. In terms of trying to recover consumer confidence and maximising consumer confidence, how many of you have been involved in discussions in the last few months about what the options are specifically, the costed options, to meet the public sector deficit? In other words, what is going to be cut? What are the options, first of all, having been involved in those discussions, the five of you, or any of you?

Mr Ramsden: Those of us who were involved on the fiscal and public spending side, what we have been involved in is the discussions that set out the consolidation path of 3.5% of GDP from 6.7% down to 3.2% that I was setting out to Mr Tyrie. That has been central to our budget discussions. I am not sure what more—

Q140 John Mann: What I am asking is have you been in discussions? I think it would be helpful, in terms of building consumer confidence, if people could see what some of the policy options were. For example, and I will give you an example because it is a much more exciting one in recent days, if the Trident programme was to be, say, delayed for five years, what would be the impact on public finances in that interim period? Or identity cards, or a range of other policy options? Have you been involved in costing out what those policy options would be in terms of what the net debt is going to be?

Mr Ramsden: In terms of when we put the Budget together, we approach the Budget from the macro level, as I was discussing with Mr Tyrie, and also in the context of the period for which spending plans are set out—so out to 2010/11—and we have set out in this Budget how, for example, departments will deliver on the five billion efficiency savings that we committed to at PBR, but we have tried to set out very clearly those macro level assumptions.

Q141 John Mann: My final question was on these efficiency savings. In terms of the impact on the economy, which will have the most positive impact on public finances and on growth: the cutting of public sector jobs or the delaying of public sector projects?

Mr Ramsden: The way we have approached this is that when we have arrived at a budget package we look at what impact we think that will have on growth and on trend growth, and trend growth we think will continue at 2.75% after we have had this 5% shock, actual growth we think on the demand side can grow at 3.25% in the medium term to close the spare capacity that has opened up.

Q142 John Mann: That is not an answer to my question.

Mr Ramsden: It is, because we have factored in those considerations.

Q143 John Mann: It is not, because I am asking which will have the bigger impact.

Mr Ramsden: I do not know if James wants to add anything in terms of how we do the micro-economic analysis of levels, but at the macro level it is an overall judgment and that is the effect.

Mr Richardson: Maybe briefly on the micro side, what we have looked at department by department is the scope for efficiencies within the way those departments operate. The efficiency of the public sector clearly makes a contribution towards increasing the efficiency of the economy as a whole and, therefore, I would say that there is a strong case from an economic perspective as well as a fiscal perspective for the Government’s continuing efficiency programme.

Q144 Sir Peter Viggers: The national debt is rising to worryingly high levels. How heavy will that burden be? If we look at page 226 of the Budget Report, do I see a public sector net debt end of year of £1,370 billion in 2013/14? Just to get the need for debt servicing in perspective, what is the largest amount of borrowing which you forecast?

Mr Ramsden: It is very clear that the global recession and financial crisis are having a very profound effect on public finances around the world. Debt is rising in all developed countries. Our debt is rising significantly, as set out in table C4.

Q145 Sir Peter Viggers: How much higher will the debt burden be for every one percentage point rise in gilt yields? It is a straightforward question.

Mr Ramsden: You cannot pick out one assumption and say that would increase the debt burden. You have to look at all the moving parts. If interest rates were 1% higher, that would presumably be for some reason. It might be because growth was higher, in which case you would be expecting debt to be coming down faster than these forecasts show.

Q146 Sir Peter Viggers: Turning to the Debt and Reserves Management Report, I see on page 61 that there are five scenarios for funding the debt and there are simulations. This is the top of page 61. There are five issuance strategies and they have been simulated and each of them assumes a nominal and real yield curve which is downward sloping. In other words, we are assuming that costs of funding debt will fall. If we then look further down, exactly halfway down the page we see that there are 10,000 replications involved in the simulation, some of which, it says exactly in the middle of the page, will be upward sloping as a result of different economic outcomes. Why did you not model the issuance strategies to have an upward sloping curve, rather than taking all five on a downward sloping curve, which must be the most favourable and optimistic assumption?
Mr Ramsden: What we try and do, when I say “we”, the DMO is doing these scenarios to inform the issuance strategy that it ends up with. I think it is important that these scenarios are set out clearly, as they are here. I think if you had the kind of scenario that you are talking about with an upward sloping yield curve, it is a long way from where we are at present at the very long end. It would imply a growth path, an inflation path, rather different from the one that we see, but I am very happy to look at what we can do on those simulations working with our colleagues and DMO who run them.

Q147 Sir Peter Viggers: The worry underlying my colleagues and DMO who run them. can do on those simulations working with our path, an inflation path, rather different from the one that we see, but I am very happy to look at what we can do on those simulations working with our colleagues and DMO who run them.

Q148 Sir Peter Viggers: What factors do you think explain the resilience of the market demand for UK gold?
Mr Ramsden: I think investors look at UK Government paper and think that it is something that they want to invest in, and they are investing in it very significantly

Q149 Mr Todd: Before I come to scrappage can I turn back briefly to Mr Tyrie’s area? Have you reflected any further on whether we were running a structural deficit through the earlier part of this decade? Do you remember, we had a little exchange in which you contended we were not?
Mr Ramsden: We did, and without wishing to make it feel like Groundhog Day and completely repeating the answer I gave to you last time—

Q150 Mr Todd: If you are going to do that we will move on, but you remain adamant we were not, in spite of the fact that a lot of people think we were?
Mr Ramsden: We think that the way to assess what has happened is to—

Q151 Mr Todd: I think the answer is you have not changed your mind. That is fine.

Q152 Mr Ramsden: We have not changed our mind, no.

Q153 Mr Todd: How many of those sales would be additional? There must be some assumption that was made as to normal demand of purchasing and whether this is just people saying, “Oh, great someone is going to give me some money for this. How kind”.

Q154 Mr Schofield: That is correct, Mr Todd, yes.

Q155 Mr Todd: So of those 300,000 that the taxpayer will make a little contribution towards, what proportion are actually additional? I have not got the figures in front of me of normal demand; it is easier to work from the 300,000 you have given.

Q156 Mr Schofield: The assumption is between 90,000 and 100,000, although to an extent none of this is additional because this may well be—
something like 550,000 jobs are in the retail trade in the UK, so quite a significant part of the value chain is based in the retail section of the market.

Q157 Mr Todd: If we turn to the micro level, most people who have got 10-year old cars, although I have been disproved by at least one honourable Member here, are likely to be in a lower income category, it is fair to say, and if they have to then buy a new car, and the lowest prices maybe about £7,000, they are going to have to finance the balance of that and get a loan. I have already had one constituent who has had a crack at working this one out and has asked around amongst local banks as to what sort of offer they would make and it is pretty uncompetitive.

How is this going to work in practical terms for the people who are presumably the intended or likely beneficiaries?

Mr Schofield: In practical terms what happens is that you would go to your dealer if you want to buy a new car, and you would bring your DVLA documents to prove that you own the car and have owned it for more than twelve months.

Q158 Mr Todd: I understand that, but you have to find a way of paying for the additional at least £5,000 or £6,000, depending on how the retailer has funded the £1,000 that is coming out of the industry, and there have been views that they are just going to bump their prices up a little bit to reflect that.

Mr Schofield: I disagree with that, actually. It is very early days, obviously, and indeed the scheme itself does not start until the middle of May, but certainly my colleagues in the Department for Business, Enterprise & Regulatory Reform talk to me about a number of adverts that are out there at the moment where car manufacturers are advertising discounts of well in excess of the £1,000 that is required under the scheme.

Q159 Mr Todd: It is obviously a very competitive market. Just selling a car is hard. In terms of the impact on the other part of the vehicle sector, so second-hand dealers and maintenance operations where, obviously, if you are running an older car the costs are likely to be higher and the work done more, has any estimate been made of the impact of this on the wider vehicle sector?

Mr Schofield: There might be some impact. If you look at some of the schemes in Europe, for example, Germany, it is a very large scheme, much larger than the scheme we are introducing here in the UK, and there have been a number of concerns expressed there that this has been distortionary to some extent, both within the car sector and beyond. What we have here though is very much a focused scheme, a capped scheme; it is much smaller, and the whole point of this is to give a short-term boost to the industry while not being so large that it is not affordable and not so large that it is distortionary elsewhere in the car sector and in the consumer sector as a whole.

Q160 Mr Todd: But it is fair to say that a fair number within the industry would have much preferred a short-time working subsidy to this potentially distortionary and, to be honest, as we have explored in the questions, significant amount of waste cost from the taxpayer within a scheme of this kind.

Mr Schofield: I think you will find that this scheme is being widely welcomed in the industry and will provide the short-term boost to the industry that I think is the purpose that lies behind it.

Mr Todd: We shall see.

Q161 Chairman: Is the scheme fraud-proof?

Mr Schofield: I believe so.

Q162 Chairman: Have you done work on that?

Mr Schofield: There has been a lot of work that has been done on that. It has learned from the experience in Europe. Just to give some examples, the owner needs to show his DVLA documents to show that he has owned the car for more than 12 months. He needs to have a certificate of destruction from an approved treatment facility, and that is a key point that I think has been learned from overseas. The Department for Business, Enterprise & Regulatory Reform are going to be employing a firm to do independent checks to make sure that this scheme is implemented effectively, so lessons have been learned. The scheme was discussed in a conference with the industry at BERR yesterday. It comes into force in the middle of May and I think those lessons have been learned.

Chairman: Okay. Are you convinced, Mark?

Mr Todd: I think that fraud is less likely, certainly. It is not a case of buying some old bangers and taking them down to trade in. The opportunity does not appear to be there for that.

Chairman: Are you going to trade in your car?

Q163 Mr Todd: I already own a relatively new Toyota manufactured and bought where I live.

Mr Schofield: From your own constituency, yes.

Q164 Chairman: Mr Ramsden, I want you to be brief with these answers but they are important for our report. Does sustained deflation remain the threat it was at the time of the Pre-Budget Report?

Mr Ramsden: I should declare an interest as well since I own a 16-year old car, but I will not be buying a new one.

Q165 Chairman: Is that not a bad example?

Mr Ramsden: I think the running costs of old cars are less because you do not have any of the electronics. Turning to deflation, I was interested by the discussion that you had with the experts yesterday on deflation because I think that for the world economy we are still in the middle of this crisis. We have forecast that we are going to come out of it. Until we can be confident of that I think underlying deflationary risks for the UK are mitigated by—and this is something the Committee has talked about before—the depreciation of sterling, and we are already seeing that in the
inflation data. Looking ahead, as I think Roger Bootle was highlighting yesterday, the fact that wage growth is coming in really quite low, particularly including bonuses, means that we should stay vigilant to that risk, but I would still see it for the UK as a low probability risk. I think the period of negative inflation is going to be temporary.

Q166 Chairman: The reason I am asking for it is looking at the exit strategy and how we move on from here. In a way it is how we turn the scheme off, so it is that background.

Mr Ramsden: The asset purchase scheme?

Q167 Chairman: Yes. To what extent do you think quantitative easing has worked to prevent sustained deflation and will the amounts already announced for that, £75 billion in the first tranche and £150 billion later, be enough?

Mr Ramsden: We started working intensively with the Bank on quantitative easing before Christmas and that was obviously when all these events were going on in the world and the UK economy and where our thinking was very much framed by these worries about the level of nominal demand. We set out in the exchange of letters the agreement in principle in January and the MPC has been implementing quantitative easing through unsterilised purchases since March. With regard to the £75 billion that the MPC programme for the three months to June covers, we have tried to be very clear in the document the assumptions we have made in box B5 about the impact of that. It gets quite into the technicalities of monetary economics and so there are some phrases in here that have not been used for a while in a Budget document, but our assumption is that the £75 billion will raise the level of nominal GDP by about that amount, so about 5%. That is an assumption. We are at the outset of this. You were taking evidence from Paul Fisher the other day, who is leading on it at the Bank. His view, which I share, is that it is the right thing to do in terms of the judgment, but in terms of the quantum and whether it is working to the degree expected, I think the Governor said it will take a few months, possibly six months. What we have agreed with the Bank of England is that we have made provision for £150 billion and they have so far embarked on a programme of £75 billion and at their meetings coming up they can review the position.

Q168 Chairman: How will the Bank of England dispose of the gilts it has purchased at a time when the Government will be selling a substantial amount of gilts?

Mr Ramsden: We have been very clear in the exchanges of letters that our approach to debt management will not be influenced by what they are doing; I think that is very important. There are two more fundamental considerations. One is that for quantitative easing to have the effect that we want it to have people have to believe in the central bank’s commitment to price stability. I think that the Bank of England’s inflation target provides that commitment device and, as the Governor set out to you in March, if we are in the position where inflation is picking up and also real activity is picking up, so the policy is working, and if the inflation target is threatened with the existing level of interest rates, the quickest thing they can do is put up interest rates, and they can do that.

Q169 Chairman: I have two quick points on the asset purchase facility. Why was £50 billion of the asset purchase facility assigned to the purchase of private sector assets rather than some other amount? Also, in terms of corporate debt, would you prefer the Bank to have purchased more of that than it is currently doing?

Mr Ramsden: The Governor and other members of the MPC have set out what they describe as a twin-track approach, and that is completely consistent with the original agreements in the exchange of letters. When the MPC asked the Government for the facility to buy gilts and for those to be unsterilised, the Government said the total was £150 billion at the outset, and that was the framing amount that the MPC had at its disposal, and within that it was up to £50 billion for private sector assets and the Bank has already set up facilities for commercial paper and corporate bonds. It is considering whether it should be engaging in the markets for other private sector assets and incrementally building that up. There is some way to go to the £50 billion and that is being kept under review, but there are already indications in terms of what has been described as the liquidity premium in some of these markets, that the differential of these riskier assets over government bonds is coming down, which may reflect the impact of this twin-track approach. If you look at the US experience, it is taking them a while to get going with their TALF programme. These are quite difficult markets to get into and it is still only April. The scheme was launched in March, but as we go through this the Bank and we will keep this under review.

Q170 Ms Keeble: By how much do you think the Government is going to undershoot its child poverty target?

Mr Ramsden: I am going to ask Mike Williams to answer that question, if I may, because he leads on child poverty.

Mr Williams: If we go back to where the target starts, it was measured for 1998–99 that 3.4 million children were living in poverty on the relative basis that is the main target. Between 1998–99 and 2006–07, which is the last—

Q171 Ms Keeble: Can I just say that we have got quite limited time and I do not really want to go through all the tracking. What I want to know is what the situation is now and by how much it will undershoot.

Mr Williams: The current situation as of now is that 600,000 children have been lifted out of poverty as measured. We think that measures since the last
measure will lift another 500,000 out of poverty, which leaves about 600,000 children who would have to be lifted out to meet the target.

Q172 Ms Keeble: How many children will be put into poverty as a result of the recession?

Mr Williams: On the relative measure it is not at all clear that the impact of the recession itself will have a significant impact on the numbers.

Q173 Ms Keeble: Let me give you an example then, because what has been very telling about what has happened over past months is that I have had at my advice sessions, and I am sure other colleagues have as well, women with children coming in—and I am very struck by the fact that we have got an array of men in grey suits and blue ties this morning—in tears because they have got incomes that look like this: husband on £500 pre-tax a week, wife on £100 part-time earnings. He loses his job. He then gets £60 a week JSA, she keeps her income, so they have a total of £640 a month income plus child benefit, which would be about £150. They have mortgage payments of round about £600, and why they are crying is because they are about to lose their homes. How do you reckon that this Budget, and particularly the proposals on SMI, help that family? There have been two key points. One, the amount of their time employment—goes on to contribution-based JSA, so how does your proposal on SMI help them?

Mr Williams: Let me therefore address specifically SMI. I think the proposal on SMI helps in the sense that it provides support to some of the people who are on benefits who are finding difficulty—

Q174 Ms Keeble: This particular family and most people in my constituency, when they lose their jobs, the husband—and it is normally the husband and the figures show that many have come out of full-time employment—goes on to contribution-based JSA, so how does your proposal on SMI help them?

Mr Williams: You are right: in many cases they will go on to contribution-based JSA, but that is not always the case. In some cases, and it may be that you would find that this happened in the circumstances you have described, they will go on to means-tested JSA.

Q175 Ms Keeble: No. On page 103 can you just confirm that where you say that SMI will be for all claimants, SMI goes to people on income-based Jobseekers’ Allowance?

Mr Williams: I think that is generally right, yes.

Q176 Ms Keeble: How does someone on income-based Jobseekers’ Allowance manage to have a mortgage of £200,000? I have not got that.

Mr Williams: I do not think we are saying that someone on income-based JSA will necessarily have a £200,000 mortgage. I think it is possible that someone, after a period of unemployment, would find themselves on income-based JSA, but whilst in employment may have had a mortgage of up to £200,000. £200,000 is a limit, not an average of any sort.

Q177 Ms Keeble: What studies were done of the way in which this Budget supported people who had previously been ticking along reasonably comfortably on below average earnings, combined but still in a reasonably comfortable position, and what studies were done on the way in which the recession impacts on those household incomes and on what is going to happen to those families? Specifically what studies were done?

Mr Williams: I think the main study is into the effect of significantly reduced interest rates on the mortgage payments of certainly the people on tracker mortgages but also the people coming off fixed rate mortgages. Also, as the box we have got on tax credit shows, in many circumstances tax credits provide further support when a family’s income declines. That is one of the advantages of the flexibility of the system.

Q178 Ms Keeble: Then why did you not link the SMI to tax credits instead of to JSA?

Mr Williams: The way the SMI system works, as I understand it, the computers are linked, unfortunately perhaps in terms of your question, Ms Keeble, to the JSA computer systems. They are not directly linked to the tax credits system.

Q179 Ms Keeble: Why should the ability of families to keep out of poverty be determined by the computer system of the Government? Why should the support that is provided and the policy decisions the Government takes be based around the needs of the families rather than the computer systems?

Mr Williams: I think the Government is trying to do that. Equally, the Government is trying to provide additional targeted short-term support, and in providing that short-term support, and the SMI support was introduced within a very short period of the extra being announced, it is building on what the system can already do. To go beyond that would take longer and would not provide short-term support.

Q180 Ms Keeble: We have got an unprecedented recession which is impacting on groups of people who previously have never had to look to the state for help. In my constituency everybody works. Most households have had two jobs, both people work, and you can see from the figures that even if both people work they are often on below average earnings and they own their own homes predominantly, and they are now being tipped into poverty and they will lose their homes. It seems to me that all you have said is that the reason for that is that the support for the crucial bit of their income, which is the ability to pay their mortgage, is determined because of what the computer system needed.

Mr Williams: That is specifically directed to SMI. There are two key points. One, the amount of their mortgage interest payments will have generally fallen very significantly over the last few months, and, two, in many cases, particularly in the two-earner households that you have described, the tax
credits system will operate to provide them with extra support over and above the tax credits that they were getting previously.

Q181 Ms Keeble: Only depending on the number of hours they work, I have to say.
Mr Williams: I agree that it is in some cases hours dependent.

Q182 Ms Keeble: How do you compare that then with a family—and I have to say of people struggle to work out how on earth, if you are on income-based JSA, which means you have probably been out of work for a considerable period of time, you ever managed to get a mortgage of £200,000, but how do you compare that with the fact that there is going to be a lot of support given to families who are in rented properties because of the change of rules in housing benefit and council tax benefit, and, since you call this chapter “Helping People Fairly”, how is it fair to treat people better because of the type of housing tenure rather than because of the actual needs of their family?
Mr Williams: The Government’s aim is not to treat people better in those circumstances but, as you say, to treat people generally fairly. If we look at the section on supporting households, there is one area where the Government is—

Q183 Ms Keeble: “Helping People Fairly”, I think it is called.
Mr Williams:—making a restriction to housing benefit on the local housing allowance because we have found that it is going beyond, for example, providing support just for rent. As I said, the key—

Q184 Ms Keeble: Sorry—can we just go back on that because repeatedly the Treasury has said it is putting £350,000 into tackling child poverty this autumn by more generous payments in housing benefit and council tax benefit? That has been the record repeatedly that has been given at this Committee.
Mr Williams: I think they are two different things.

Q185 Ms Keeble: And it is another Red Book.
Mr Williams: They are two different things. There is a change coming through this autumn to how, in the housing benefit computation, you treat child benefit, which I think we discussed after the last Budget, which is when that was introduced. The change mentioned in paragraph 5.33 of the Budget Red Book is to the local housing allowance which determines how much rent it is possible to get housing benefit for, so they are different elements of the computation of how much housing benefit you get.

Q186 Ms Keeble: No, that is a completely different issue because the rent allowance works completely differently from housing benefit and council tenures and those situations are just completely different. I do not want to go into it now because it is very techie. I just want to ask one further question though about the Asset Protection Scheme. We have had a lot of discussions in this Committee about the valuations and the risks involved and so on, and I wondered, in terms of the macro budget, what assessment you have done yet, if any, of likely losses and the impact that is likely to have on the public finances, given these quite optimistic figures that we have got here.
Mr Ramsden: As we were discussing earlier, our assessment of a range of losses from all the schemes of 1.5% of GDP to 3.5% of GDP—

Q187 Ms Keeble: When you say “all the schemes”, which ones are you talking about?
Mr Ramsden: That includes implicitly the Asset Protection Scheme.

Q188 Ms Keeble: But explicitly what are the calculations so far for the Asset Protection Scheme?
Mr Ramsden: What we have done is a global estimate of what we think the losses will be, based on our assessment of the outlook, as I was saying earlier, both for the economy and for the banking sector informed by the range of due diligence work that is done for the different schemes, including the Asset Protection Scheme, to arrive at what we consider to be a cautious provision of 3.5% of GDP.

Q189 Ms Keeble: But the provision that you might make for that in these kinds of macro figures is based on a variety of assumptions. It is not based on a detailed assessment of the particular scheme, and what I want to know about is the detailed assessment that has been done around the Asset Protection Scheme because we have asked the Governor separately about the APF because that is his baby, so to speak. It is specifically about the Asset Protection Scheme.
Mr Ramsden: Actually, the APF in terms of any fiscal losses is the Government’s responsibility, but on the Asset Protection Scheme, as you know, the negotiations with the two banks which are taking part in the Asset Protection Scheme in terms of finalising the position are ongoing. We set out back in January and then in early March our estimates of the assets covered, but our 3.5% provision, which is a significant amount of money; it is 3.5% added to debt in our fiscal plans, covers our assessment of all the schemes and that includes the Asset Protection Scheme.

Q190 Ms Keeble: Can you tell me where the detailed figures are just so I know which table to look at?
Mr Ramsden: I have said that it is a global figure. There are no detailed figures in the document.

Q191 Chairman: Before we go on to the next one, could we look at the Homeowner Mortgage Support Scheme that Sally mentioned. Not all banks and building societies have signed up to it; is that correct?
Mr Richardson: Basically banks and building societies covering 80% of the mortgage market have signed up, either to the scheme or to provide comparable provisions for their mortgage holders. Around 20% of the market have not signed up.
Q192 Chairman: The reason I ask the question is I have spoken to quite a number of the building societies and banks and they tell me that this is a hugely bureaucratic scheme with them having to sign some 200 pages of paper, so it is working against the interests of individuals. As Mr Fallon mentioned in his Budget speech last week, he has got people that are wanting to apply but they are being prevented because of their level of savings. Really what I am putting to you, before the Chancellor comes tomorrow, is that this scheme is really not working to the best advantage of individuals and you should be looking at that again.

Mr Richardson: We are always happy to look at it in the light of the views of the Committee but, as I say, banks and building societies covering 80% of the mortgage market are offering comparable terms.

Q193 Chairman: I know that you have got a statistic there to throw at us, but the fact is that quite a lot have not signed up to it because of the bureaucratic arrangements, and I am asking you to take that back so that when we do face tougher times with increased unemployment and increased repossessions that we have a scheme that is fit for purpose.

Mr Richardson: We are very happy to look at the Committee’s views obviously, as we always are.

Chairman: Jim?

Q194 Jim Cousins: Mr Williams, I would just like to ask you why something more was not done in the Budget to extend the eligibility of tax credits because, of course, as you will appreciate, people on the lowest incomes, in the most from fragile jobs very often cannot get tax credits because they do not work enough hours.

Mr Williams: What we have looked at in tax credits primarily is not extending eligibility, because I think the eligibility does encourage, at the moment people to take jobs above a certain number of hours, but focusing on where people go below full-time hours, for example, providing them with additional support in those circumstances, that is where the tax credit system is operating to provide that support.

Q195 Jim Cousins: Mr Williams. I recognise that the proposal in the Budget to allow eligibility to be extended for people who previously had the right number of hours but whose employment situation has deteriorated so they no longer work that number of hours, so in a backhanded way you have extended the eligibility, but there are still millions of people out there on the very lowest incomes in the most fragile jobs who cannot get tax credits because they do not work enough hours, and more and more of the vacancies that are available through the job centres are for precisely those sorts of jobs, but they cannot get tax credits and therefore cannot share in the automatic stabilisers.

Mr Williams: I think there in deciding whether you would extend tax credits to people working fewer hours you have to balance two effects. One is that clearly in the circumstances that you describe, Mr Cousins, there are some people who there would get rather more support, but, on the other hand, if you did go below the current hours limit you would be encouraging, or at least not disincentivising, people to work fewer hours than now which would not be encouraging employment in those circumstances where people have got jobs where they are fortunately able to work for longer hours and do so currently. I think that is a choice that the Government assesses very carefully in arriving at the existing hours limit.

Q196 Jim Cousins: So it is the view of the Government that people who can only work a limited number of hours because of the availability to them of jobs should be disincentivised?

Mr Williams: The Government has had to strike a balance here for the reasons I described and it considers that where the balance is struck at the moment on the 16 hours is the right place.

Q197 Jim Cousins: You do see the contradiction between that disincentivisation and the Government’s policy objectives through welfare reform?

Mr Williams: I see a tension between the two objectives as I described. I do not think it is a tension with the Government’s objectives regards welfare reform generally, where encouraging people to work where they can work has been one of the core objectives of welfare reform over the last 10 years.

Q198 Jim Cousins: On a slightly different matter, have you done any work on the behavioural effects of the student loan repayment system which of course imposes what is effectively a tax of 9% on a threshold income above £15,000 a year so that for young, well-qualified people their effective tax rate is in fact 29%? Have you done any work on that?

Mr Williams: I think a key point there is that those young people, precisely because they have just come out of higher education and are relatively young, are generally in jobs where their incomes will be rising quite rapidly, and I think that you have to take that into account as well as the marginal tax rate that they suffer.

Q199 Jim Cousins: So no work has been done on what behavioural effects there might be on the behaviour of not terribly well-paid, well-qualified recent graduates?

Mr Williams: Often they are being not terribly well paid if they are well qualified, as I am sure many of them are, precisely because they are in either their first or maybe their second job, and like most of us you start off on relatively low pay and many graduates then see relatively swift pay increases.

Q200 Jim Cousins: So really it is tough bananas?

Mr Williams: Well—

Q201 Jim Cousins: Mr Troup, what was the point of the stamp duty holiday and is the point being achieved?
Mr Troup: I am sorry, I am going to pass that back to Mr Williams.

Q202 Jim Cousins: Is that Mr Williams’ responsibility?
Mr Williams: Stamp duty, I am afraid, is one of my areas as well. The point was to help people on relatively modest incomes to get through the downturn by giving a stamp duty holiday up to £175,000, which, as you know, has been extended to 31 December.

Q203 Jim Cousins: By buying a house?
Mr Williams: Stamp duty in those circumstances arises when people buy houses, yes.

Q204 Jim Cousins: Do you see any contradiction, Mr Williams, between the rich variety of home-buy schemes that the Government has offered, I think there are five at the present time (although the complication is somewhat reduced because virtually no-one is taking them up, but still there are five of them on the one hand) and the Government’s stated policy that it wants to decrease loan-to-value ratios? Thus we have a stamp duty holiday to encourage people to buy houses; we have five home-buy schemes which nobody is taking up because they are all too complicated and they apply to this person here and that person there and who knows who, on the one hand, and a general Government policy of saying that people should put bigger deposits down. Is that all not just a muddle?
Mr Williams: Clearly it is in everyone’s interests that mortgage lenders lend prudently. Equally, the Government has tried to help the housing market through the downturn with this stamp duty holiday originally of a year and now of 16 months to the end of December. I do not think that is inconsistent.

Q205 Jim Cousins: Mr Richardson, I wonder if I could try you. On housing policy, we have accepted that the Government now has a very complex policy package which gives individual people entirely contradictory signals—buy; do not buy; buy here but not there; buy if you are a school teacher in London—so it is all quite complicated to find your way through that. The Government is putting £600 million into supporting the housing market to build houses but the Government also has the Pathfinder scheme to deal with housing market failure which is pulling a lot of houses down, so we are putting a lot of money in to get houses built and we are putting another lot of money in to pull houses down. Are we doing the right kind of things? Are these the right kinds of policies? Are these the right kinds of sums of money?
Mr Richardson: I think they are the right kinds of policies. I think we have to recognise that the housing market is not a single, uniform market selling a single uniform product throughout the country to identical people. Instead we have a wide range of people in very different circumstances with a wide range of different housing needs and, at the same time, on the supply side we also have a wide range of different properties, and the match of demand to supply is not identical for different types of people or throughout the country, and therefore I think a policy response that reflects that is much more likely to be successful than a policy response that treated the housing market as if it were the market for a simple standard product instead, which it is not.

Q206 Jim Cousins: Goodness, I would have to study that very carefully before I could even begin to hazard a guess at what it might mean! Back to you Mr Williams, you were kind enough to refer the Committee to paragraph 5.33 of the Budget Book and you were also kind enough to draw our attention to the fact that local housing allowance, having been introduced to provide a two-way incentive to people from April 2010, will only provide a one-way incentive. Thank you for pointing that out. What does the last sentence of paragraph 33 mean: “Existing claimants will move on to new arrangements on the anniversary of their claim”? Mr Williams: It means that under the way that housing benefit is administered claims are generally reassessed every year on the anniversary of a claim. Therefore, if you say that someone is in month eight of their current claim and getting more local housing allowance than they are paying in rent, say they are getting £10 extra, that £10 a week extra would continue to the anniversary of the claim at which point it would be reassessed, so it is telling you when the provision is applying to people who are already making housing benefit claims.

Q207 Jim Cousins: So we have introduced local housing allowance to incentivise people to go for good rental values and to allow them to make a bit on their local housing allowance if they can do so, and that was part of the purpose of local housing allowance, but from April 2010 we are going to stop them doing that, we are going to take the money back off them if they have managed to make any? Mr Williams: The reason the Government is making the change—and Ms Keeble has already highlighted concerns of some of her constituents about the housing benefit system—is, as you say, this system was introduced in April 2008 but in fact the costs of this have very significantly exceeded the expenditure that was planned into the policy, and ministers have therefore decided to reign back the policy to reflect that.

Q208 Jim Cousins: Mr Williams, do you see that there is a broad problem here of the contract relationship between people in the most difficult circumstances, on the lowest incomes, in the most fragile jobs, and they literally cannot fathom the bewildering, constantly changing, ever more complex structure of eligibilities, conditions, requirements, duties to report their changes of circumstances, the savings caps that hit them so that if they do manage to contribute to the raising of the savings ratio by getting a bit of savings they then find they have disqualified themselves from future
benefits, and for people on the lowest incomes, in the most fragile circumstances, they have literally lost faith in these constantly tweaked systems that are constantly tweaked to their disadvantage? Do you realise that?

Mr Williams: I hear what you say, Mr Cousins, and I think it is important that, whenever we can, we seek to streamline the administration and the clarity of the housing benefit regime, amongst other regimes.

Q209 Chairman: Before we move on, it has been reported that Northern Rock has been sold into the market early. Is there any substance to those stories?

Mr Ramsden: Reports this morning?

Q210 Chairman: Yes?

Mr Ramsden: Not that I am aware of. I have not received anything but I am sure the Chancellor can update you.

Mr Love: Has Richard Branson been seen at the Treasury?

Chairman: If you could put the Chancellor on notice for that tomorrow. Michael?

Q211 Mr Fallon: Just to clear up the stamp duty exemption, how many people have benefited since 3 September?

Mr Williams: I would need to get the exact numbers and give you a note on that.\(^2\)

Q212 Mr Fallon: You are spending £270 million a year on this, you must know how many people have benefited.

Mr Williams: I do not know immediately how many have benefited up to now.

Q213 Mr Fallon: How many are going to benefit from the four-month extension?

Mr Williams: A significant number of people who buy houses under £175,000.

Q214 Mr Fallon: If you are spending £270 million of our money a year you must know how many people benefit.

Mr Williams: I do not know precisely the number to hand, Mr Fallon, and I would like to give you the accurate number so therefore—

Q215 Mr Fallon: Could you do that before the Chancellor appears tomorrow?

Mr Williams: Of course.

Q216 Mr Fallon: You are also the Director for Personal Tax. Could you tell us more about the 50% rate. On page 106 you say that it is from 2010 so this is not a temporary thing, is it?

Mr Williams: The change applies from 2010 and will apply from 2010 until such time as Parliament decides to change the rate.

Q217 Mr Fallon: So it is not a temporary rate? It has not just been introduced because of the recession or for a couple of years or anything like that?

Mr Williams: Like the other rates I do not think you could describe them as temporary either.

Q218 Mr Fallon: Fine, so it is a permanent rate, I just wanted to clarify that. The modelling exercise you did on evasion, could you just confirm that?

Mr Williams: I am very glad that you asked that question because I think there have been some misconceptions about that. I know Mr Love asked yesterday about this. The modelling exercise on that is in two parts and, if you like, I will cut to the chase and then go back if you want more detail. The modelling exercise assumes that of the total theoretical yield that you would get from the extra 10 percentage points from 2011–12 onwards that we would get about 31% of that, which is not the same as saying that only 31% of the people affected will benefit, as I think you will see. What it is about is of the total extra theoretically obtainable the best estimate made, taking into account behaviour, is that we will get just over 30% of that.

Q219 Mr Fallon: So you will lose 70% of that; that is your modelling exercise?

Mr Williams: I am not sure that “lose” is the term that I would use. If you take the costing in two parts, first, you look at how many people there will be with incomes above, say, £150,000 in 2011–12 and apply the 50% rate, where you were previously applying the 40% rate, and that gives you one figure, the maximum theoretically obtainable figure. What is scored and what we think is the best estimate after behaviour from 2011–12 onwards is 31%, but just to clarify yet further, because of course there is interaction with the pensions tax measure, if you then take into account the pensions tax measure that in itself acts to reduce the behavioural effect from the 50% rate and if you take the two together, which you can choose to or you can deal with them separately, that takes the behavioural effect down so the yield goes up to about 38%.

Q220 Mr Fallon: But the answer is that you are introducing a tax that 70% of those who could pay it will not?

Mr Williams: No, and this is back to the point that Mr Love was on yesterday. If you look at the pot of tax theoretically obtainable then the assumption, taking into account pensions taxes, is that the yield will be about 38% of that, and without the pensions tax measure about 31%. That does not mean that 70% of the people would not pay it.

Q221 Mr Fallon: What is the assumption that you applied previously to the 40% rate? Do you lose 70% or a lower figure?

Mr Williams: The way the modelling is done is essentially on a similar basis. The assumption of the amount that you would lose would be rather less because you would be moving from 40% to 45% rather than 40% to 50%.

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Q222 Mr Fallon: Just sticking with the 40%, which is the tax at the moment, what was the assumption on the loss rate for that, was it 70% or 50% or 30% or whatever of the theoretical total take?
Mr Williams: We have had the 40% rate in for about 20 years and I do not think we can go back.

Q223 Mr Fallon: What is the answer to my question? What do you assume on the same modelling basis that you lose out of that every year?
Mr Williams: We do not do that same modelling basis because that is the tax rate that we already have and we have evidence of the collection rate from it, so what we are doing in the costing is seeing what extra you would get on a baseline that uses the 40% rate.

Q224 Mr Fallon: So this is a figure in footnote 3 of £2.4 billion yield from 2012–13 and that is only 30% of the possible yield; is that right?
Mr Williams: The figure there assumes for the 50% measure that without the pensions tax measure then the yield would be about 31% of the theoretically obtainable maximum yield.

Q225 Mr Fallon: So you are building in a 70% leakage rate?
Mr Williams: We are assuming of the theoretical maximum that you get 31%, therefore you would not get the rest.

Q226 Mr Brady: Following on from that, why choose £150,000 a year as the point at which to charge a new higher rate?
Mr Williams: It was just felt that was an appropriate point, bearing in mind the aim as ensuring as part of the—

Q227 Mr Brady: — But according to your modelling, do you regard that as the optimum level at which to begin that higher rate?
Mr Williams: I think ministers regard it as the right point to make the change on the basis, as we set out in the Red Book, that those individuals most able to do so should make the greater contribution to fiscal consolidation.

Q228 Mr Brady: So it is based on a moral judgment as to whether people should be earning £150,000 a year rather than a technical judgment as to where you can extract tax?
Mr Williams: Ministers considered that—

Q229 Mr Brady: I know what ministers considered; what I am asking is what your advice was as to how you would best construct an efficient tax system to maximise the revenue from higher earners?
Mr Williams: This is back to the point that Mr Fallon raised just now, and our advice was that a 50% tax rate applying on incomes above £150,000 would raise significant additional yield which is the yield that we show in the Red Book table.

Q230 Mr Brady: Presumably you gave a series of other options, both about the rate of tax and the starting point of tax, with different levels of the yield accordingly?
Mr Williams: In framing the Budget, obviously ministers consider various options and obviously in those circumstances we cost options and, equally clearly, in circumstances where it looked as though something would not create yield—

Q231 Mr Brady: Did any of the other options yield more than 31% of the available maximum?
Mr Williams: I do not think we addressed the questions that were addressed in framing the Budget in that sort of way, Mr Brady.

Q232 Mr Brady: Obviously what has been created is a very complicated structure for personal taxes above £100,000 a year. In looking at the treatment of pension tax relief, would it not have been much simpler simply to reduce the annual limit for contributions to a pension scheme?
Mr Williams: We looked very carefully at whether that was a viable way of restricting the amount of pensions tax relief at the top end, the quarter that goes to people who are about 1.5% of the total pension savers on more than £150,000 a year. I think there are two reasons primarily why the option is not as good as I agree it looks prima facie to be. First, and I think most crucially, if we do significantly reduce the lifetime allowance you are in some circumstances hitting people much lower down on the income scale. You could go down for example to people say on £70,000 a year, yet we know that a quarter of the tax relief goes to people—

Q233 Mr Brady: But you could reduce the annual payment cap rather than the lifetime cap.
Mr Williams: If you do not reduce the lifetime limit then I think you get into similar issues with policy. There is also the point on that that if you apply the existing lifetime allowance it actually creates difficulties if you bring it down significantly, in terms of people working out whether they are up against the lifetime allowance or not. There is an extent to which what we have got works because it does not affect that many people.

Q234 Mr Brady: Moving on, could I ask you, Mr Troup, a lot of what the Government has been trying to do, clearly, is to assist industries that are in some difficulty. It is well-known that the aviation industry is suffering at least as much as any other in the current recession and yet the Government has decided to proceed with the planned increase in passenger duty. Are you not concerned that those tax increases might do further damage to that industry?
Mr Troup: I think, as you said, a lot of industries are suffering in the recession. The evidence is that although the aviation industry is definitely suffering, APD is a relatively inelastic tax and we do not expect the increase in APD to have significant additional effect on demand which is already declining in some areas but is robust in others.
Q235 Mr Brady: So it is not intended to limit the level or the growth of air passenger numbers?

Mr Troup: As you will recall from last year, the reforms to air passenger duty do have an environmental objective, which is to better align the duty with the carbon emissions of a flight so, yes, there is an intention to have an impact on emissions and, indeed (sorry, I do not have the numbers in front of me) we do expect a reduction in emissions and with that a reduction in flights, but I think looking at the context of taxes and their effect on businesses overall, the effect of APD is less severe simply because of the inelasticity of air passenger demand to prices than other areas which might be taxed.

Q236 Mr Brady: A final question to you Mr Troup on fuel duty for hauliers, would not reducing fuel duty for hauliers have been a good way of assisting most, if not all, hard-pressed businesses?

Mr Troup: We do have a single rate of excise duty across both diesel and petrol and have had for some years. Differentiating within diesel between hauliers, commercial users and personal users would be extremely difficult. It would require the introduction of another red diesel-type regime. The Government has done quite a lot for hauliers over recent years and while we appreciate that fuel is a significant cost for hauliers, the business regime otherwise in the UK is quite competitive for hauliers, so although no doubt we will hear more from the hauliers, and are hearing more from the hauliers, diesel prices are 30 pence down from their peak last summer and that was certainly a factor in deciding to proceed with the fuel duty increases.

Q237 Mr Brady: Do you recognise that there is a competitive pressure from some European countries, for example from Hungary?

Mr Troup: Not really. The haulage industry’s own study in 2006 only identified about 1% of haulage activity in the UK as cabotage, which is operation in the UK by foreign hauliers who come over to do a UK-to-UK journey. We do not have any more up-to-date figures on that but the Department for Transport are doing a survey over the summer so we hope that we will have further evidence.

Chairman: Three colleagues want to come in so in combined further questions and answers they have two minutes, starting with Peter.

Q238 Sir Peter Viggers: Can I ask Mr Williams what facts are known about the number of people who put themselves outside the UK tax jurisdiction as a result of the tax on non-doms and what assumptions have been made about the number of people who have placed themselves outside UK jurisdiction? If you cannot answer immediately I would be grateful for a letter.

Mr Williams: We do not yet know that information because the tax change only applied in 2008–09 and for most of them, unless they have been extraordinarily quick off the mark, we have not had tax returns, for 2008–9, which is the main source of data on non-doms.

Sir Peter Viggers: In that case a note on what assumptions you have made.3

Q239 Ms Keeble: I wanted Mr Williams to clarify his earlier comments just to confirm that there will be no increase in the number of children living in poverty as a result of the recession?

Mr Williams: I think there is no reason to believe that that will have an impact which is more likely to be one way rather than the other. The evidence of past recessions is that that can go either way.

Q240 Mr Love: Can I just ask Mr Williams, I would take up one or two of the other issues that you raised earlier on, but if I could just ask him whether or not the Treasury will publish the behavioural assumptions behind all the issues that go into the 50 pence tax and the changes in terms of tax subsidy to pensions because I know that there was a flurry of activity earlier on over the 45% increase in tax and a Freedom of Information application had to be made. Will this all be spelt out explicitly so that people can see the assumptions on which that 31% figure you talked about arises?

Mr Williams: We have already provided quite a lot of information on that, Mr Love. If people want more then obviously that is something that we would look at.

Chairman: I think we have asked for a few notes today, so if you could get them across to us this evening before the Chancellor comes tomorrow, that would be helpful. Can I thank you for your time.

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Members present
John McFall, Chairman

Mr Andy Love
Mr Andrew Tyrie
Mr Mark Todd
Mr Colin Breed
Mr Mark Bowman
Mr Michael Fallon
Mr Sally Keeble
Mr AndrewLove
John Mann
Mr Andrew Tyrie
Mr Mark Todd
John Thurso
Sir Peter Viggers

Witnesses: Rt Hon Alistair Darling, MP, Chancellor of the Exchequer, Mr Dave Ramsden, Chief Economic Adviser, and Mr Mark Bowman, Director, Budget and Tax, HM Treasury, gave evidence.

Q241 Chairman: Chancellor, welcome to the evidence session this afternoon. Can you introduce your officials for the shorthand writer, please?
Mr Darling: Yes. I am with Dave Ramsden, who you saw yesterday, who is the Chief Economic Adviser, and Mark Bowman, who is the Director of Budget and Tax.

Q242 Chairman: Welcome. Chancellor, the present environment has been described as uncertain but you have come out with optimistic growth figures which are against the trend. Given the huge public debt overhang we have, we are really in a bit of fix, are we not, and it is a bit gloomier than you are suggesting?
Mr Darling: You are certainly right that we are living in extraordinary and very uncertain times. Inevitably in forecasting, which is difficult even when times are pretty settled, the uncertainty around in this country and other countries makes matters more complicated. You are right too that our debt levels have risen, as they have done in every other major country in the world, and that is a consequence of what has been happening over the last couple of years. What I wanted to do last Wednesday was to set out the position to be realistic and to my mind that means taking account of the shock there has been to the system, and I did that, but also I believe the economy will start to grow towards the end of this year and we will see modest growth the year after, recovering after that time. My forecasts for this year are not that out of line with the current range of forecasts that are around at the moment and, indeed, next year there are some that are more optimistic than I was. What I wanted to do was to set out a forecast that I believe is realistic and one that we can justify.

Q243 Chairman: On the issue of the huge increase in public borrowing, how much of that has been for the bank bailout, how much has been for the automatic stabilisers payment and how much for the other discretionary payments?
Mr Darling: You are right, there are various elements. The fundamental reason why borrowing has gone up is the obvious one—borrowing is simply the difference between what the Government spends and what it gets in—and if you look at the income side of it, there is no doubt that the fall in revenues from the financial services sector which accounted for about 27% of our corporate tax take, that is way down. As I said to this Committee before, understandably people have been calling for a cut in bonuses but that has had a downside as far as the Treasury is concerned because no bonuses, no tax. In addition to that, our stamp duty revenues are down and other revenues are down too because of the general slowdown in the economy, hence the rise in borrowing. In addition to that there has been about a 4% fiscal stimulus. That is partly deliberate policy choices that we made, for example the VAT reduction, the increase in personal allowances, therefore the reduction in personal tax, and various other measures that I set out at the PBR and at the Budget. Because of the way in which our welfare state works the automatic stabilisers, the rise in benefits which comes with rising unemployment, have had an effect as well. A combination of those factors has meant that what the Government spends has been increasing and what the Government gets in has been going down, and obviously that has a feed through into debt. As I have said on many occasions at both the PBR and at the Budget and since, there are two elements to what I am trying to do. I am trying to support the economy now but, equally, there is quite a substantial tightening as we come into recovery, over £50 billion, and that I think is an important element because it is important to send a clear signal that whilst you support the economy now, like all countries, like all businesses, you have got to live within your means in the medium and longer term and we have got to have sustainable public finances.

Q244 Nick Ainger: Chancellor, certainly the opening part of your Budget Statement was related to the state of the economy in terms of the recession and unemployment and the measures that you were putting in place to address particularly youth unemployment, the under-25s. In questions earlier this week Martin Weale indicated that he felt the measures which were in place would still not stop unemployment rising to over 3 million and Professor Blanchflower said that without a very significant fiscal stimulus he thought that unemployment could rise as high as 4 million. Do you think the measures
that you have put in place are going to keep unemployment within that 3 million limit or is it likely to go further? If it is likely to go further, are you prepared to take further action to try and keep it down?

Mr Darling: I think both Martin Weale and Danny Blanchflower take a similar view. Certainly Danny Blanchflower would have wanted to have seen another quite significant fiscal stimulus. My view was that you have got to look at what I announced last week together with what we announced in the Pre-Budget Report last November where there was quite a substantial fiscal stimulus. You need to balance what you do by way of stimulus with the fact that at the end of the day it has got to be paid for, there is a trade-off there. My judgment was that the combination of both what we did in November and at the Budget last week is a significant fiscal stimulus. Remember it is not the only thing, we have talked about the automatic stabilisers, but you have got the lower interest rates, you have got inflation coming down and energy prices will come down. You have also got the effect of the Bank of England’s action of putting initially £75 billion into the economy. Taken together with the measures that other countries are taking, which of course affect us as a trading nation because you have to take them into account, my judgment was that was sufficient. As we come through this, and I come back to the Chairman’s point about uncertainty, of course at the Pre-Budget Report and at the Budget you would expect me to take into account what was happening in the general economy. As you identified, I did announce two quite major steps in relation to trying to help people who lose their jobs. One was generalised help through Jobcentre Plus and the other was quite specific in terms of a guarantee for the 18–25 year olds. Many of us remember what happened if you do not intervene. Unfortunately, a short spell of unemployment at that stage can lead to quite a long period in and out of employment. These are things you have got to keep under review. My judgment is that what we did, together with the forecasts we have in relation to growth generally and the overall performance of the economy, what I announced was sufficient, but, like everything, the reason that we have a Budget once a year and Pre-Budget Report once a year is it is an opportunity to take stock and see what needs to be done and to adjust accordingly.

Q245 Nick Ainger: You rightly target the resources on the under-25s because of the long-term impact that can have on the whole of their working career and, again, Professor Blanchflower has done some work on that. They represent approximately 40% of those who are unemployed. 60% of those who are unemployed are over-25. We will come on to the vehicle scrappage scheme which is targeting a particular industry, but did you give serious consideration to a short-time working package in addition to the tax credits which are available?

Mr Darling: Firstly, in relation to the point you make about there being many people who lose their jobs over the age of 25, of course I am very focused on that. The reason that we overhauled Jobcentre Plus and set up Jobcentre Plus, which as you know is an amalgam of the old Benefits Agency and the Employment Service, was because the model that we developed when the New Deal was introduced of intensive help seems to be successful, and indeed other countries are following that. The Jobcentre Plus is the core of our approach and that is designed to help anyone who loses their job. It is worth bearing in mind that at the moment the majority of people do find work within a matter of weeks and 75% within six months. Even in March it was over 200,000 people who went back into work. That is something that we want to capitalise on. I hope that helps deal with your first point. In relation to job subsidies, if you like, of course I considered it because it is something that some of the other countries are doing, although in France, for example, it seems to be quite intensely tied up with their national insurance scheme. My judgment was we provide that help to families, as you correctly say, through the tax credit system and, as I said in the Budget speech, about 355,000 people in March alone saw their incomes go up by about £35 a week because basically the tax credit took the place of a reduced income. In relation to a generalised subsidy there is a problem there, I think. One is inevitably there would be some element of deadweight cost and there is also the risk that if employers thought the Government was going to step in, then why not reduce their wages and the Government will make up the difference. Thirdly, if you are going to help specific industries then I think it is better to have specific help, whether it is, as you mentioned, car scrappage or there are other measures that we have taken to help the automotive industry through the European Investment Bank, for example, or direct help in research and development. I think it is better that you have something specific. I am not convinced, and you can see that in the Budget I was not convinced, that a generalised job subsidy of the sort of scheme I think you are referring to would be the right thing to do.

Q246 Mr Breed: Can we just turn to the asset purchase facility. Could you explain perhaps why, bearing in mind there is a great deal of emphasis on getting banks to lend into the industry and such, 50 billion only was allocated to the purchase of corporate bonds?

Mr Darling: That is out of the total.

Q247 Mr Breed: Out of the 75.

Mr Darling: When I authorised the Bank to go ahead in March I authorised a global figure and subsequent to that the Bank of England decided it would spend £75 billion. The whole purpose behind quantitative easing is to put money into the economy. What I did was to fix what I thought was a realistic envelope with which they could buy corporate paper, corporate bonds and, of course, the Bank is now starting to do that. As the Governor said when he spoke to you recently, the object there was not so much to be judged on quantity but what effect it actually has in terms of the willingness and the price at which companies can borrow. It is having
Q248 Mr Breed: 50 billion into corporate paper and such, presumably 25 billion to gilts?

Mr Darling: No, remember it was 50 out of a total of 150.

Q249 Mr Breed: So where is the other 25 from the 75?

Mr Darling: I authorised 150 that I said 50 of which could be used for corporate bonds, corporate paper. The Bank of England at, I think, the next meeting of the MPC took the decision that initially the first tranche would be 75 billion; however, we did not then sub-divide the proportion. The total of 50 simply refers to the ceiling, if you like, for the 150. I can tell the Committee were we to come to the position where they reached that level and there was a need to go on that is something I would look at, but we are not at that position at all at the moment.

Q250 Mr Breed: Essentially you are in agreement with the Governor as to the current levels?

Mr Darling: I like to think I always agree with the Governor whatever he happens to be saying. The point I am making is I have to authorise the totality of what the Bank does and I also have to authorise the split, if you like, between corporate activity and Government gilts.

Q251 Mr Breed: So at this stage you do not believe there should be any more into corporate paper at the present time?

Mr Darling: At this stage, given that the Bank of England is nowhere near that ceiling, that question does not arise. The point that I was making and the point that I think the Governor was making when he spoke to you was that it is not necessarily by quantity that he should be judged but rather by the effect of his interventions, and that is probably right.

Q252 Mr Breed: Could you just explain to us what the likely exit strategy from that would be?

Mr Darling: When we get through this, and the Bank of England’s target on inflation is 2% and that has not changed. If its judgement was that as the economy started to grow there was a problem with a rise in inflation the first and easiest mechanism it has at its disposal is interest rates. If you have purchased corporate bonds and Government gilts and you want to exit it, it is something that you can do without too much difficulty but you would want to make sure you were doing it in an orderly manner and you would want to do it in discussion with the Government’s DMO operations anyway because the markets would want to have an idea of how the Bank of England was winding down its position.

Q253 Mr Breed: But there is no broad principled strategy for the exit strategy at the present time, we will approach that when we think it might be necessary?

Mr Darling: The principles are these: firstly, the Bank of England’s target on inflation is 2% and that has not changed. If its judgement was that as the economy started to grow there was a problem with a rise in inflation the first and easiest mechanism it has at its disposal is interest rates. If you have purchased corporate bonds and Government gilts and you want to exit it, it is something that you can do without too much difficulty but you would want to make sure you were doing it in an orderly manner and you would want to do it in discussion with the Government’s DMO operations anyway because the markets would want to have an idea of how the Bank of England was winding down its position.

Q254 Mr Breed: You do not think market confidence might be improved if there was some clearer idea as to what the exit strategy is?

Mr Darling: When we get to that stage then that is something that we and the Bank will discuss. It is important that the market knows what is likely to be coming on to the market, just as the DMO at the moment—we have some experience of this—indicates to the market how many options there will be, for example, so the market has an idea of what its activity is likely to be.

Q255 Mr Fallon: Chancellor, do you recall that in the March 2003 Budget your predecessor promised that public finances would be back in balance by 2006 and that by 2006 that had slipped out to 2009, this year, when we are already over 50 billion out of balance even before the extra borrowing? In other words, the structural deficit was worsening well before the recession started and well before the bank bailouts.

Mr Darling: I thought you might ask that, and I do recall the 2003 Budget. If you look at page 252 of the Red Book, which I see you have got in front you, you will see that the structural deficit in 2006–07 was 2.3%. Of that, a large part which you will see in the column “Public Sector Net Investment” is accounted for by the fact that we have been for some time running quite a high level of public sector investment. In fact, I think it is three times what it was 30 years ago. Bear in mind, I was going to say we do not own any industries but we have acquired one or two recently, we do not have British Steel, British Shipbuilders or all that, but we have been building roads, schools and hospitals. You will see the historic series in that table which takes you back to what the structural deficit was in 1993, for example, when it appeared to be 5.4%, 5.5% in 1992 and it was coming down. As with all things when you look ahead, as they say, events occur and we have had quite a big event in the last 12 months.

Q256 Mr Fallon: But the deficit worsened before the last 12 months, that is the point that you cannot deny, is it not?
Mr Darling: My point was that for some time we have been carrying quite a high level of public sector investment and maybe we will come on to discuss that later. I am very happy to fully justify that because I think the infrastructure in this country did need more investment. You do not need to build a new school or a new hospital every single year, they last longer than that, which is why I have made an adjustment further out as we come through what has been quite a sizeable amount of investment in the economy.

Q257 Mr Fallon: We will come to that. Why did your Government then promise to balance the Budget in 2006–07?

Mr Darling: That was a Budget Statement six years ago. The Government set out what its objectives were and, indeed, Mr Ramsden is reminding me, if you look at the tables of where we got to by 2006–07, we were making progress. Since 2007 we have been hit by an extraordinary series of events, as indeed every other country has as well.

Q258 Mr Fallon: How are you going to convince the markets that you will eventually balance the budget, as you have now said, by 2018 starting in some rather difficult years if you failed to balance it in the boom years?

Mr Darling: Firstly, if you go back to the early part of this decade it is true that we spent more on schools, hospitals, police and so on, and there were not that many people saying, “Oh no, you shouldn’t”; indeed, many people were saying, “You should actually be spending more”. Equally, I think very few people would have quibbled with the idea in the late 1990s that in terms of our schools, hospitals, certainly our transport system, we needed to spend more, so, yes, we did spend more. You ask a perfectly pertinent question about where we are now where clearly borrowing is much, much higher and debt levels are higher as well, and the reason for that, as I said to the Chairman at the start, is given the extraordinary circumstances we and other countries have at the same time, I am in no doubt it is absolutely necessary, just as I would argue that we need to support the economy now, we do need to have a pretty clear view that this level of borrowing and the levels of debt need to come back down. As you know, in the Budget I set a path for halving the deficit over the next five year period.

Q259 Mr Fallon: Let us look at the impact on net investment. What is the cut in net investment that you are proposing this year? Is it the figure in Table C4 of a reduction of 8 billion, is that right?

Mr Darling: What I am proposing to do is bring the investment down so that it is growing at a rate of 1.25% after 2012. You will see Table C4 sets all the figures out from 2009–10 onwards. The figure is £44 billion in 2009–10, then it falls to 36, 29, 26 and 22. The reason for that is after the Olympics, which is obviously quite a major piece of infrastructure, and after a lot of the school and hospital building programmes are complete, we will still be running at a level twice what it was 10 years ago of public sector investment. On top of that, as I said at the Budget, having asked for a proper review to be carried out, I think we can do more in terms of asset disposal, the proceeds of which can be applied to public sector investment, capital investment.

Q260 Mr Fallon: Okay. The cut is 8 billion next year and then 7 billion the year after. Where will those cuts fall?

Mr Darling: We have set out our spending for both current and capital up until the end of the Spending Review period. We have not done the next Spending Review period.

Q261 Mr Fallon: This is the current period, Chancellor. You are cutting by 8 billion next year. Will those cuts fall on the Health Service, on school building, on what?

Mr Darling: For a large part of it we know what we are going to be spending. Some of the spending that we thought when we set out these plans is not going to take place. I believe that on the schemes that we have set out, the proposals in terms of hospitals and schools, we can maintain that programme of the things that we promised to do, and when the next Spending Review comes in we will have to look at every aspect of expenditure, and we will do it at that time.

Q262 Mr Fallon: I understand that. We are limited for time here. If it is not falling on hospital building or school building, where is the 8 billion cut falling next year?

Mr Darling: The figure next year is simply an adjustment we have made having regard to what we think we will actually spend next year.

Q263 Mr Fallon: You are calling it an adjustment but it is a cut of 8 billion.

Mr Darling: It is not a case of a school or a hospital that will not be built.

Q264 Mr Fallon: How can you cut 8 billion without something not being built?

Mr Darling: Because when we set the spending profile for the current review of 2007 we made assumptions as to what we would spend and sometimes those assumptions are realised and sometimes they are not. The actual expenditure of what we are doing at the moment, I made it very clear I want to maintain what we are doing, all those things that were planned at the end of the Spending Review period, and then we move to the next Spending Review period.

Q265 Mr Fallon: How can you maintain what you are doing if you are proposing an 8 billion cut? Would it not be more honest to say, “Yes, we are cutting 1 billion here or 2 billion there”?

Mr Darling: There is also another element, of course, that we have brought forward some expenditure that was planned in Year 3, 2010–11, in housing in particular and also in relation to the fact that there will be one or two schools, I am not sure about hospitals. We have brought forward some
expenditure so the totality of what is being spent within the period, apart from in some cases where we will not spend what we thought we might have spent a couple of years ago, there has been some bringing forward and housing, to my recollection, is one where there is quite a clear move, we brought it forward a year and, therefore, the money would not be spent in the third year.

Q266 Mr Fallon: So this is not a real cut of 8 billion then?
Mr Darling: What you are seeing in the figures next year is what we expect to spend.

Q267 Mr Fallon: So it is a cut?
Mr Darling: It is a recognition of two things. One, as I said, and this happens always from year to year, is sometimes you do not spend as much as you thought, but a lot of it is money being brought forward. It was last November that I promised that I would bring forward because I wanted to protect jobs at the present time. That is the position.

Q268 Mr Fallon: But overall it is a cut of 8 billion next year and 7 billion the following year?
Mr Ramsden: Can I just add that in 2009–10 we are actually saying that public sector net investment is going to 9 billion higher than we said a year ago at Budget 2008, so there is 9 billion more public sector net investment in 2009–10.

Q269 John Mann: The personal credit limits have come down drastically for everybody—virtually everybody—in the last nine months, so people have had to adjust their spending patterns. What evidence do you have, and if you do not have it now when will you have it, to see whether that is a one-off realignment of people’s spending, in other words they have reined in their debts but now they are on an even keel?
Mr Darling: I suppose the obvious answer to that is you will only know what people actually spend after the event. What we think is happening at the moment—

Q270 John Mann: That happened last year.
Mr Darling: We know people are spending less and we know that companies are spending less. We think that as the economy starts to recover because of people being back in work, because of lower prices, then that spending will begin to recover. At the moment you are right that consumers are restricting their spending although, interestingly, if you look at the retail sales figures, which—

Q271 John Mann: I am asking about personal credit. Do you have figures now on the amount of personal debt that people have, separate from mortgage debt, personal credit debt?
Mr Darling: We can estimate it.1 Dave might want to say more.

Q272 John Mann: Has it gone down significantly?
Mr Ramsden: To be honest, I do not have those figures in my head.

Q273 John Mann: In that case, it would be useful to know when we could get them.
Mr Ramsden: I think the Bank of England publish regular data on that and we can certainly let you have that information.

Q274 John Mann: Let me ask almost the same question but in a different way. Someone who was paying an interest-only mortgage last summer of £24,000 a year now would be paying an interest-only mortgage of £16,000 a year, so they have got £8,000 more to spend. What evidence is there that that spending is waiting to be spent as opposed to it has disappeared off somewhere?
Mr Darling: As I said, intuitively some people will save their money and some people will spend it. As Dave said, the Bank of England does make calculations on this.

Q275 John Mann: My question is are they saving it? We know whether they are spending it but are they saving it? Is it being used to write off previous credit debts?
Mr Darling: My recollection is in the Bank of England’s last report people are reducing their indebtedness. I cannot remember when the last Bank of England report was, February would it be, but there was evidence that people are reducing their credit card indebtedness and you can tell from the general activities that—

Q276 John Mann: If you have got £8,000 more a year to spend you can only reduce your credit card indebtedness once and then it is removed, that is a one-off adjustment.
Mr Darling: Yes, but you either then spend it or you save it.

Q277 John Mann: Absolutely. We do not know yet.
Mr Darling: No, because you are asking about future activity. We could make assumptions.

Q278 John Mann: It is only just the future. You are projecting a £175 billion public sector deficit and some economists are suggesting, are paid to do so in newspaper articles, it could be worse than that, but business seems to be suggesting the public sector is rather a rosier scenario in terms of how they perceive it. Are you not overstating what the deficit this year is going to be?
Mr Darling: Firstly, in terms of our fiscal projections they are cautious, and I know you had a discussion about that at the hearing yesterday. You are right, there are some forecasters who say that our borrowing will be less than we think it is and there are some who think it will be more. We have tried to set out our forecasts on the basis of all the information we have. At the moment, you are right, once you have paid off your debts, if you like, then either you save it or spend it. Our projections are that people will start to spend their money as we start to
come through the recession and, as you rightly say, if you look at the figures just now, frankly, they are mixed. There is some evidence that people are maintaining their spending and there are other surveys that we look at which suggest we have got some way to go yet.

Q279 John Mann: My final question is there are a lot of people who have got more money to spend because their mortgages have come down so they have got a lot more potential disposable income, the majority of spenders in fact, so there is money there to be spent, but it is confidence of course. Would it be helpful if you were to outline what the real options are should the deficit be anything like your cautious assumptions and projections by providing the options on public sector cuts in the future, in particular outlining whether it should be capital projects that are delayed while the economy recovers or whether your choice would be jobs that go because of the public sector deficit? My answer this morning from the Secretary of State for Defence, to give one example, was he estimates the Trident costs for the next two years as being at 400 million and 400 million. Would it be helpful to have that kind of capital spending figure so that the policy options on projects which could be delayed can be outlined in order that consumers can see what the real options are over the next two or three years?

Mr Darling: Two things. My attention is being drawn to the fact that we are giving a further memorandum on spending which I think you asked for yesterday and which you are about to get. On the general point you make, what we do in the Budget is we set out what we assume is going to happen and on the assumptions that we make, both in terms of current and capital spending, and as I was saying to Mr Fallon a while ago, which I think everybody accepts, at the time of the next Spending Review we will have to decide how much we are going to spend on current and how much we are going to spend on capital. That is the whole purpose of having a review. Given the present uncertain times, and especially given the fact that we have not started that process yet, it really is impossible to tell you what the Government might decide to do or not. What is quite clear is the envelope in which those decisions will be made will be tighter than it was and if you look at the level of public spending it is 50% higher than it was in 1997. That is a decision that we will have to make at the appropriate time.

Q280 Mr Tyrie: Were you aware, Chancellor, before the Budget and before the IFS pointed it out, that from 2011–12 onwards you announced a small real terms cut in public spending?

Mr Darling: Was I aware what I announced?

Q281 Mr Tyrie: Were you aware, before you announced your Budget, that in the Red Book – Mr Darling: Of course I was. The Budget and the Red Book go together. Obviously I was not aware of the IFS’s reaction because the IFS publish their reaction, self-evidently, after the event.

Q282 Mr Tyrie: So you are accepting that you have announced cuts in real terms in public spending?

Mr Darling: What I announced was—

Q283 Mr Tyrie: I want clarity.

Mr Darling: I know what I announced.

Q284 Mr Tyrie: Okay. Have you announced cuts in real terms in public spending from 2011–12?

Mr Darling: Public spending will grow as we set out in the Red Book. Your question was did I know what was in the Red Book, well, quite clearly, I did. What I have done though is that the assumption in relation to public spending will grow at 0.7% and the capital spending will come down after 2012, as we discussed earlier. It is a much tighter spending envelope than we have had in the past although there have been tighter ones in the past.

Q285 Mr Tyrie: I am asking a very straightforward question, are you clear that you have announced a cut in real terms in public spending from 2011–12?

Mr Darling: What I announced was that—

Q286 Mr Tyrie: Have—

Mr Darling: Let me answer the question. Current spending is going to grow at 0.7%; capital spending will come down to 1.25%.

Q287 Mr Tyrie: I am talking about total managed expenditure.

Mr Darling: I know you are.

Q288 Mr Tyrie: Why are you giving me an answer broken into the various components?

Mr Darling: It is important to make the distinction between the two, I think.

Q289 Mr Tyrie: What I said therefore is correct and the IFS are also correct?

Mr Darling: What I said—

Q290 Mr Tyrie: Is that a yes or a no?

Mr Darling: What I said is that current spending will grow at 0.7%, capital spending at 1.25%. Of course you can derive a figure from total managed expenditure, but in terms of actually looking at what happens and what the effect is and what the Government spends on schools, hospitals and the police on the one hand or building railways or housing or roads or whatever on the other hand, then I think you need to look at those two figures individually.

Q291 Mr Tyrie: For the wider public, from a Government which has said persistently that we need higher public spending, do you not think it will come as something of a surprise and a shock that you are now announcing a cut in real terms in total managed expenditure?

Mr Darling: I do not know if you have in front of you Table C4, but you will see current spending is increasing over that period. If you take public expenditure, I have made it clear on many occasions we have increased public expenditure because we
believed it was right to do so on the key public services, like the NHS, like police numbers, we have also increased capital expenditure, and as I said it is three times as high as it was back in the 1970s, but as we go into a period where we have spent a lot of money, where we do need to make sure our borrowing and our debt starts to come down, that does mean you have to take some quite tough decisions. I think it is perfectly reasonable. People will accept, for example, that you do not need to build a new school, a new hospital, every year, self-evidently, but you do need to take decisions in relation to how much you want to spend on employees in the public service and so on, how much you spend on defence and so on—

Q292 Mr Tyrie: Chancellor, I am only really asking as an initial question for clarification, that you are telling the public that you are planning to cut public expenditure in real terms over the planning period? Mr Darling: Current expenditure will grow by 0.7%.

Q293 Mr Tyrie: They—
Mr Darling: That is not the answer you want, but that is the answer.

Q294 Mr Tyrie: They will notice the evasiveness of that answer.
Mr Darling: They will notice the fact that public spending will grow at 0.7%.

Q295 Mr Tyrie: Yesterday, David Ramsden and I had an exchange about the structural deficit, which is now at nearly 80% of GDP, based on what we eventually established as a realistic assumption of the NAO’s that there had been a one-off fall in GDP of 5%. Knowing what you know now and with the advantage of hindsight, and looking only at the public finances side, do you think there is anything advantage of hindsight, and looking only at the fall in GDP V

Mr Darling: Firstly, in relation to the deficit over the last few years—and my answer is exactly the same one as I gave to Mr Fallon—if you look at the 2006–07 figures, most of it was contributed to by the fact we were running a comparatively and historically high level of public investment in things like transport and new build schools and hospitals and so on. That is something which I think was absolutely right. There was a woeful legacy of under-investment in the past and I fully justify it. In relation to the discussion you had with David Ramsden yesterday, which I had the benefit of reading, my interpretation of the exchange is not quite the way that you put it, in that what Dave said—and as he is here he will no doubt correct both of us if either of us is wrong—is that we have assumed that although at this stage no one can be sure about what the effect of pure recession, if you like, is on our economy, we think there is undoubtedly going to be some hit and that is why we assumed 5%. That is a sensible assumption, it is driven by a number of NAO assumptions. Then of course that structural deficit comes down from 6.7 to 3.2% by 2013–14. But what we are not saying is that this is a permanent hit or as a result of everything that has happened in the past, but it is sensible for us, is it not, to make some assumption, and inevitably that assumption is going to be surrounded by uncertainties.

Q299 Mr Tyrie: You said a moment ago that this is not a permanent hit. Just to be clear, are you saying that this 5% cut is not a once-and-for-all—
Mr Darling: Can I—

Q300 Mr Tyrie: Hang on! Are you saying that 5% cut is not a once-and-for-all loss of GDP as the NAO have said it is?
Mr Darling: It is a loss to the GDP, what I am saying in the longer term—

Q301 Mr Tyrie: A permanent loss to the GDP? A once-and-for-all loss, as it is described by the NAO?
Mr Darling: What you cannot be sure of, even five years out, is to what extent other parts of the economy will develop and other parts of the economy will grow. Inevitably at this stage, our estimate is driven by a degree of caution.

Q302 Mr Tyrie: Is this a once-and-for-all loss or not?
Mr Darling: We make that assumption—

Q303 Mr Tyrie: Could you possibly say yes or no to that?
Mr Darling: We make that assumption but—

Q304 Mr Tyrie: That is a yes. Is that a yes?
Mr Darling: What I am saying to you is, at this stage, looking out over the next five years, there are all sorts of uncertainties about what will or will not happen in the economy.
Mr Tyrer: No further questions, Mr Chairman.

Q305 Sir Peter Viggers: Chancellor, you have always defended your statement made in your Budget last year that Britain is better placed than any other economies to withstand the slowdown in the global economy, since when the pound has fallen against the dollar by 27%, it has fallen against the euro by 15%. Current receipts are down by £39 billion compared with comparisons and the fiscal balance is down by £128 billion. I suppose my question really is to invite you to recant or at least explain and apologise for your statement last year, and perhaps it is more in the field of psychoanalysis than economics to ask whether you are still in denial that your statement last year was wrong.

Mr Darling: Firstly, in relation to our economic position in March 2008, we had had then, as you all know, over 10 years of very substantial growth in our economy. We had more people in work, three million more in jobs. We had low inflation. Our debt levels were lower than most other G7 countries, a point noted by the IMF in its fairly recent report when it said that Britain and other G7 countries had entered this difficult phase better placed to be able to do something about it.

Q306 Sir Peter Viggers: So you are still in denial?

Mr Darling: You cannot deny the fact that there were more people in work, there was lower inflation and there were lower debt levels than there had been in the previous 10 years. Since that time, quite obviously, the conditions have deteriorated but we are not alone in this. Look at the German figures out today, look at the American figures out today, look at what is happening in France and Spain.

Q307 Sir Peter Viggers: Yes, but on the markets we have been marked down, have we not?

Mr Darling: No, no. There has been a lot of volatility in a lot of markets and it is simply not true, and I do not know of anyone outside of a fairly narrow band in this country who seriously believes, that only our country is affected by this.

Q308 Sir Peter Viggers: The national debt is rising to worryingly high levels. How heavy will that debt burden be at its peak?

Mr Darling: The debt figures are set out, but just coming back to your earlier point, look at the German figures published this morning and about the impact they think they have in quarter one, the American figures, what is happening in Spain. All countries are being affected by a similar problem. Yes, debt levels have risen substantially here and in other countries, and indeed other countries do have higher debt levels than we have at the moment and that is likely to continue. This is an inevitable consequence of the turbulence that the world economy is going through at the moment.

Q309 Sir Peter Viggers: Okay, you are in denial.

Mr Darling: I am sorry, it is a matter of fact.

Q310 Sir Peter Viggers: How much higher will the debt burden be for every one percentage point rise in gilt yields and are you satisfied that you will be able to raise the necessary money?

Mr Darling: Yes, I am, and if you look at our effective rate of borrowing at the moment it is lower than it was in the past. We continue to see a very healthy appetite for government gilts, and I think markets know, even if you will not accept it, that other countries have got similar difficulties to the ones that we face. What they are looking for is two things. One is the country taking sensible steps now but also that the country is prepared to take the necessary steps to make sure that we live within our means in the medium and long term, so the answer to your question is yes.

Q311 Sir Peter Viggers: I raised yesterday, and you may have been briefed, the debt service cost trade-off of the five issuance strategies which are looked at in the Debt Management Office’s publication. There are five possible strategies in this publication and in each case the simulation of the nominal and real yield curves are downward sloping, whereas in fact some of the projections are upward sloping, so what would happen if the markets turned against you and you needed to raise the vast amount of money you will need to raise?

Mr Darling: You are asking me to speculate on something that I do not anticipate being the case and it is quite pointless to do so. What we have got here is the simulations that the DMO does and they are based on the best estimate of what we are doing. I did not need to see the exchange between you and Mr Ramsden yesterday on that point.

Q312 Sir Peter Viggers: How do you explain the current resilience of market demand for UK government debt?

Mr Darling: Explain the resilience?

Q313 Sir Peter Viggers: Yes.

Mr Darling: I think there is a demand from both overseas and from pension funds, and if you look at what is happening and compare us with other countries, which you appear to be increasingly reluctant to do, one of the things that I think investors like is that a lot of our stock is comparatively longer dated than a lot of the stock that is available in the European markets so far, and remember, just in case you come back and get me one day, as Mr Stheeman, who runs the DMO, said, we are in uncertain times but so far there appears to be a healthy demand for our gilts.

Q314 Sir Peter Viggers: You said in response to a question from a colleague a few moments ago that you would be publishing a spending report soon. Is that the long-term public finance report which was not published alongside the Budget?
Mr Darling: Because of all the uncertainty at the moment I think it is better if we publish the long-term finances report later in the year and we will do that. With regard to the point being raised, I think by John Mann or Colin Breed, in relation to the next spending review, we have still to decide when we do that.

Q315 Sir Peter Viggers: One commentator, Martin Weale, described the temporary operating rule as a tautology. How much thought has been given to a new fiscal framework to replace the temporary operating rule?
Mr Darling: That is something that we need to address in the present conditions and there is so much certainty around that I think that we should stick to where we are. I read his criticism but my main focus at the moment as we try to get through this, and we will get through this, is to make sure that we do what I said in the last PBR, and that is to work towards reducing the amount of borrowing and reducing the amount of debt. I think that is the main focus of us and, at the risk of provoking you further, most other countries in the world.

Q316 Mr Todd: You used the words “dead weight costs” in answer to an earlier question. What proportion of the cost of the scrappage scheme is dead weight?
Mr Darling: I saw your exchange yesterday in relation to the scrappage scheme. There is a fine judgment to be made here. There is no doubt that the automotive industry in this country, which, as you know, because, if I remember rightly, you represent the Burnaston plant, which I did indeed visit the first day I was Secretary of State for Trade and Industry, has been one of the success stories in British manufacturing for the last 10 or 15 years, and in 2007 I think we were making nearly as many cars and vans as we did in the heyday of British car manufacturing. There is a lot of expertise in there, there is a lot of development going on, and the question is, what can we do to help? As you know, we have made money available through the EIB, and I looked at this, and there are arguments, frankly, that you can run both ways, as you know, but the balance of my judgment was that I thought that this would help the industry as a whole, and I know there is the argument about how much is British in any one car that is imported or exported.

Q317 Mr Todd: And how many people would simply buy a car anywhere.
Mr Darling: That is right, although part of the car industry’s problem at the moment is that not that many people are buying cars.

Q318 Mr Todd: The calculation we came up with consensually in the discussion yesterday was that perhaps between 10,000 and 15,000 cars produced in the UK might be supported by this scheme. £300 million seems quite a lot if one is defining the goal as narrowly as that.

Mr Darling: Yes, but that is quite a narrow definition. If you look under the bonnet of most cars, if you are feeling very bored one day and look around at who makes the various components, it is remarkable how cars are pretty multinational and some of the cars that are assembled in France or Germany will have British components in them. The distributive trade, as you know, is also part of the supply chain.

Q319 Mr Todd: They will presumably lose second-hand business as a result of this.
Mr Darling: They sell on new and second-hand cars. This is a time limited scheme. It is also cash limited, because I did look at what happened in Germany, where, of course, they spent an awful lot more, and in France too, but I thought on balance, given the importance of this industry, and it is a major employer in your constituency and in others, it was right to see whether or not it would work, but it is cash limited and it is time limited.

Q320 Mr Todd: There are some major employers close to my constituency as well in the brewing industry who might have hoped for more favourable treatment on taxation in this Budget.
Mr Darling: On alcohol duties.

Q321 Mr Todd: Indeed. Did you consider the claims of the Save Our Pubs campaign?
Mr Darling: Yes. I had a lot of representations, as you might expect, from both the pub industry and the brewing industry, but the basic difficulty is this, that at a time like this, when everybody agrees that borrowing needs to come down, you do need to raise revenue. There are two problems. One is that in the nature of this tax you cannot differentiate between on-sales and off-sales.

Q322 Mr Todd: I will agree with you and then qualify it by saying that there does appear to be some evidence that you could distinguish between cask, bottle and tap.
Mr Darling: But I think it is pretty limited. I did look at this because I am conscious of the importance, especially in a number of communities, of the pub life, if you like, and also of the smaller brewers.

Q323 Mr Todd: And also the environmental impact of bottling and canning as opposed to recycling.
Mr Darling: Can I just make the general point that there are some things you can do at the margin but, as you know, if you look at the price of alcohol, especially in the supermarkets, which in real terms has come down quite substantially, I have to take that into account when deciding overall what is fair in terms of revenue raising. By the way, I have not met a single person who will tell me a tax that nobody has signed up to and everybody would like to see increased. All taxation causes difficulties. On the pub trade there is, as you know, a long-term problem. The number of pubs has been in decline for 30 years now and there are various other factors—the smoking ban, people changing habits and so on, although some of the broader business measures I
have introduced, like time to pay, being able to carry back losses, the ability to spread the business rates and so on, I hope will help as well.

Q324 Mr Todd: Would you reflect a little further on the opportunities to differentiate to some extent in the packaging of the product because there are substantial differences in both the environmental impact of how you enclose the alcohol but also in terms of the public order issues of the use of bottles and cans and so on when you are drinking in the street? There is a broader set of public policy issues which would suggest to me that there is room for some nuance, as you were suggesting.

Mr Darling: Of course I will, and you would expect me to do that at any Budget or Pre-Budget.

Q325 Jim Cousins: Chancellor, can I just ask you to confirm that there are not proposals on the table for the sale of Northern Rock?

Mr Darling: There are people who will always be interested in buying Northern Rock for as long as it exists but perhaps I should just repeat what I said in the House of Commons yesterday because I know you raised it at the hearing yesterday. Firstly, we have always said that our intention is to return the banks that we own back to the private sector. That does not, by the way, rule out if someone came along with a proposal for a mutualisation; of course we would look at that. However, my overriding concern is to make sure that when we come to sell we get value for the taxpayer who has had to step in and put a lot of money into Northern Rock, and indeed other banks, so it is not something that I want to rush into. I am not saying if someone came along tomorrow morning and offered a fantastic price for it we would not sit down and look at it, but if someone is thinking of coming along and offering one of these deals where basically I appear to have to pay them rather than they pay me then I am in no hurry to sell. Northern Rock’s long-term future, as we said right from the start, will not be in government ownership. The Government does not believe that it is in a position to run that bank any more than it is in a position to run the other banks that we happen to own at the moment.

Q326 Jim Cousins: What follows from that, Chancellor, and I do welcome what you have said, is that at some point in the future we will look to dispose of the holdings in RBS, Lloyds, Northern Rock and so on, and you are right that at that time there will be money coming onto the books that will be on the plus side. However, just at the moment, as you are rightly say, we are both agreed on this: it would probably be right to assume that we are probably going to have these banks for a little while yet.

Mr Darling: You are absolutely right; at some point in the future we will look to dispose of the holdings in RBS, Lloyds, Northern Rock and so on, and you are right that at that time there will be money coming onto the books that will be on the plus side. However, just at the moment, as you are rightly say, we are both agreed on this: it would probably be right to assume that we are probably going to have these banks for a little while yet.

Q328 Jim Cousins: That is very helpful to me and perhaps to the Committee as a whole. Can I just ask you about home buying? Home buying, setting up home, is crucial for the public finances because in setting up home people produce revenues for the Government in a big way by buying not just the home but also everything that goes in the home.

Mr Darling: Yes.

Q329 Jim Cousins: This is perhaps a topical moment for Members of Parliament to mention such practice. Now, could I sort of say that in the various proposals there are to help the housing market, there is no simple, universally available and accessible scheme to support home-buying. Why is there that gap? Could not the money which is being used on this whole scatter of other schemes have been better used on a simple scheme like that?

Mr Darling: First of all, I fully accept the underlying premise of what you say, that it is the Government’s policy, and I think it has been a successful government policy, to support home ownership. It is an aspiration that millions of people have and we want to help people fulfil that. We also need to make sure, for the sake of completeness, that there is an adequate rented sector too because I think that is important. In relation to supporting home ownership, I think there are two big things that are fundamental. One is the availability of employment because it is people’s jobs and their incomes which will determine their willingness and their ability to purchase, and the second is the availability of mortgages. That is one of the reasons that I decided that, given what had happened to the Icelandic banks and so on and other difficulties, we would let Northern Rock come back into the market which will make more money available, and I think it is about £5 billion. Also, in the Budget I was able to say that at long last we had got state aid clearance to put in place a scheme that would allow for greater securitisation, therefore, as the market picks up more money, but the two big things that would help people are employment, trying to get people back into work, protecting jobs as much as you possibly can, and the availability of mortgages. Underneath that, there are specific schemes that are more designed for people who are getting into difficulty. There is the support for people who have lost their jobs, which comes in after 13 weeks, there is the Mortgage Support Scheme for people where one partner has lost his or her job, and then of course there is also the Homebuyer Direct Scheme as well, but the primary way of helping people, I think, is through employment and through the availability of mortgages.
Q330 Jim Cousins: Do you not accept, Chancellor, though that, if a deposit of 25 to 40% is going to be asked for upfront before a home is purchased, that means that young people at all levels of income who do not have access to the bank of mum and dad, they are wiped out and they cannot enter home ownership and that means a big loss of revenue to the Government?

Mr Darling: You raise a moot point as to whether or not the Government and, therefore, taxpayers in general ought to be providing deposits or a contribution to deposits. You know that for many, many years under successive governments there was mortgage tax relief which was phased out, I think, in the 1980s and I think most people do not see an argument for reintroducing that. Frankly, at the moment I think the big challenge for us, firstly, is to make sure that we maintain as many people in work as we possibly can and, secondly, that we get the building society lending going again. There have been some more encouraging signs there of late and you are seeing higher LTVs, loan to values, being offered than you have seen in the past, although banks and building societies are being more careful than they were perhaps in the past and saying, “If you borrow larger sums of money, we will either ask for more security or we will be careful that we price that right”, but, if you are asking me whether we are thinking of subsidising that, quite clearly there was not such a measure in the Budget, although I am not at all sure whether that is what you would want to do, but we are here to discuss this Budget.

Q331 Mr Brady: Chancellor, last year when you set up your Tax Task Force, you said, “I’m determined that we will do what is necessary to remain one of the world’s best places to do business”, and in last year’s Budget you said that we would have a competitive and simplified tax regime as that was essential. Are you not concerned, therefore, that from next year we will have the highest income tax rate in any of the major Western economies?

Mr Darling: Well, firstly, I would not raise tax unless I felt I had to, and the reason that I raised the top rate and brought it forward to 50 pence was that, as I think many people would concur, we do need to set ourselves on a path where we can reduce the amount of borrowing, that we can reduce debt at the same time of course as helping people at the present time. Now, as Mark Todd was saying, he drew attention to the fact that alcohol duty is going up and that is a tax that many people pay, it is a broad-based tax. I do not think it is unfair, given that people at that top end, and we are talking about the top 1%, have seen their incomes go up quite dramatically over the last 10 to 15 years, that we should not say to them, “Look, you’ve got to make a contribution”. I think in relation to the pensions tax relief, if you were starting from here, you would not develop a system where a quarter of all the relief you give goes to 1% of the top earners—

Q332 Mr Brady: I was not asking about that.

Mr Darling: No, but I thought I would mention it.

Q333 Mr Brady: I was asking about competitiveness. I think the top rate in Germany is 45%, in France it is 40% and in the United States it is 35% and we will have a rate of 50%.

Mr Darling: If you want to start looking at the German and French regimes, you have to look at everything they pay because some of their social insurance payments take you up quite high. Also, in America you need to look at the state taxes as well as the federal taxes.

Q334 Mr Brady: And, in aggregate, you are confident that we will still have a lower tax rate than all of them?

Mr Darling: You are asking me about the need to be competitive, by which you mean when people look around the world and decide where they want to do business, yes, of course we need to be competitive and tax is one of the things that people look at, ease of doing business, the general environment in which you operate, your regulatory environment, all of them. I want us to remain competitive, and I was saying this morning at the IoD that you do not raise tax for the sake of it, but I decided that in the present circumstances where clearly we do need to take action and indeed, at the risk of provoking Sir Peter again, other countries are going to be facing exactly the same problem, we have got to make sure that we in the medium and the longer term take action to get down the amount of borrowing we have got.

Q335 Mr Brady: Why did you pick £150,000 as the starting rate for the new tax?

Mr Darling: There is no science behind it, it is just simply my judgment that I thought that figure was an appropriate figure. It is the top 1%, as it happens, of earners in this country and I decided that that was the right level at which to pitch it. Indeed, when we talk about the 45% rate, you will remember that that is attached to the £150,000 as well.

Q336 Mr Brady: You will be aware of the exchange I had with Mr Williams yesterday from the Treasury, and he did not appear to be able to tell me whether you had looked at other possible starting rates which might have had a higher yield as a percentage of the total available.

Mr Darling: I was quite clear that, as far as the rate of taxes was concerned, I wanted to push it as high up as I possibly could. I was particularly concerned about people on, what I would call, middle or modest incomes, people up to £100,000, and I did not want to do anything that would increase the amount of direct tax that they paid. You ask me why I chose the level of £150,000 and that was simply my judgment. I had to balance reluctantly, if you like, because, having spent the best part of 10 years in a government that had essentially two rates of tax, I think it is important that we are competitive, but in the present circumstances, and other governments are going to be confronted with this, we need to take
action to support our economy and also to live within our means, and I thought this was a fair thing to do.

Q337 Mr Brady: You will be aware that it has been reported that the Defence Secretary and the Communities Secretary wanted it set at £200,000, the Leader of the Commons wanted it to come in lower at £100,000, your former colleague in the Government, the Member for North Tyneside, described it as “cynical politics” and said it was just “political positioning and tactical manoeuvring”. You say that this was something you felt was appropriate, but it was not scientific. How do you answer the charge that this was just a political exercise?

Mr Darling: Well, I simply do not accept it. I know why I reached the decision that I did, and I reached the decision because I thought, in the circumstances, that this was the fair way of ensuring that we did raise sufficient revenue. There are general taxes, if you like, indirect taxes which people have to pay, and that decision was mine and I stand by that decision.

Q338 Mr Brady: And it is worth introducing a new tax which might only yield 31% of the potential?

Mr Darling: Again I saw that in the exchange with Mike Williams yesterday. Inevitably, we will take a cautious view as to how much we raise, especially at higher levels. The point was being made, firstly, because I mentioned the pensions contributions which we are going to restrict, and that means actually that we think we will collect rather more because the option of simply paying yourself through the pension will be taken away. In relation to people at that level of income, inevitably, people will want to take advantage of ISAs and they will do various other things, but, if you look at the actual table and if you see the yield that comes in from those measures, and this one, I think, is about £2.4 billion when it is there totally, it is quite a substantial sum of revenue. All I would say to people who tell me they do not want me to do it is, “Okay, so what else are you suggesting? Where else would you go?”

There is no getting away from the fact that we do need to take steps to deal with the result of the fact of our corporate tax revenues, which could well come back in years to come, which, for as long as banks do not make any money, they will not be paying any taxes.

Q339 Mr Brady: Chancellor, you have raised twice the question of the pensions implications. All you have done is break a fairly longstanding principle that tax relief on pension contributions will stay at the highest marginal rate. Can you give some certainty that that is now not going to change again, that you do not see it as a reasonable thing to go back and change?

Mr Darling: I certainly do not want to. As I think I said earlier on, if you were designing a system of pension tax relief, I can see the logic, if you like, of simply aligning the relief with whatever the rate of tax happens to be, but you do reach a stage where, if a quarter of everything that the general taxpayer forgives in terms of tax relief is going to 1% of top earners, you do begin to think, “That can’t be right”, and it is about £3.5 billion, it is quite a lot of money. That is why, especially at a time like this where, inevitably, you are going to be faced with difficult choices, you have to ask yourself, “Okay, who’s going to shoulder the burden?” and I do not think it is unreasonable to say to people at the very top, some of whom have put remarkable amounts into their pension schemes in one way or another, that they have to make some contribution.

Q340 Mr Love: Can I follow on from that and come at it from a slightly different angle because, as has already been mentioned, we were told yesterday that the yield from the 50p tax rate is roughly 31%, but you talked about fairness. Are you satisfied that raising only 31% meets your criteria of being fair?

Mr Darling: I think the figure that Mike Williams quoted, when you take into account the pensions measures, takes you up to about 38%. It does not mean that the rest are not paying it, it means that we have to take account of the fact that people will use tax-planning, which they are perfectly entitled to exercise, and other means, and it is sensible to budget for a slightly lower yield. The amount you actually get, we will have to see when that comes in, but I think the question you are asking and the question Mr Brady was asking as to the rationale behind it, “Why are you doing it?”, it is quite simply because, at a time like this, we do need to make sure that we can raise revenue.

Q341 Mr Love: And we are raising revenue, but we are also missing out significantly on revenue. You mentioned the yield going up to 38% with the interactions on the pension tax relief, which I understand. If you consider a range of options for combining both of those, it would have raised a higher yield.

Mr Darling: The reason why, if you like, that you do not get absolutely everything in is that, for example, I raised the ISA rates as part of the Budget, which is mainly aimed at people on incomes a lot lower, but, if someone is earning, say, £170,000/£180,000, they can take advantage of ISAs, they can take advantage of various other things. Short of shutting off just about every avenue, which I think would be more difficult to justify, I think what I am proposing is fair and reasonable. Really, if you look at those figures, the actual collection rate, if you like, it is a cautious estimate, but I think we are right to be cautious because, if you assumed you are going to get a great deal more than that and then you do not at the end of the day, you would be criticised.

Q342 Mr Love: Well, I do not want to get into the ISA issue, but there has been quite considerable comment in relation to the 50p tax rate, that the two ways in which people can offset the amount that will be raised will be, first of all, to put it into a pension, and we have talked about that, and raising the yield, and the other way is to turn some of their income into capital and pay a different tax rate on that particular part of their income. Was any
consideration given to that, considering that almost all of the comment that there has been is that there will be a significant shift from income to capital and, therefore, reduced tax rates for these people?

Mr Darling: No. I had a number of things to do in the Budget, and one was to make sure that we raise sufficient revenues, so I looked at those rates, but I did not really want to dig up the entire tax system. I think that would have caused more difficulties and, especially at a time like this when you are actually wanting people, for the large part, to be spending money and to be considering investment, I think that would not have been the right thing to do.

Q343 Mr Love: Finally, in relation to that, it is clear that there has been public acceptance of the idea that, as you mentioned earlier, people who have done exceptionally well over the last 10 years should make a contribution. Are we not rather undermining that public perception and public support by accepting that significant numbers of people and amounts will be lost through one means or another by tax-planning?

Mr Darling: Tax-planning has been with us, presumably, since the beginning of the 19th Century when, you will remember, income tax was introduced on a temporary basis during the Napoleonic Wars and, I dare say, ye olde tax planners have been doing a roaring trade ever since. It is perfectly legitimate for people to tax-plan. They planners have been doing a roaring trade ever since. The principal thing that we were doing to stop the problem that you are concerned about, but it might be quicker to send you this note.2

Q344 John Thurso: Chancellor or Caesar—Mr Darling: No, no, no!

Q345 Mr Love: Chancellor, will that be enough? What market-testing have you done and what consultations have you carried out to ensure that, when some of these things come forward with a guarantee, the investors will look to invest in them because of course the trust and confidence in asset-backed security was shot through from before?

Mr Darling: I happen to have a note here and there is no reason, just looking at it quickly, why you cannot have it, which sets out the work which we have done, the criteria which, I hope, will give you some reassurance that there are safeguards here precisely to stop the problem that you are concerned about, but it might be quicker to send you this note.2

Q346 John Thurso: can I turn to the green chapter of your Budget, building a low-carbon recovery. Firstly, a specific question: you spoke quite a lot about offshore wind, but why all the money for offshore wind and nothing for tidal energy?

Mr Darling: The principal thing that we were doing was to change the Renewables Obligation, which you are familiar with, to support offshore wind, and the reason for that is that there are a number of offshore wind farms where the financing has been stalled primarily because of the credit crunch, and we spoke to a lot of people in the industry to say, “What sort of things do you need to do if we’re going to get this unstuck?” Frankly, the reason that we went for it now is because there are a number of offshore schemes that are almost ready to go, or near to that stage, and we wanted to see them brought forward. Now, in relation to marine, as you will know, whilst there is quite a lot of experimental work being carried out and indeed there are a number of prototype marine schemes, it is not at quite the same stage as, for example, some of the big offshore wind farms down the east coast of Britain.

Q348 John Thurso: That is the point that I actually want to get to because the Crown Estates are in the middle of licensing the first round of them at the Solway Firth. Two major international companies are committed, one to investing £150 million and the other to £100 million, and our biggest, most important and best known engineering company wants to put a factory there for 300 jobs, and all they

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are waiting for is equal treatment with wind. Is this not a golden opportunity for you actually to be able to deliver quickly?

**Mr Darling:** We did announce, I think it was, a £400 million scheme to encourage investment in new technology. As you know, I am familiar in general terms with what is going on in the Solway Firth, not the actual detail of each scheme, but we did announce additional money that might be available and might help, and you may want to take that up with the Secretary of State for the Environment.

Q349 **John Thurso:** I have actually taken it up with the Secretary of State today and with the Secretary of State for Scotland. It worries me that the Treasury does not know about it, so may I take it up with the relevant person in the Treasury?

**Mr Darling:** I know about the marine developments because my 18 months or so in the DTI did leave some impression on me, but what I am saying is that the particular schemes you refer to, whether or not they would qualify, I cannot tell you that, but what I can tell you is that there is a fund, it is about £400 million, and it is available, I think, to help with the sort of thing that you are talking about.

Q350 **John Thurso:** Can I move on to the generality. In the briefing that we had from Professor Jackson at the Sustainable Development Committee, he states that the £50 billion figure which is quoted is largely private investment that will flow from government policies and it is not committed spending. These policies were set in place before the economic crisis and this spending cannot, therefore, be seen as stimulus spending. Do you concur with that?

**Mr Darling:** Well, I know the argument which I do not accept, that people say that, unless it was announced as stimulus, it is not stimulus. For example, last November we announced about £20 billion worth of extra spending. Some of that was directed towards energy-related projects. I do not think you can divorce that from the totality of what the Government has announced. I have looked at the comparisons between what we do and what the Americans have done and I very much welcome the comparisons between what we do and what the Government has announced. I have looked at the actual detail of each scheme, but we did announce additional money that might be available and might help, and you may want to take that up with the Secretary of State for the Environment.

Q351 **John Thurso:** A number of respected figures from Lord Stern through a variety of others, including organisations such as Greenpeace, have all said that, whilst to one degree or another they welcome the money that is going in the direction of green investment, they all say it is going to undershoot, and there are a variety of figures, but they are all much higher than the Government’s. What they are saying is that you will not meet the carbon emissions targets with the spending that you have put forward. What do you say to that?

**Mr Darling:** Well, two things. Firstly, everyone who has got an interest in these things will want you to spend more and that has to be tempered by the fact that that has to be financed one way or another. As you know, we set out the first Carbon Budget last Wednesday for the next three periods and we believe that we can meet those targets. We have got a fairly stretchy target at the moment and it may go further actually if we can get agreement at Copenhagen later this year, but we have set out a number of measures which mean that we think we are going to meet them. Now, obviously, if you are looking out over a longer period, you are going to have to come back to that each year to see how you are doing, but I would say that by making this a legally binding imposition on the Government, and I think we are the only Government to have done that, it does give a clear direction of travel.

Q352 **Ms Keeble:** I want to ask about child poverty, and you will have seen the transcript from yesterday when Mr Williams said, looking at the relative measure, that it was not clear that the impact of the recession would have a significant impact on the number of children in poverty. If you were to take an absolute measure of poverty, what would you expect to see happening as a result of the recession?

**Mr Darling:** I suppose that does depend on the extent of the downturn and the extent of the recession, but key to this actually is, I think, making sure that, if people lose their jobs, we get them back into work because the income level of the household is one of the big determinants of absolute poverty.

Q353 **Ms Keeble:** But what, do you think, is actually likely to happen on numbers?

**Mr Darling:** Well, it is difficult to tell at this stage because you can only look at these things after the event, but my priority at this stage in this Budget was to ensure that we put more money into the economy to help people get back into work as quickly as possible precisely because it has got merit in its own right, but also I was very mindful of the fact that people with children could lose their jobs and it was very important to get them back into work.

Q354 **Ms Keeble:** Obviously, there is an argument that says that, if there is a recession, wage levels come down and, therefore, in nominal terms the figures could actually look quite good. Do you not think that that is going to be a bit of an odd way of resolving child poverty, to bring the poverty levels down rather than taking children out of poverty?
Mr Darling: I am glad you raised that because I remember when I was Secretary of State for Social Security and Work and Pensions for four years that people said that what was important was relative poverty because, at that time when the economy was growing and wage levels were stretching, they were concerned about that. Of course, relativity is one of the many things you take into account, but we always argue, and I always argued, that absolute levels of poverty and persistency in poverty are equally important. Indeed, I think as you know, over the years there have been many attempts to try and get a broader indicator so that you can properly measure poverty. The relativities tell you the difference between obviously rich and poor, but I think there are other factors you need to take into account.

Q355 Ms Keeble: But, if you are interested in absolute poverty, how many children are in absolute poverty now and what do your projections show would happen?

Mr Darling: I said earlier when you were asking me about what was the effect of the current situation that it is going to be very difficult to answer that question until we actually know the full extent of what happened because it depends on unemployment levels and it depends on a number of factors.

Q356 Ms Keeble: Do you think that the Government is actually going to achieve its standards of halving child poverty by 2010–11?

Mr Darling: Well, we will need to take stock next year because, as you know, we know we have taken 600,000 children out of poverty already and we think that the measures that we have announced since the end of 2007, I think it was, would bring another half a million children out of poverty, but, as you know, the way in which these things are calculated, it sometimes takes time to know what actually happened but, remember, our overarching target is to abolish child poverty over the 20-year period and we remain committed to that.

Q357 Ms Keeble: When it comes to producing the legislation, which I think is out quite shortly, how is that going to be framed? That, presumably, is going to look at relative poverty, is it?

Mr Darling: You will forgive me, but you will see that when it is published, and I think I had better wait until we actually publish that.

Q358 Ms Keeble: When you look at issues about housing, because you can be cash-poor and you can be asset-poor as well, you said just now that, when people lose their jobs, after 13 weeks they will get SMI, but that is only if they are on income-based Jobseekers’ Allowance, is it not?

Mr Darling: No, I think it is if they are on Jobseekers’ Allowance.3

Q359 Ms Keeble: No, it is if they are on income-based. If they are on contributions-based, they do not get it. Have you got any assessment as to what the actual projections are?

Mr Darling: I may be wrong and Mark will correct me, but I think we changed that in January.

Mr Bowman: Everyone who is on JSA after 13 weeks can apply for mortgage interest relief. These were changes which were made in January.

Q360 Ms Keeble: Well, is it?

Mr Bowman: We can clarify that.

Mr Darling: I was concerned when I read the exchange yesterday because I had always understood that it was the JSA that everybody was entitled to after 13 weeks, and my strong advice from my officials, and I have no reason to believe they are not right, is that you do. I will put this way, that, were that not to be the case, then I will almost certainly tell you, but I believe that after 13 weeks, if you are on JSA, you can apply for this help.

Q361 Ms Keeble: I think that is going to be news for my Jobcentre Plus. I notice, on page 152, that next year the extra spend on that is not in any longer. Is that because it is only a temporary measure or is it because you do not expect any increase in the cost to the Exchequer?

Mr Darling: I will ask Mark, but what the table shows is changes on year.

Q362 Ms Keeble: Yes, and I was not sure whether that was just because you do not expect it to cost any more in 10/11 or if that is because it is only a temporary measure, the 13 weeks, and whether you have not budgeted it in for the future year.

Mr Bowman: The measure that is costed in here is the cost of maintaining the interest rate at a higher level. Mr Darling: That is the 6%.

Q363 Ms Keeble: To ask one question on the Asset Protection Scheme, yesterday you will have seen the exchange when your officials said that they did not know yet how much the losses might be on the Asset Protection Scheme. I wondered if you were concerned about that because the potential knock on the public finances, which I understand colleagues have been asking about earlier, could be very considerable.

Mr Darling: I did not take that from the exchange. We have made an estimate of what we think the losses are.

Q364 Ms Keeble: The global losses?

Mr Darling: No, our losses.

Mr Ramsden: The global losses to the Exchequer from all the schemes are in the range of 1.5 to 3.5% and we have provisioned for 3.5% in our debt projections.

Q365 Ms Keeble: That is right, yes, that is for all of them, but what was also said specifically on the Asset Protection Scheme was that there was not a separate disaggregated figure just for that.
Ev 48  Treasury Committee: Evidence

29 April 2009  Rt Hon Alistair Darling, Mr Dave Ramsden and Mr Mark Bowman

Mr Darling: I know what you are getting at.

Q366 Ms Keeble: I wondered what the concerns were, if you had particular concerns about that, and when you expect to have some more concrete figures specifically for that scheme.

Mr Darling: I think the answer to that is that I announced the Asset Protection Scheme in January. We announced that RBS and Lloyds would be taking up the scheme and I indicated the order of magnitude of the extent of their taking it up in March, and you will remember that I gave a statement to the House in relation to both of these. We are now going through in absolute detail the assets which are to be insured. Now, inevitably, when you are trying to insure an asset at the moment, the price changes quite a lot and there is a lot of diligence to be done, and there is also a fair amount of work to be done yet and, when that is completed, obviously we will know a lot more. The point that, I think, was being made yesterday is that, because we got into this before many other countries, we are a lot further down the line and we have a further idea. Of course, I will keep the House informed as to what the position is, consistent also with the fact that I do not want to get into a situation where I am commercially disadvantaging the banks in which we happen to have shareholdings.

Q367 Chairman: Chancellor, this is just a technical question. Your revenue projections of what will be raised with the 50 pence tax, does that include any impact on the revenues from indirect taxes and the high earners spending less? If you do not have that answer right now, which I do not think you will have, maybe your officials can convey it to us.

Mr Darling: You asked for a note yesterday and we will of course oblige.

Q368 Chairman: Your first question again in terms of the money for the banking bail-out, the automatic stabilisers and the other discretionary spending, I was not too sure with absolute clarity on that, so could you provide us with some answers on that again?

Mr Darling: On the?

Q369 Chairman: On the figures for the banking bail-out and the automatic stabilisers because we want that for our Report.

Mr Darling: On the banking support, I think we had better send you a note on that because there are a number of schemes and they are not all spending, some of them are guarantees.

Chairman: Well, we need it for our Report, Chancellor. On that very point, can I thank you for your attendance.

4 Ev 72
5 Ev 72
Written evidence

Memorandum from the Association of British Insurers

ABI RESPONSE TO THE 2009 BUDGET

The Association of British Insurers (ABI) is the voice of the insurance and investment industry. Its members constitute over 90% of the insurance market in the UK and 20% across the EU. They control assets equivalent to a quarter of the UK’s capital. Through the ABI their voice is heard in Government and in public debate on insurance, savings and investment matters.

OVERVIEW

— The 2009 Budget is a mixed bag for the UK insurance industry.
— We recognise the Government faces exceptional challenges and has few easy answers.
— While only affecting a minority of pension savers we are disappointed with the Government’s decision to curtail tax relief on pensions contributions for people earning over £150,000.
— To maintain consumer confidence in the pensions system, the Government must give a categorical assurance that the historic principle of pension savers receiving tax relief on their contributions will not be undermined any further.
— We are pleased the Government has accepted our arguments on foreign profits and the need to raise ISA limits substantially.

REstricting Tax RELief on Pensions Contributions for People Earning Over £150,000

1. The move announced in the Chancellor’s budget will not directly affect the vast majority of people saving for retirement. Nevertheless, it is vital that the value of savings for the vast majority of people is reinforced. Going forward we need a strong message to ensure people understand that, for most, tax reliefs are unchanged. Further, we need to strongly encourage savings.

2. Although only affecting a small minority, we are concerned that the Chancellor’s announcement sends a worrying message on pension savings that the Government is now breaking its contract on tax relief. Tax relief compensates responsible people who agree to defer some income by locking pension savings away until they retire. That principle was enshrined by Lord Turner in his Government-backed report on pensions in 2006.

3. We would welcome a commitment from the Government that it will not further erode tax relief on pension contributions for income groups below very high earners. The ABI’s State of the Nations Survey from 2008 showed that 50% of the working population are either not saving in a pension at all, or are not saving enough.

4. The move announced in the Budget is likely to be expensive for the industry to implement. Although being done through self-assessment, communication changes, for example, will reintroduce complexity and change to the pension framework, just three years after the Government’s “A-Day” reforms. The “A-Day” reforms were presented as the new simplified framework for pensions. Complexity confuses consumers and puts them off savings.

5. The ABI believes it is vital there is detailed and effective consultation on the implementation of these changes and we welcome the Treasury’s commitment to this. This should minimise the implementation and ongoing costs that these complex measures will impose.

6. Pension providers, advisers and customers need urgent clarification from the Government on the anti-forestalling measures that took effect from 22 April.

Foreign profit Taxation

7. In the 2008 PBR the Chancellor announced that foreign dividends received by large and medium groups would be exempt from UK tax. He also announced plans for a worldwide debt cap on interest so that tax deductions for interest claimed by UK members of a multi-national group would be restricted.

8. The taxation of foreign profits is a key area for insurers; the UK insurance industry pays the third highest amount of corporation tax of any sector, at £2.9 billion. Two insurance firms have recently announced plans to leave the UK over worries over the tax competitiveness of the UK. (Brit Insurance to Netherlands and Beazley to Ireland).

9. The dividend exemption on foreign profits should help rebuild the UK’s battered reputation as a modern base for global financial service firms. It is good news that it will be adopted in July this year and we now need an early completion of the review of controlled foreign companies rules.

10. The exclusion from restrictions on relief for interest, (the “debt cap”) for financial service firms is the right move. It recognises the unique nature of the sector.
RAISING THE ISA LIMIT TO £10,200

11. The ABI has called for the ISA limit to be raised to this level and we welcome the Government’s announcement. This will help people save in a flexible product that addresses their lifetime needs. The ISA’s flexibility, in allowing both cash and equity investment, will be welcome by savers and should play a part in moving the UK to an economy led by investment.

TRADE CREDIT INSURANCE TOP-UP SCHEME

12. The ABI welcomes the Government’s action on trade credit announced in the Budget. By ensuring that fundamentally healthy companies will get extra support, the Government has not tried to second-guess the judgement of insurers. By basing its proposals on the risk assessments carried out by insurers, the Government has endorsed the need for the market to judge and price risk. The ABI and trade credit insurers have worked closely with the Government to make this scheme possible, and constructive dialogue on how insurers can help to provide that support will continue.

13. ABI figures show that in Quarter 4 2008, the number of trade credit insurance claims rose to 8,366, up from 5,540 in Quarter 4 2007—an increase of 51%. The value of claims incurred in 2008 was £360 million, up from £257 million in 2007. This demonstrates the commitment of trade credit insurers to support their clients when trading is difficult, by providing them with as much cover as possible and carefully monitoring their risks.

GLITS

14. Companies will need to see more flexibility in the maturity profile offered, as well as in the introduction of book building approaches to raising the debt. The shift to an ever-greater public sector in the economy, and a financial system which is required to fund it, is bad news for the private sector. Capital will become more expensive and less available. Britain’s corporate sector is relatively well positioned going into the downturn as regards leverage. However, the impact of government borrowing plus the “generation long” timeframe is a heavy blow.

April 2009

Memorandum from the Aldersgate Group

2009 BUDGET SUMMARY

The Aldersgate Group (AG) is a coalition of private, public and third sector organisations who believe that high environmental standards are essential for long term economic growth and international competitiveness.

1. The Aldersgate Group’s recently published report, Green Foundations 2009, argues that far from presenting a crisis for environmental policy making, the challenges posed by the economic recession and financial crisis actually reinforce the urgent need to accelerate the transition to a low-carbon, resource efficient economy, and align economic, environmental and societal benefits. It draws on a rapidly growing body of new evidence and research that substantiates a positive interaction between high environmental standards and economic growth—enabling companies to become more efficient and productive, and creating new opportunities to secure the jobs and wealth of the future. The environmental sector is projected to grow substantially in the next couple of decades, and the UK must ensure it gains competitive advantage in the emerging domestic and global markets, particularly in the context of the critical economic forecasts outlined in the 2009 Budget.

2. In the short-term, it is imperative that the fiscal stimulus to ensure a sustainable economic recovery and build a strong economy for the future provides strong incentives and support for the environmental sector, creating competitive advantages and employment. The Aldersgate Group wrote to Alistair Darling on 16 March 2009 and recommended that in absolute terms, if the UK was to at least match the ambition of the recent American Recovery and Reinvestment Bill (assuming the UK is five times smaller than the United States in terms of GDP), the size of the overall green stimulus package should be in the region of £14 billion (US $100 billion).

1 www.aldersgategroup.org.uk/reports
3. In relation to this benchmark, an initial estimate of £510 million of actual government spending on green measures, alongside the £535 million of green stimulus measures announced in the Pre-Budget Report, is inadequate. HSBC\(^2\) estimate that in total, the new measures announced in the Budget takes the UK’s green investment fund to over USD 3.7 billion (increasing the percentage of the green component of the stimulus to around 10.6%). This is below the global average (around 15%) and competitors such as China (34%), South Korea (80.5%) and France (21.2).\(^3\)

4. The Aldersgate Group have advocated that 20% of the UK’s stimulus should be “green”. The UK figure of 10.6% (as estimated by HSBC) will limit the impact of green job creation, economic development and environmental protection in the UK and put at risk the UK’s ambitions to be a world leader in green technologies. Commenting on the Budget, Lord Nicholas Stern stated that the additional green expenditure must be “the initial first step along the path towards a major structural shift in policy which we trust will follow over the coming decade”.\(^4\)

5. The £510 million of additional government spending is part of a £1.4 billion overall package for additional targeted support for the low-carbon sector. Subsidies for offshore wind are particular welcome to sustain the UK’s leading position in this sector, helping to develop UK expertise, and so is the assistance for low-carbon energy and advanced green manufacturing. The addition funding for the Low-Carbon Buildings Programme will enable companies that specialise in micro-renewables to plan with confidence for the launch of the feed-in tariff in April 2010. It is essential that this timetable is now met.

6. The Climate Change Committee\(^5\) advised that there is major scope for significant emissions reductions through energy efficiency improvement and relatively minor changes in behaviour that have minimal consequences for welfare. Not only would this make a significant contribution to meeting the UK’s carbon targets, but are a prudent investment considering the projections on public finances. There is a very short payback period for consumers, businesses and the public sector, ensuring competitive advantage in the economy. In this context, the new spending of £365 million for energy efficiency across the economy is a missed opportunity and is not ambitious enough. Retrofitting the existing housing stock is an employment intensive activity and would present an opportunity to re-skill those currently unable to find work in the construction sector.

7. The Climate Change Committee also envisaged carbon capture and storage (CCS) would play a major role in a cost-efficient global abatement strategy. Before the Budget, there was general scepticism about the UK’s stated objective to be a world leader in CCS technologies as it had only committed to funding one post-combustion demonstration project. Therefore, the announcement that the Government will put into place up to four demonstrations, both pre and post combustion, is warmly received, as well as the proposals put forward by Secretary of State Ed Miliband on 23 April for no new coal power plants without CCS demonstration.

8. The Budget acknowledges that falls in carbon and energy prices, tight finance conditions and exchange rate fluctuation is creating risks for renewable and other infrastructure investment, leading to project delays and failures. The £4 billion of new capital from the European Investment Bank (EIB) will help support the industry raise the necessary finance in challenging economic conditions.

9. It is not clear how other policies in the Budget, such as the recovery of a further two billion barrels of North Sea oil and gas, support for the car industry and £750 million for infrastructure building will affect the UK’s carbon budgets and could increase the UK’s overall carbon emissions. Lord Stern has made clear that it is “important that fiscal measures that are not explicitly ‘green’ do not make achieving climate change goals more difficult by subsidising greenhouse gas emissions or locking in high-carbon infrastructure for decades to come”.\(^6\) As recommended by the Environmental Audit Committee, the Treasury should publish an assessment of the net impact of the Budget on the environment.\(^7\)

10. The car scrappage scheme, aimed to boost new car sales in the recession, is only expected to have a neutral or modestly positive environmental impact. This is a missed opportunity as it should be designed in such a way as to encourage consumers to buy low-emission vehicles. Is there an opportunity to implement a safeguard by setting a g/km CO\(_2\) reduction as part of this scheme?

11. In the medium term, the Chancellor announced his intention to undertake severe spending cuts to regain control of public finances. The Treasury should state to what extent it would now be desirable to reform the overall tax burden from “goods” to “bads” (consistent with its 1997 Statement of Intent on Environmental Taxation)\(^8\) and accelerate the auctioning of EU Emission Trading Scheme permits in Phase III (from 2013) to boost public revenues. It should also undertake a detailed analysis on measures to “green” the bank bail outs (such as environmental criteria for investment strategies) and ensuring stringent environmental conditions when it supports other sectors in the economy (such as the car industry).

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2 HSBC Global Research (22 April 2009) Green Stimulus: Round 1 to Asia
3 See HSBC Global Research (February 2009) A Climate for Recovery
4 www.guardian.co.uk/uk/2009/apr/22/budget-low-carbon-economy
5 Committee on Climate Change (December 2008) Building a low-carbon economy: the UK’s contribution to tackling climate change.
6 Alex Bowen, Sam Fankhauser, Nicholas Stern and Dimitri Zenghelis (February 2009) An Outline of the Case for a “Green” Stimulus.
8 HM Treasury (July 1997) Statement of Intent on Environmental Taxation.
12. Perhaps the most significant announcement in the Budget is the publication of the world’s first carbon budgets, as required by the Climate Change Act. This commits the UK to a minimum 34% reduction in greenhouse gas emission by 2020 with respect to 1990 levels, without the purchase of overseas credits outside the EU ETS. This should be adhered to, as preventing excessive reliance on external credits will lead to competitive advantage and emission reductions for domestic industry. Overall, it is not clear if the measures announced in the fiscal budget are adequate to meet the targets in the carbon budgets, which the Government should clarify when it publishes its energy and climate change strategy in the summer.

April 2009

Memorandum from the Environmental Industries Commission

**RESPONSE TO BUDGET 2009**

The 2009 Budget failed to include an ambitious green economic stimulus that would have supported job creation, economic development and environmental protection. The extra £1.4 billion for the UK’s environmental sector is timid and inadequate—and puts the UK at a competitive disadvantage.

Other countries around the world, from the USA to Korea, have used multi-billion “green new deals” to create thousands of jobs in their environmental industries—putting them at the heart of a future global low carbon economy.

Gordon Brown recognises that the UK’s future competitiveness will depend on an urgent transition to a low carbon economy. The Budget was a real test of how serious the Government is about making this transition and the thousands of new British businesses and hundreds of thousands of new jobs it could create. Sadly it is another wasted opportunity.

Unless we take urgent action, we face the daunting prospect of a long-deep recession—with rising unemployment and declining output—and an ecological catastrophe that will make a long recession appear like a tea party. The Government needs to focus on tackling these challenges together.

Not only to create a low carbon economy but one that safeguards all aspects of the environment protection—from improved air quality, to waste minimisation, to brownfield development, to water efficiency. A clean, clever and competitive UK economy.

EIC’s recent “Green Jobs Growth Strategy” set out a range of policy recommendations that would put the UK at the forefront of this huge opportunity.” EIC’s subsequent report “A Budgetary Stimulus for Green Collar Jobs” set out the fiscal support mechanisms that the Government should announce in the Budget.

EIC was calling for a far-reaching green economic stimulus package embracing the following recommendations:

EIC was calling for the Budget to include:

— A £10 billion “Green Jobs Investment Fund” in the 2009 Budget with:
  — £6 billion for an infrastructure fund to build 50,000 new (low-carbon) social houses (on brownfield sites) in 2009–10 [creating/protecting approx 160,000 jobs].
  — £1.5 billion for extra investment in energy efficiency retrofitting of low-income family homes in 2009–10 [creating approx 145,000 jobs].
  — £1 billion extra investment on energy efficiency retrofitting of schools and hospitals in 2009–10 [creating approx 21,500 jobs].

NB. EIC was not alone in calling for a bolder approach.

The TUC called for £25 billion. The Government’s own advisers, the SDC, called for £30 billion.

— Greater investment in energy efficiency, including:
  — Introduction of a new Green Building Allowance for buildings.
  — Urgent improvements to the Enhanced Capital Allowance Scheme.
  — Increasing the ambition of the Carbon Reduction Commitment.

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9 The level of ambition will be raised if a global deal on climate change is reached, in which case the Government would expect to purchase external credits to form an important part of the additional effort required. The Aldersgate Group supports this position.
— Support for brownfield development, including:
  — Ensuring that the extension of the Land Remediation Relief fully supports the redevelopment of brownfield sites.
  — An urgent programme of air quality retrofit in the UK’s transport fleet, including:
  — Retrofit of PM and/or NOx abatement technologies.
  — Support for far greater resource efficiency in business, including:
  — A significant increase in the level of funding for business support programmes for resource efficiency.
  — Clarity on the future of the landfill tax.

Many of these recommendations were not addressed in the Budget. EIC would like to draw the Committee’s attention to the following:

1. **Energy Efficiency**

   EIC was calling for £1.5 billion for extra investment in energy efficiency retrofitting of low-income family homes.

   The £100 million to improve insulation for 150,000 homes in the social sector is welcome, but inadequate.

   The Budget, also announced £100 million, as part of a new housing package, for the construction of new homes at higher energy efficiency standards. The housing package includes a £600 million fund to stimulate housing development in the short-term. It is estimated that this will deliver up to 10,000 additional homes.

   EIC understands that “higher energy efficiency standards” means the equivalent to the energy efficiency requirements of Level 3 of the Code for Sustainable Homes. Level 3 will become mandatory from April 2010 through the Building Regulations. Whilst the £100 million is welcome, though small, it is in reality for the construction of new homes at energy efficiency standards—indeed not “higher” standards.

2. **Enhanced Capital Allowance (ECA) Scheme**

   EIC called for an increase in the ECA to 150% to provide a real incentive to ensure building owners specify qualifying technologies. ECAs currently provide a 100% first year allowance on the purchase of certain energy saving technologies.

   The current problem is that energy or water saving plant on the lists will either be more expensive to install or cost time and money for consultants to specify, identify and claim. The additional costs erode the overall value, and a 100% first year allowance is merely an acceleration of tax relief that you will currently already get over a period of years.

   The 2009 Budget does not make any new announcements regarding Enhanced Capital Allowances. However the Financial Statement that accompanies the Budget highlights that “the list of designated energy saving and water-efficient technologies qualifying for 100% first-year capital allowances will be changed during 2009.”

   The report goes on to highlight that this will generate additional revenue for the Government of £10 million in 2009–10, £15 million in 2010–11 and £15 million in 2011–12.

   Can that be right for a tax relief?!!

3. **Brownfield Development**

   EIC was calling for a £6 billion for an infrastructure fund to build 50,000 new (low-carbon) social houses (on brownfield sites) in 2009–10. EIC does not believe that the £600 million housing package (including £100 million for the construction of energy efficient homes) to stimulate housing development in the short-term was enough.

   Furthermore, EIC is very concerned that the economic problems faced by the brownfield development sector will be compounded by a tax burden the Government is imposing through the replacement of Landfill Tax Exemption for contaminated soils with an extension of the Land Remediation Relief.

   EIC fully support the principle of incentivising a move away from landfill to treatment. However, these changes were meant to be revenue neutral—i.e the extra revenue from the Landfill Tax would be recycled back to the industry through the extension of the Land Remediation Relief. However, this is not the case.

   EIC Members could only identify one site where the extended Relief was likely to be claimable. This means that the change will simply result in a net flow of revenue to the Treasury—and away from brownfield development.
4. Resource Efficiency

The Financial Statement accompanying the Budget projects that the extra revenues from the Landfill Tax increases—which we very much welcomed—will generate an additional £80 million for HMT in 2011–12 (up from minus £5 million in 2009–10 and minus £25 million in 2010–11).

Despite this, there is no commitment to reverse massive cuts from resource efficiency programmes announced last year. WRAP’s budget was cut by nearly a third. Envirowise by 55%—from £22 million to £9.4 million. The National Industrial Symbiosis Programme (NISP) budget was cut by 42%.

5. Air Quality

Beyond incentivising Euro VI, which is welcome but the devil will be in the detail, EIC is disappointed that there were not any announcements on air quality.

Approximately 3,500 people are currently employed in the UK by the retrofit market. Furthermore, an estimated 80% of the UK’s retrofit market is supplied by UK owned companies. The UK’s share of this market could increase significantly through effective Government support.

In addition to the specific shortfalls against EIC’s recommendations, we would like to draw the Committee’s attention to the following concerns in the Budget:

1. European Investment Bank (EIB)

The Budget announced that UK renewable and energy projects stand to benefit from up to £4 billion of new capital from the European Investment Bank.

This £4 billion will be made available through “direct lending to energy projects and intermediated lending to banks.” This aligns with the two main financing facilities of the EIB: direct loans and intermediated loans.

The direct loans are only available for programmes costing more than EUR 25 million. Unfortunately this will not register with many of the SMEs in the environmental industry.

The Budget states that “the Government believes that this initiative can bring forward £1 billion of consented small and medium-sized UK renewables projects to deployment.”

Given the requirements of the direct loans being above EUR 25 million, presumably most of this £1 billion will have to come through the banks? How will this be implemented/enforced?

2. Supporting the development of low-carbon and advanced green manufacturing sector

— The Budget announced £405 million to support the development of low-carbon and advanced green manufacturing sector in the UK.—the delivery mechanisms are:
  — £155 million for the Environmental Transformation Fund—which funds close to market technologies.
  — £250 million for the Strategic Investment Fund—which provides grants for mature markets to attract inward investment into the UK. This £250 million is one third of the total Strategic Investment Fund announced in the 2009 Budget. £50 million of the total Strategic Investment Fund (i.e in addition to the £250 for low carbon technologies) will be invested in the Technology Strategy Board to enable it to increase its capacity to “support innovation in areas which have high potential to drive future growth, such as low-carbon technologies.”

This is welcome but it is not money being directed at stimulating demand for low-carbon technologies. It is welcome to support development of these technologies but the most important thing is to stimulate demand—through, inter alia, a supportive policy framework.

Many of the recommendations in EIC’s Budget report called for spending on stimulating demand. This was lacking from the Budget.

Furthermore, the Low Carbon Buildings Programme is one of the existing support measures incorporated by the ETF. Does this mean, therefore, that the separate announcement of “£70 million to support decentralised small-scale and community low-carbon energy” largely through the LCBP is actually part of the £155 million new money for the ETF?

Also, ETF incorporates the Carbon Trust Salix Scheme. Does this mean, therefore, that the separate announcement of “£65 million of new funding for loans to install energy efficiency measures in public buildings” is also actually part of the £155 million new money for the ETF?

Also, ETF covers Carbon Trust administered energy efficiency loans scheme for small and medium sized enterprises. The same question applies concerning these announcements in yesterday’s Budget.

EIC is not clear whether the £405 million is extra money or whether it includes, inter alia, these separate announcements above.

April 2009
Memorandum from Professor David Heald

BUDGET 2009: THE FUTURE CONSIDERATION OF PUBLIC EXPENDITURE

INTRODUCTION

1. The key feature of Budget 2009 is the collapse of tax revenue projections (Treasury 2009b, Table C6 on p.231) between November 2008 and April 2009. This turns Table C3 on fiscal balances (p.224) into very grim reading. For example, the projected 2009–10 surplus on the current budget—the critical number for the golden rule during the last economic cycle—moved from a deficit of £4 billion (Pre-Budget 2008) to a deficit of £132 billion (Budget 2009).

2. The current Comprehensive Spending Review (CSR) period runs from 2008–09 to 2010–11, meaning that this is the beginning of the second year of three. Budget 2009 sets assumptions for aggregate spending for the three years 2011–12 to 2013–14: an average of 0.7% in real terms for current spending and public sector net investment falling to 1\% of GDP by 2013–14 (Treasury 2009b, p.113). Given the foreseeable pressures on expenditure, a long period of public expenditure plenty will be followed by a much harsher environment, if not one of famine.

3. This context makes it very important to establish exactly what is happening to public expenditure. Table C10 (p.239) shows for 2009–10 a small upward revision (0.85%) in Resource Departmental Expenditure Limits (Resource DEL) in 2009–10 and a larger uplift (7.2%) in Capital DEL. A factor in the latter will be the pulling forward of some capital expenditure as an anti-recession measure. The position with regard to Annually Managed Expenditure (AME) is predictably different given that it includes social security benefits and central government debt interest: 2009–10 shows an increase of 7.45% and 2010–11 of 9.20%. Within Total Managed Expenditure (TME) there will be pressure from AME of a kind never experienced since the present public expenditure control system was established in 1998. To the extent that TME is regarded as a hard control total, the uncontrollable—at least in the short term—components of AME will put increasing pressure on total DEL.

4. In the context of growing pressure on DEL, Table C11 (Treasury 2009b, p.241) should be supplemented by tables showing (a) differences from figures in the previous publication, whether Pre-Budget Report or Budget Report, and (b) differences from one year previously (ie Budget Report 2009 compared with Budget 2008, and Pre-Budget Report 2009 compared with Pre-Budget Report 2008). The importance to Parliament and the public of such information is evident from the content of para C71 (Treasury 2009b, p.240), which summarises—in words, though not in numbers—factors leading to changes to DEL budgets since Pre-Budget Report 2008.

5. Faced with evaporating tax revenues, the Government has made limited changes to the public expenditure plans established in CSR 2007, which covers the years 2008–09 to 2010–11 (Treasury 2007). If there had been an annual public expenditure survey, as occurred until 1997, there would have been more debate about possible public expenditure reductions in 2009–10 and 2010–11 in light of the dramatic reductions in projected tax revenues. Given the depth of the current recession, there are in practice strong macroeconomic arguments for holding to the existing plans in order to support the economy, thus letting borrowing take the strain. Much will depend in future on:

— political choices about desirable expenditure levels; and

— the extent to which what is now happening to taxation revenues is reversed as the economy comes out of recession (ie cyclical) or turns out to be the consequences of a large structural hit on the productive capacity of the UK economy.

In terms of micro-level incentives for departments, there is the important issue of whether—and under what circumstances—the large amounts of accumulated End-Year Flexibility are allowed to be drawn down or are cancelled. Decisions about these matters should be made transparent to Parliament by means of clear reporting.

6. Alongside the Pre-Budget Reports of 2002 to 2006, the Treasury published an annual Long-Term Public Finance Report which explored the sustainability of UK public finances using a comprehensive projection methodology. Sitting on the platform of the five-year medium-term economic forecast, projections are made on both a 50-year and infinite time horizon. The benefits of this exercise probably arise more from highlighting future policy choices than from the calculated fiscal gaps, not least because of difficulties in specifying what is “current policy”.

7. There was no Long-Term Public Finance Report accompanying the 2007 Pre-Budget Report but one was published alongside Budget 2008 (Treasury 2008a). Pre-Budget Report 2008 (Treasury 2008b, para

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8 Declaration of interest: the author is a member of the Financial Reporting Advisory Board, nominated as an independent economist by the Head of the Government Economic Service. The views expressed are entirely his own.
2.116) stated that “The next Long-term public finance report will be published in 2009”. This could have been interpreted to mean alongside Budget 2009, given that the previous issue accompanied Budget 2008. However, Budget 2009 (Treasury 2009b, para 2.107) states:

The next Long term public finance report will be published in 2009 and will be able to reflect the EU Economic Policy Committee’s latest, 2009, budgetary projections, which give 50-year projections of age-related expenditure across EU countries. Budget 2009 set out projections for net debt, cyclically-adjusted net borrowing and current balance until 2009–10, consistent with the requirement of the Code for fiscal stability.

It is easy to understand the difficulties inherent in long-term projections when the present and near future are so uncertain. There will always be new generations of, for example, EU age-related expenditure projections; this stated reason for delay is less convincing than would be an acknowledgement of the unprecedented uncertainties about the platform on which the long-term projections sit. If there were slippage beyond Pre-Budget Report 2009, an important innovation in fiscal reporting might be lost. It would be helpful if the Treasury were to re-affirm its continuing commitment both to undertaking this work and to regular publication.

8. The UK public expenditure system is characterised by Executive domination, with a very limited role for Parliament. Illustrations of this reality are easy to find:

— The timing of the Budget is in the hands of the Government and the date chosen will affect the time available for the Treasury Committee to take evidence and report; this is exemplified by the 2009 Budget being as late as 22 April.

— Spending Reviews and Comprehensive Spending Reviews are usually published in July, which may be convenient for the Government but minimises the opportunity for Parliamentary scrutiny.

— The Government decides when Spending Reviews take place: after establishing a pattern of 1998, 2000, 2002 and 2004, what was expected to be SR2006 became CSR2007; and the two-year cycle was not restored in 2009.

— Notwithstanding its constitutional importance the Estimates procedure is almost entirely formal, affording no opportunity for Parliament to debate expenditure priorities; in fact, the Estimates simply convert the Government’s expenditure plans for that year into the required format.

— Parliament finds it difficult to obtain timely information that the Government does not wish to release; examples from recent years have included commitments under the Private Finance Initiative (PFI) and analyses of claimed efficiency savings—eventually such material becomes available but not when Parliament first requires it for scrutiny purposes.

— The Government controls costing information, therefore making it difficult for others (e.g. Opposition parties, Government backbenchers and select committees) to construct credible alternatives to existing policy.

9. My memorandum to the Treasury Committee at the time of the Pre-Budget Report in November 2008 drew attention to the Treasury’s Alignment Project:

Whereas the Treasury owns public expenditure aggregates and changes them at will, Parliament does own the Estimates system … The Treasury … is currently consulting Parliament and other stakeholders on the Alignment project, intended to simplify budgetary documents and—as far as possible—align Budgets with Estimates and Resource Accounts. Much of what the Treasury wants seems reasonable, though care is needed about the detail: for example, on the timing of information and on there being systematic overviews of departmental information. Implemented well, there are gains for Parliament as well as for the Government, but Parliament should exploit the leverage its ownership of Estimates potentially confers over the broader question of how financial information is reported to Parliament (Heald 2008, para 17).

The Treasury (2009a) subsequently published detailed proposals in March 2009 concerning a “clear line of sight” between Budgets, Estimates and Resource Accounts. This “Alignment project” is an important opportunity for Parliament to engage with the Treasury on issues that have two interconnecting dimensions:

— some of the detail is inevitably technical and requires careful consideration of the potential implications; and

— this proposed reform takes place in the context of the constitutional balance of power between the Executive and Parliament.

10. Important developments in financial reporting by government are in process. The anchor for central government financial reporting moves from UK Generally Accepted Accounting Practice to International Financial Reporting Standards in 2009–10, with impacts on, for example, the balance sheet treatment of PFI schemes. The first published UK Whole of Government Account (WGA) will relate to 2009–10.
Alignment project can be seen as part of the process of improving central government financial reporting and accountability, bringing more clarity and reducing unnecessary complication. However, there are important issues that Parliament should address, including:

— the safeguards that should accompany a move to “net” voting;¹¹
— the safeguards that should accompany the alignment of Estimates to the Government’s expenditure control system;¹²
— the timing of the financial planning cycle, both in terms of when decisions are taken and when Parliament becomes involved, whether in voting or in scrutiny; and
— the prompt provision of overview information so that the overall public finances are more transparent.

These issues are constitutionally and substantively important and their satisfactory resolution would enhance Parliament’s scrutiny capability.

¹¹ During a period of fiscal consolidation the argument will be heard that this can only be done effectively when there is a strong Finance ministry and when the Executive dominates the process, thereby avoiding the problem of “divided authority”. This argument will be used against attempts to enhance Parliamentary financial authority (eg put life back into the Estimates procedure) and to extend financial scrutiny. In contrast, I would argue that the “take it or leave it” character of UK public expenditure and taxation decisions is seriously damaging. It is important to stress that there has been no breakdown in public expenditure control systems, as occurred, for example, in the 1970s. Public expenditure has grown very rapidly since 1998 because of explicit political choices taken by the Labour Government in the series of Spending Reviews. Leaving aside discussion of the merits of those decisions, it is clear that Parliament has neither been allowed nor equipped to exercise effective scrutiny. There might now be some opportunity to redress these deficiencies in accountability for public expenditure.

29 April 2009

REFERENCES


Memorandum from the ICAEW Tax Faculty

INTRODUCTION

1. We welcome the opportunity to submit evidence in response to the invitation published on http://www.parliament.uk/parliamentary_committees/treasury_committee/tc060208pn23.cfm.

2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Appendix 1. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Appendix 2.

¹¹ Currently, Parliament votes “gross”, meaning that it approves both gross expenditure and the Appropriations in Aid (eg receipts from fees and charges) that departments are authorised to spend by the Estimate. Receipts beyond what has been authorised have to be surrendered to the Treasury as Consolidated Fund Extra Receipts. Under net voting, there must be clarity about (a) the type and level of charges that are to be imposed and (b) budgeted and actual amounts.

¹² The present expenditure control system of TME, DEL and AME has been in place since 1998, an unusually long period in comparison with earlier years. If Estimates are aligned on the existing control system and then that control system is replaced by the Government, the Estimates would be stranded on the old system unless Parliament agreed to realign the Estimates on the new system. In practice, the long-established veto over changes to the Estimates that involve “questions of principle” (Limon and McKay, 1997, p.744), without the prior approval of the Public Accounts Committee and the Treasury Committee (and its predecessors), would have been rendered ineffective.
DEALING WITH THE CREDIT CRUNCH—LOSS RELIEF AND THE FINANCIAL SERVICE COMPENSATION SCHEME PAYMENTS

3. The ICAEW supports the tax-related changes announced by the Chancellor in response to the credit crunch including:
   — the expanded debt management service and the ability to make in-year loss relief claims; and
   — the extension of the loss carry back rules to cover losses for a two year period rather than a one-year period.

Loss relief rules

4. In our 2009 Budget submission, we proposed that the losses eligible for the extended three year carry-back proposed in the 2008 Pre Budget Report (2008 PBR) should be extended from one to three years. Our rationale was that for many unincorporated businesses, the relief applied too early and the proposal discriminated against unincorporated businesses although we recognised that it may have revenue implications.

5. The 2009 Budget proposal is that losses arising in a two-year period can be carried back for three years, up to a limit of £50,000 per year.

6. Whilst the extended two year loss period is welcome, we remain of the view that greater flexibility is likely to be required, particularly in respect of unincorporated businesses. Whilst the government expects growth to resume later this year, many commentators are forecasting that the UK could experience negative growth in 2010, and it is only now that many businesses are beginning to experience serious problems. An unincorporated business with a year end of, say, 30 April may find that it makes losses (or makes further losses up to the £50,000 limit) in the year to 30 April 2010, which would be outside the proposed extended two year time limit which is for accounting periods ending in the tax year 2009–10. We therefore remain of the view that this relief should be extended for a further year.

Financial Services Compensation Scheme

7. In our 2009 Budget submission, we recommended that as a temporary measure any interest credited in a tax year, which cannot be withdrawn due to the illiquidity or insolvency of the financial institution should not be taxed until actually received. We also requested clarification of how payments received under the Financial Services Compensation Scheme (FSCS) would be taxed and that payments from FSCS should be treated firstly as a return of capital and only amounts in excess of the capital contributed to the account should be treated as interest.

8. Although some technical clarification is now being provided for the tax treatment of payments received under the FSCS, no provision is being made to provide relief where:
   — any interest credited in a tax year cannot be withdrawn from the account until a later tax due to insolvency or withdrawals from the account being temporarily blocked by the financial institution; or
   — the amount received by an investor from the FSCS is less than the capital deposited in the account.

9. We should like to see both these issues addressed.

INCREASE IN THE INCOME TAX RATES AND CHANGES TO THE PERSONAL ALLOWANCES AND PENSIONS RULES

10. Tax rates are properly a matter for government to decide. Nevertheless, the proposed changes to the tax rules for higher earners will do little to address the budget deficit. Given the predicted size of the deficit, it is inevitable that action will be needed to bring the UK’s finances back into balance and that this is likely to involve a mixture of more broadly based tax increases and cut-backs in public expenditure.

11. The ICAEW is concerned about the impact of the various proposed changes to the income tax rules, namely:
   — the new 50% tax rate (replacing the proposed 45% rate);
   — the withdrawal of personal allowances for those earning over £100,000 (creating a marginal 60% tax rate);
   — the scaling back of tax relief on pension contributions (creating very high effective tax rates);

and their combined effect upon the UK as a place to live, work and invest.

The 50% tax rate

12. The Institute of Fiscal Studies (IFS) has expressed doubts as to whether the 45% tax rate would result in a net increase in revenues and the day before the Budget suggested that the optimal tax rate was 40%. We suggested in our 2009 Budget submission that a detailed economic analysis should be made of the proposed change before any final decision is made to proceed with the increase. Given the weight of evidence that such rates may not be effective in raising revenue we remain of the view that a detailed economic analysis of the impact of the proposed 50% tax rate needs to be made, before any such policy is implemented.
13. For trusts, the proposal to raise the trust rates of tax are likely to result in the majority of trust beneficiaries needing to file repayment claims, which will create more work for HMRC as well as the beneficiaries. This is because whereas a trust rate of 40% reflects the marginal rate of tax paid by most individuals on high incomes currently only 2% of taxpayers are in the £100,000 plus income bracket (according to paragraph 2.48 of the PBR 2008) so we would expect significantly fewer will be in the 50% marginal rate band. Many beneficiaries such as minor children, vulnerable beneficiaries and all those not liable at the new 50% higher rate who receive payments of trust income will be able to apply for tax refunds before the trustees have even had to file a tax return and pay tax for the year.

The withdrawal of personal allowances

14. The way in which the personal allowance is withdrawn does not result in a progressive tax system. Withdrawing the personal allowance at a rate of £1 for every £2 of income above £100,000 results in an effective marginal income tax rate of 60% (61% with NIC) on income between £100,000 and £112,950 (using the 2009–10 personal allowance of £6,475) into the UK tax system. The same comments apply as to the effective rate as for our comments above about the 50% rate.

15. Aside from this concern, these proposals introduce considerable complexity into the income tax system and associated tax calculations. There is a major practical problem, with associated costs for both HMRC and taxpayers, where the taxpayer is within PAYE. The actual amount of the allowance depends upon the level of income in the tax year which will not be known until the after the end of the tax year. The PAYE system cannot deal effectively with such situations and will have to be based on estimates. In circumstances where an individual usually has income well below £100,000 but receives a one-off bonus which takes income up to £120,000, that taxpayer will face an unexpected underpayment of in excess of £2,590 simply because PAYE will not be able to deal with this. That taxpayer will have expected PAYE to be collecting the right amount of tax during the year.

16. The result will be an increase in the need for form filling, the issue and processing of which together with making the associated payment/repayments or coding adjustments will increase the administrative burden and costs for many taxpayers and HMRC. We recognise that a similar situation happens at present for the less well off elderly taxpayers within age allowance taper.

17. A more straightforward option would be for personal allowances to be given in full but for the rate of tax applying to be higher over £100,000 of taxable income. This would have the benefit that PAYE would then be able to deal effectively with bonuses and the like so that underpayments of tax would be less likely. Some analysis will need to be done to identify an appropriate rate of tax.

Restriction of tax relief for pension contributions

18. We are very concerned by the level of complexity of the proposed new rules in connection with the restriction of tax relief for pension contributions and the tax rates that can ensue. Furthermore the anti-forestalling provisions effectively accelerate the reduction in relief by up to two years in many situations, for example in redundancy and when approaching retirement, where taxpayers often pay larger than usual contributions to improve their pension provision.

19. At this stage it is not easy to ascertain exactly how these new rules will work. Our initial calculations suggest that individuals are likely to face very high marginal rates. We are still working through the detail but would be happy to supply the Committee with further information on this point.

20. As part of the anti-forestalling provisions in advance of the restriction on tax relief for pension contributions for taxpayers of earnings of £150,000 or more, the proposal as per Budget Note 47 will prevent higher rate tax relief for most pension contributions on or after 22 April 2009 other than where contributions “are paid quarterly or more frequently”. This appears unnecessarily restrictive.

21. Pension contributions made by the self employed individuals are often one-off, annual, contributions once the likely level of profits for the tax year is known. Therefore, many self-employed who nevertheless make regular contributions will not pass this test and face the possible immediate loss of higher rate relief. We recognise that in his Ministerial Statement on 22 April 2009 the Financial Secretary to the Treasury stated “The Government recognise that those with less regular contribution patterns may be affected and would welcome views on whether there are ways of ensuring the contributions of this group are protected in the same way as those making more regular patterns, while continuing to meet the objectives above”.

22. In order to ensure that such individuals continue to benefit from relief we suggest that there should be a second test calculated by reference to average contributions made in, say, the highest two tax years 2006–07, 2007–08 and 2008–09—perhaps indexed up by reference to the changes in the annual personal allowance.

23. The inclusion of pension contributions made by employers in taxable income is likely to result in the new provisions affecting those with incomes considerably below the £150,000 threshold being quoted. This, together with the anti-forestalling provisions, is likely to result in compliance issues particularly for those taxpayers who do not believe that they will be affected by these changes. HMRC will need to undertake an extensive publicity campaign so that taxpayers understand the changes.
24. In the same way as mentioned above in connection with personal allowance withdrawal, dealing with the changes through PAYE and the net pay arrangements is likely to be very cumbersome and difficult, resulting in extra costs for HMRC, employers and taxpayers and adding to the administration burden for employers and pension schemes.

FOREIGN COMPANY PROFITS

25. It was confirmed in the Budget that dividends and other distributions received by UK companies from foreign companies will be exempt for corporation tax and the relief will also apply to all companies. We welcome the Government’s commitment to introduce this improvement to the UK tax system and to have confirmed that the exemption will extend to small companies and will apply to dividends and other distributions received on or after 1 July 2009.

26. We remain concerned that the introduction of the worldwide debt cap, which will now apply to accounting periods beginning on or after 1 January 2010. Whilst the revisions announced on 7 April 2009 will remove many from the complexities of the tests, the rules will still need to be considered by all companies looking to invest into the UK and hence will place an additional hurdle that investors will need to overcome before choosing the UK.

27. For those companies that continue to be affected, the rules will be extremely complex in practice and will undermine the competitiveness of the UK tax system. In the absence of revised draft clauses, which will presumably be contained in the Finance Bill to be published on 30 April 2009, it is difficult to form a judgement as to how complex, and how damaging to the reputation of the UK tax system, the world wide debt provisions are likely to be.

28. We intend to make detailed representations once we have had a chance to review these detailed provisions.

29. We welcome the decision of the government to disengage changes to the Controlled Foreign Company (CFC) regime from the introduction of the dividend exemption and we have already submitted an informal paper to HMRC with our comments and recommendations about the CFC regime.

VAT

Changes to the place of supply rules

30. The proposed changes to the VAT of supply rules for services is of fundamental importance and the most major change since the VAT Single Market rules were introduced with effect from 1 January 1993. In our 2009 Budget submission, we expressed a number of concerns about the proposals, namely:

— the complexity of the changes;
— the continuing uncertainty as to how certain services will be treated;
— the complex change to the time of supply for VAT purposes;
— the onerous reporting requirements; and
— the added risk to business of the joint and several liability proposals.

31. We remain concerned that due to the number of issues that need to be resolved, businesses will not be ready in time to implement these changes by 1 January 2010. In particular, we have:

I. called on HMRC in February 2009 to agree the removal of the time of supply changes from the VAT Package, and to harmonise the principal time of supply around the invoice date. HMRC may regard this as unrealistic, but the alternative, namely imposing a reporting requirement which both HMRC and business know cannot be implemented, is even worse; and

II. asked HMRC not to agree to the Commission’s joint and several liability proposals, which would allow the tax authorities of the 26 other EU Member States to assess UK businesses for the unpaid foreign VAT which should have been paid by their customers in the other Member State.

32. We consider that the changes will do little to combat cross-border (MTIC) VAT fraud. As we have stated publicly on many occasions, MTIC fraud will only be halted when the obvious loophole in the VAT system, known to the Commission and to Member States since before 1993, is blocked, and VAT is charged on intra-EC cross-border supplies as it is on domestic transactions. However, Member States cannot agree on this and the result is that we continue with the faulty, fraud-prone “transitional” system, but with the Commission and national tax authorities increasingly placing further costs on business to police it. In addition, by extending the range of services subject to the reverse charge, the Commission and Member States need to recognise that they have also extended the opportunities for crossborder VAT fraud.

33. The timing of these changes is unfortunate. Many businesses are fighting for survival in the worst financial climate for decades. HMRC are now asking them to divert resources and incur significant additional on-going costs without any commercial benefit to the business itself. This demonstrates a lack of understanding of the current business environment by those concerned with framing VAT policy.
34. We are increasingly concerned at the additional costs being transferred to business by HMRC. From the inception of VAT, businesses have been required to work as unpaid tax collectors for government. In addition, businesses are increasingly being required to carry out a tax audit function for government. We do not think it overstates the position to say there is a real danger that the changes, taken as a whole, will:

- deter some UK businesses, particularly SMEs, from supplying goods and services cross-border within the EU; and
- encourage others to re-route supplies, transferring business activity away from the UK.

Temporary reduction in the VAT rate from 17.5% to 15%

35. In our 2009 Budget submission, we were concerned that changing the VAT rate back to 17.5% on 1 January 2010 is a highly inconvenient time for businesses, particularly retailers. In addition, for the reasons given above, we are concerned that the start date for the proposed changes to the VAT place of supply rules for services will also come into affect from the same date, thus businesses will need to deal with a major change in the VAT system and a change in rate at the same time.

36. We suggested that (assuming that the date of supply of services change remains 1 January 2010, the date that the VAT is increased to 17.5% is put back to 1 April 2010, ie to the beginning of the VAT year. This recommendation has not been accepted but we remain concerned about the date and that consideration should be given to a short deferral of the date.

HMRC’s Powers and Service Standards

Working with tax agents

37. We welcome the publication of the consultation paper “Working with tax agents”. The paper recognises the vital role that tax agents play in the delivery of the UK tax system. The paper considers a number of possible reforms and we look forward to commenting on these in due course.

38. We note that HMRC is not convinced of the need for a proposed registration scheme for agents. We agree with HMRC’s position. We look forward to further discussions with HMRC aimed at ensuring that all those involved in delivering the tax system are appropriately skilled and work to agreed professional standards.

Publishing the names of deliberate tax defaulters

39. The ICAEW supports efforts to combat tax evasion and it is right that government considers a variety of policy options. The proposed measure is based closely upon the approach that has been adopted in Ireland for a number of years, although the Irish scheme also appears to cover a wider variety of offences including, for example, excise frauds such as cigarette smuggling and fuel duty evasion.

40. Whilst we recognise the attraction of this particular measure, nevertheless we have some concerns with it:

- we are not convinced that the measure is fully compliant with the Human Rights Act 1998 and believe that there is need for a detailed statement about this aspect;
- we do not understand why tax credits are excluded and think that it is just as important that such a scheme is extended to false tax credit claims; and
- consideration should be given to extending to scheme to cover frauds related to excise duties and related areas.

Personal tax accountability of senior accounting officers

41. The proposal set out in Budget Note 62 to require senior accounting officers to certify that the accounting systems are adequate for the purposes of tax reporting was an unexpected announcement and appears a disproportionate response to the identified problem. It appears to reflect a Sarbanes Oxley style requirement which appears unnecessary for the vast majority of companies.

42. A corporation tax return includes a declaration that the return is correct and complete. It needs to be signed by someone authorised to do so, invariably a senior officer of the company. A tax return cannot be correct and complete if the company does not have processes and internal systems that enable a correct and complete return to be made. Therefore, this proposed new requirement appears to impose further onerous obligations whilst adding nothing new in terms of tax compliance.

43. The proposed measure is disproportionate because it applies a potentially onerous personal liability on all the senior accounting officers ab initio. HMRC’s risk analysis procedures should identify the small number of large companies that do not have adequate accounting systems to prepare a correct and complete return. It would then be reasonable to target those companies with measures such as this. In other words that the company and its senior accounting person is first put on notice that continued default will result in a fine.
44. We would suggest that rather than introduce this measure, if HMRC is concerned about internal accounting systems it would make more sense to extend the existing declaration that is required on the corporation tax return.

**HMRC service standards**

45. We remain concerned that the current efficiency programme is leading to a reduction in service standards “on the ground” and that further efficiency savings are likely to lead to a further reduction in service standards. We refer Committee Members to our recent submission to the Committee which included detailed comments on HMRC’s service standards and which was based upon a recent survey of members. We are in the process of finalising the results of this survey and would be happy to provide further evidence to the Committee on this point.

**Taxpayers’ Charter**

46. We welcomed in our 2008 Pre-Budget Report submission the government’s decision to introduce a new Taxpayers’ Charter.

47. We recommended that the Charter should have statutory backing and we were delighted that the Chancellor announced in his 2008 Pre-Budget Report that he had accepted the need for such backing. We are concerned that the Budget Note seems to indicate that this statutory backing will “require HMRC to prepare and maintain a Charter” but beyond that the only (statutory) requirement is said in the Budget Note to be

“to report annually on how well HMRC is doing in meeting the standards in the Charter.”

48. In our representation we recommended that:

— the legislation should set out the process by which the Charter is established and kept under regular review and how and when appropriate reports are to be made;

— the legal effect of the Charter should be covered and the extent to which HMRC should take account of the Charter; and

— there should be independent oversight of the Charter and the regular review process should be under the aegis of a Parliamentary Select Committee.

49. HM Revenue & Customs recently published, 3 February 2009, a second Consultation Document containing a draft of the proposed Charter. We have submitted (TAXREP 20/09) our detailed comments on this prior to the deadline for comments of 12 May 2009.

50. Budget Notice BN92 published on Budget Day adds very little of substance to what has already been published in the earlier Consultation Document.

51. In our response to the February Consultation Document we noted that the draft Charter contained in that document will require significant revision before final publication if the Charter is to serve its proper purpose which is to set out clearly the rights (and obligations) that taxpayers enjoy (or owe) in their relationship with HMRC.

52. The rights of taxpayers will need to be more clearly stated in the final Charter and we are concerned that many important rights are currently omitted from the draft Charter.

53. We agree with HMRC that the primary Charter document should be a simple short statement but this then needs to be underpinned by more detailed statements explaining what the various rights and obligations mean in practice, plus where further information is available.

54. We remain of the view that the title of the Charter should be aimed at the taxpaying public and that to call it an HMRC Charter, which appears to be the current intention, does not give the correct signal. We do appreciate that HMRC is responsible for much more than just the collection of tax, for instance the payment of tax credits. Nevertheless, HMRC is responsible for the collection of a very considerable number of different taxes and all residents of the UK will pay one or other of these. For example, those below the income threshold will still pay VAT. So we have recommended that the Charter should be called a Taxpayers’ Charter which is the name adopted by almost every other jurisdiction in the world that has introduced such a Charter.

**Abolition of the Furnished Holiday Lettings Rules**

55. We were surprised to see that the special tax rules for Furnished Holiday Lettings (FHLs) will be extended in 2009–10 to include properties in the EEA but will then be abolished entirely for 2010–11.

56. We appreciate the potential problems with compliance with EU rules, but we suspect that this change is likely to have a serious impact on the provision of holiday lettings in tourist areas. There is concern that it could encourage FHLs to be sold off (most likely as second homes) or transferred to being let as unfurnished residential accommodation and thus reduce the stock of tourist accommodation. There is particular concern about the impact on investment in multiple unit complexes if entitlement to capital allowances is lost.
57. We think that an economic analysis of the proposal needs to be undertaken and whether the concerns about the EU aspects of this could be resolved in a way that does not involve the complete withdrawal of the scheme.

58. We assume that there is concern that the more generous loss treatment could lead to a loss of revenue to the Exchequer if claims are made on holiday homes. However, the FHL activity must be commercial and if necessary the existing rules could be tightened.

59. The deemed trading qualification of FHLs overcomes the lack of a substantive definition of what constitutes a trade in the Taxes Acts. If the FHL rules are to be abolished in their entirety then clear and detailed guidance will be required as to what level of services establishes a trading activity. Further, the cost of furnishing properties is substantial and it is entitlement to capital allowances that remains most important as well as start-up loss relief to help finance the considerable capital costs.

60. We are also concerned about the implications of the abolition of the FHL rules on hotel companies as it has been common since the 1980s for seaside hotels to also provide some furnished self-catering accommodation. If FHLs will no longer be entitled to capital allowances then will it be necessary to distinguish between furnishings in hotel rooms as opposed to self-catering units? This is likely to be practically very difficult.

61. We recommend that there should be detailed consultation on the implications of this significant and unexpected proposed change in the legislation.

April 2009

Memorandum from Professor Tim Jackson, Economics Commissioner, Sustainable Development Commission

GREEN STIMULUS IN THE 2009 BUDGET

1. This short briefing note reflects on the environmental or “green” stimulus aspects of the 2009 Budget. The note draws explicitly on the work of the Sustainable Development Commission in this area, most notably our recent publication A Sustainable New Deal—a stimulus package for economic, social and ecological recovery. That publication is available on the web at:


2. The context of this note is a unique combination of circumstances: 1) the need for fiscal stimulus to promote economic recovery following the recession; 2) the need for substantial investment in the transition to a low-carbon economy; 3) the opening on 22 April of what is commonly agreed to be one of the most important Budgets in recent UK history; and 4) an emerging international consensus on the value of a “green stimulus” or “Green New Deal”: that is, a substantive programme of investment targeted specifically at low carbon technologies, energy efficiency and ecological investments.

3. The UK Government has championed the green stimulus idea in the international arena. Speaking to the World Economic Forum in Davos in January, the Prime Minister pointed to “the need to lay down now the infrastructure and the hardware to support a low carbon recovery and the green economy of the future.” The sentiment was echoed in Ministerial speeches at the Low Carbon Industrial Summit in March. Lord Mandelson argued, for instance, that the “transition to low-carbon is an environmental and economic imperative... Low-carbon is not a sector of an economy—it is an economy.”

4. Across the world, an estimated 16% of stimulus spending has already been dedicated to green investment. The American Recovery and Reinvestment Act 2009 had a green component amounting to 12% of the package. In South Korea, 80% of the fiscal stimulus package was dedicated to green investment.

5. The UK Pre-Budget Report in November 2008 identified a small “green stimulus” component of £335 million—mainly comprising spending brought forward in areas such as home energy efficiency, low carbon transport and flood defence. This represented less than 3% of the stimulus spending in total and only 0.01% of GDP per year.

6. Budget 2009 announced £1.4 billion of “extra targeted support in the low-carbon sector” over the next three years including: £405 million to support low-carbon industries and advanced green manufacturing; £375 million to support energy and resource efficiency in businesses, public buildings and households over the next two years; £70 million for decentralised small-scale and community low-carbon energy and uplift in support for offshore wind energy.

13 This investment is critical, in particular, to meet the carbon budgets established by the UK Climate Change Act 2008 and set out for the first time (and uniquely across the world) in Budget 2009.

7. This still represents less than 0.1% of GDP spread over three years, or around 0.03% of GDP per year. This level of spending is clearly inadequate to the challenge presented by the transition to a low carbon economy and falls well short of the Government’s rhetoric on this issue. Lord Stern has argued that investment spending to address climate change should be at least 2% of GDP per year—upwards of £30 billion a year.

8. Treasury has defended the scale of its green commitments in both the PBR and Budget 2009 by pointing to pre-existing low-carbon spending commitments of £50 billion established in the 2007 Comprehensive Spending Review. In addition it suggests that the uplift in support for offshore wind energy will bring forward additional private sector investment of £9 billion.

9. This defence is questionable on several grounds. In the first place, the CSR 07 figure of £50 billion is the expected out-turn (largely in terms of private investment) that will flow from government policies. It is not committed spending. These policies were set in place before the economic crisis. This spending cannot be seen as stimulus spending. More importantly, it needs to be demonstrated that this outturn will in fact be achieved under the changed economic circumstances. Planned investments in wind energy, for example, have already suffered as a result of strictures in private investment. The expectations for uplift of £9 billion in offshore wind must also be seen in the same light. There is an urgent need to re-examine the expected outturn from CSR 07 commitments.

10. Beyond these obvious limitations there are serious questions about the adequacy of investment by government in terms of making adequate progress towards its own carbon reduction targets. To take only one example, retrofitting the domestic housing stock to achieve an 80% reduction in emissions would entail an investment programme in excess of £10 billion per annum over a 20 year period. Substantial commitments also need to be made in areas of sustainable mobility (low carbon travel), renewable energy, the electricity grid and public sector buildings.15

11. In the light of these investment needs, the Sustainable Development Commission has called for a green stimulus equivalent to £30 billion per year over three years. The Commission estimates that such a package could create at least 800,000 jobs. More than 50% of the investments incurred under a programme of this kind would generate significant financial returns within a couple of years. Funding (and recouping costs) need not rely solely on deficit spending and rising debt. But it will require fiscal innovation in terms of green taxation, green bonds, public equity and other invest to save mechanisms.

12. In short, we welcome the low carbon commitments in Budget 2009 and applaud the unique establishment of carbon budgets. However, we believe an important opportunity has been missed to match rhetoric with action. There remains an urgent need to establish a sustained, long-term investment programme for a low-carbon economy.

April 2009

Memorandum from The Rank Group Plc

I would be grateful if you were to question the Treasury about the Budget announcement to increase bingo duty from 15% to 22%. We at the Rank Group—and our peers at the Bingo Association—are very disappointed by this proposal, which perpetuates the Government’s long-standing discrimination against Britain’s licensed bingo clubs. As a result of the changes announced in the Budget, the range of gaming and betting duties in Great Britain is now as follows:

- Bingo (in a licensed club): 22%.
- Bingo, casino & poker (online): 15%.
- Sports betting (online): 15%.
- Sports betting (in a betting shop): 15%.
- Football pools: 15%.
- Betting exchanges: 15%.

NB—casino gaming duty is taxed on a sliding scale from 15% to 50%. If bingo clubs were taxed on the same scale, all bingo would be dutiable at 15%.

What at first glance appeared to be a successful conclusion for our campaign to remove VAT from bingo participation fees, was in fact a sleight of hand from the Government. They have given with one hand (by removing VAT) but taken away a great deal more with the other (by raising bingo duty).

The Government’s claim that these changes will benefit the industry by £15 million per annum is fundamentally flawed—a shortcoming rooted in Treasury’s admitted inability to identify VAT charged on games of bingo. In fact, the net effect of the changes announced last week is that Mecca Bingo (which represents roughly one-third of the industry by value) will pay another £6 million per year to Exchequer. This is within the context of a business that last year generated operating profit of £41.8 million.

This is what Treasury failed to disclose, when describing the tax change as “welcome” to the bingo industry:

— in May 2008, the VAT & Duties Tribunal ruled that that the application of VAT to interval bingo in Mecca Bingo’s clubs was in breach of the EU principle of fiscal neutrality (that the same services or products should be subject to the same taxation);

— as a direct consequence of this ruling, Mecca Bingo (in common with a number of other operators) ceased to pay VAT on interval bingo;

— thus the “benefit” of the VAT abolition applies only to mainstage bingo, which represents about one-third of all bingo by value;

— the increase in bingo duty affects all bingo, whereas the reduction in VAT benefits only one-third of our bingo revenue; and

— Treasury has over-estimated historic levels of output VAT paid on games of bingo (the £50 million cited in the “Red Book”).

We have never asked for a hand-out from the Government; we have simply called for a level playing field; but this has now been distorted yet further. As a consequence of last week’s Budget, the Rank Group (the only quoted operator of bingo clubs in Great Britain) was forced to issue a profits warning to the Stock Market. This was the second time in three Budgets that the Group was forced to publish a profits warning as a result of unheralded changes to taxation without consultation.

The following excerpt from a stockbroker research note is typical of the City’s reaction to the announcement and refutes the Chancellor’s claim that “every decision” in the Budget was underpinned by principles of “fairness” and “stability”.

“We expected the Budget to leave old-ladies-indoors-socially-valuable Bingo alone and take a swipe at wicked-hard-gaming-roulette-on-the-high-street Bookmakers. Instead the bookmakers got off almost scot-free and Rank has to absorb a 9m annualised hit to costs (c.f. 22% of FY08 PBT). The Treasury thus shows how it can get its own back on companies which have successfully won legal battles for overpaid tax.” (Evolution Securities, 23 April 2009)

This latest assault on Britain’s bingo clubs could hardly have come at a worse time, with the nation in the grip of the worst recession for more than 60 years. Unless, the discriminatory policies of Treasury towards bingo clubs is over-turned, many more bingo clubs will close this year—possibly in your own constituencies. This in turn will result in increased unemployment (which Treasury does not include in its calculations of fiscal reform on the basis that job losses in bingo will be compensated for elsewhere in the economy), the loss of an important social amenity and ultimately the loss of revenue to Exchequer.

I urge you to press Treasury on this matter, asking:

1. Whether Treasury is aware of the negative impact these proposals will have on Britain’s bingo clubs?
2. Whether Treasury’s decision to abolish VAT on bingo but increase bingo duty in any way connected to last May’s VAT & Duties Tribunal ruling that the application of VAT to interval bingo was in breach of EU principles?
3. Why Treasury refused to consult the industry when (by its own admission) it has been unable to calculate empirically the level of taxation currently applied to bingo?
4. Why Treasury has increased the tax burden on bingo (one of the softest forms of gaming) at a much higher rate than sports betting and online gaming and the football pools?
5. Whether it considers profits warnings from listed British companies to be an acceptable outcome from a Budget announcement, particularly given that Treasury is the sponsor department of the Financial Services Authority?
6. Did Treasury consult with the Department for Culture, Media and Sport (bingo’s sponsor department) on the social policy effects of the tax increase?

In the past, the bingo industry has repeatedly been given reason to call into question the veracity of Treasury’s responses to parliamentary questions on bingo taxation.

April 2009
Memorandum from Martin Weale, National Institute of Economic and Social Research

THE FISCAL POSITION IN THE MEDIUM TERM

INTRODUCTION

That the Budget has shown the highest levels of borrowing in peace-time history comes as no great surprise, and indeed occasional high levels of borrowing in a generally sound fiscal framework are of no real policy concern. The last two years have seen the complete rupture of the government’s previous fiscal rules and in the 2008 Pre-budget Report they were replaced by the tautology that “the Government is setting a temporary operating rule: to set policies to improve the cyclically-adjusted current budget each year, once the economy emerges from the downturn, so it reaches balance and debt is falling as a proportion of GDP once the global shocks have worked their way through the economy in full”. The tautology is that the Treasury can claim that the global shocks have not worked their way through the economy in full until it reaches a point where the current budget is in balance and debt is falling. As a consequence the question whether the Treasury is set to meet its rule is not worth asking unless there is a more precise definition of what is meant by it and a clear statement of how it will be assessed.

Instead there are two rather important questions which should be asked. First of all, what are the fiscal prospects in the medium term and secondly how far are they consistent with prudent management of the government finances and the economy as a whole. These are much more important than the more immediate question whether the economy will perform as well as the Chancellor has forecast for this year and next year, although my own expectation is that it will not which raises the risk that the short-term deficit and therefore cumulated debt will be larger than forecast.

Here the focus is on the prospects for the medium term. The results of the exercise are such that there is little point in arguing that a prudent policy might be even tighter, although our view is that it would be.

THE MEDIUM-TERM OUTLOOK

As always in looking at long-term fiscal forecasts, the key determinants are i) the normal level of output, ii) the trend rate of growth iii) the extent to which any deviation from trend is closed and iv) the tax take (the share of taxes in GDP). It is generally recognised that increased risk premia in financial markets are likely to reduce long-run output, and also that shrinkage of the financial sector is likely to lead to a further reduction. The National Institute sees an output fall similar to that of the Treasury, but notes that losses in the banking system mean that income (which provides the tax base) is likely to decline more than output, but two other factors lead to a more substantial gap in actual output projections. First of all we see the economy as being further above trend in 2007 than the Treasury had assumed and secondly we see the trend growth rate being slightly lower. These taken together lead us to expect output to be about 2½ per cent lower than the Treasury has probably assumed for 2017. We also expect prices to rise less rapidly, but this affects nominal rather than real aggregates.

If we let real government spending grow by 0.7 per cent per annum measured with reference to the GDP deflator in the period from 2013–04 to 2017–08 while we let social security benefits grow in line with underlying GDP and reflect changes in labour force participation and population structure, we then find that nominal spending on goods and services has to stagnate from 2012 onwards. Real spending measured with reference to the GDP deflator falls at about 1½ per cent per annum from 2012–13 to 2017–18, giving an overall annual decline of nearly 1 per cent per annum over the period 2009–10 to 2017–18 and taking the share of public consumption in GDP down to levels not seen since the Second World War. Freezes on public sector pay will be needed if cuts in public services are to be avoided. Obviously the squeeze on public consumption could be mitigated by reducing social security benefit entitlements. Even with this squeeze tax increases of about 2p in the standard rate of income tax are needed to bring the current account deficit to just below 4 per cent of GDP.

An alternative would be to let public spending grow faster, to sustain positive real growth of consumption of goods and services of 0 to 1 per cent per annum from 2012–03 onwards and over the whole period from 2009–10 to 2017–18, as measured with reference to the GDP deflator. This would maintain the share of public consumption in GDP at its average for the first part of this decade. But it would require an increase in the standard rate of tax of 9–10p in the pound while once again leaving the deficit on the current account at just under 4 per cent of GDP.

These choices are summarised in table 1.
Table 1

THE BUDGETARY CHOICES FOR 2017

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<thead>
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<th></th>
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<tr>
<td>Severe squeeze</td>
<td>−0.9% p.a.</td>
<td>22p</td>
<td>−3.8%</td>
</tr>
<tr>
<td>High Taxes</td>
<td>0.6% p.a.</td>
<td>29-30p</td>
<td>−3.8%</td>
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</tbody>
</table>

April 2009

Memorandum from John Whiting, representing PricewaterhouseCoopers LLP, the Chartered Institute of Taxation and the Low Incomes Tax Reform Group

TAX MATTERS IN THE CHANCELLOR OF THE EXCHEQUER’S 2009 BUDGET

This paper is a commentary on some of the taxation measures contained in the Chancellor’s 22 April Budget speech, associated Press Releases and other papers. It does not attempt full analysis and cannot be exhaustive. Comments are included from PricewaterhouseCoopers, the Chartered Institute of Taxation (CIOT) and Low Incomes Tax Reform Group (LITRG).

INTRODUCTION

It is for others to comment on the economic impact of the 2009 Budget; but it will certainly have a considerable impact on the UK’s tax system as the 93 Budget Notes and multiplicity of accompanying documents are put into effect. Progress on simplification seems limited; the overall package does point to a still more complex system.

Proper consultation—over a proper timescale with good listening and reporting back—is ever more important. Two of the most significant areas this year (foreign profits and the continuing review of HMRC’s powers) demonstrate this to good effect; many other changes, including a significant number of anti-avoidance measures, have also been improved through consultation. The truncated Finance Bill timetable puts an even greater premium on this.

BUSINESS TAX

1. The announcements on the taxation of foreign profits (dividend taxation, the debt cap, CFCs and Treasury Consents) are generally welcome and show good signs of consultation having moved the original proposals to a more balanced position. In particular, the differential introductory dates for the dividend exemption (1 July 2009) and the debt cap (1 January 2010) are sensible (subject to seeing the detail in the Finance Bill). This should allow a better timescale to evolve the interest rules so that they do not discriminate against UK-based groups (as the original proposals did) and do not impose undue administrative burdens, though the whole debt cap principle is misconceived and it is disappointing that the opportunity to move to a proper territorial system is being lost.

HMRC is to be congratulated on listening to the concerns of advisers and business and it is to be hoped that the constructive engagement will continue. All parties have put a huge amount of effort into the development of these new rules which are very important to get right as they will become a key part of the UK’s internationally competitive tax system. But it is disappointing that there are no Gateway tests that pass the EU non-discrimination tests and that the new CFC rules are still some way off.

2. The temporary 40% first year allowance for plant and machinery has a significant revenue cost (largely timing) but may only reward investment already in the pipeline. Small businesses are unaffected, thanks to the annual investment allowance; large businesses will benefit but their investment projects will often have a lengthy timescale; difficult to bring forward into the comparatively short window for this enhanced allowance.

3. The extension of the £50,000 3-year loss carry back is welcome; but why not extend it to 31 December 2010, the year end used by most companies? A higher limit would also help many struggling companies.

16 Though HMRC assess the administrative burden of the debt cap at £8.7 million a year.
PERSONAL TAX

4. Inevitably, the advent of a 50% top rate of income tax is causing a great deal of comment. The impact it has on the UK’s competitive position must not be underestimated. More subtly, there is the message being taken by many that the UK’s tax system is no longer as stable as it was—after all, the planned 45% rate is being altered five months after its announcement and before it had even come in. None of this is meant to detract from the simple point that tax revenues need to be raised to help tackle the UK’s serious budget deficit, but there is a wider impact to be considered.

There is unfairness in the way the new rate is to apply to trusts. The rate of tax on trusts was aligned with the higher 40% rate, on the (arguable) basis that most of those involved with trusts were higher rate taxpayers. Extending the trusts tax rate to 50% as is intended is wrong—far from all those involved with trusts will be 50% taxpayers. LITRG has already been in discussions with the Treasury about the unfairness of imposing high rates on trusts for disabled people; this has the potential for exacerbating the situation and makes the exemptions granted even more important.

5. It is only three years since we had a major recast of the pensions tax system into what was meant to be a framework that would subsist for the long term, commensurate with the long-term nature of pension investment. Introducing a further cap on relief for high earners is perhaps understandable but the method chosen raises anomalies and complexities and may in due course add to the decline of company pension schemes.

As a simple example, someone earning £150,000 would be able to contribute £100,000 to their pension and gain 40% relief; but somebody earning £200,000 and contributing £20,000 would only gain 20% relief from 2011. Why?

The transitional “anti-forestalling” rules sensibly allow for regular patterns of contributing to be continued. However, the focus on quarterly or more frequent contributions ignores the very significant numbers of self-employed and senior employees who make annual or bi-annual contributions in the light of the profits of their business. The transitional rules need to take them into account—such people have a pattern of contributing: it is simply that they, given the nature of their position, cannot commit to the sort of frequency and consistency of premiums that HMRC indicates as the only normal situation.

One has to question why the curtailing of relief was not effected by a change to the maximum annual contribution limit. Would it not have been much easier to simply align that with the level at which the 50% tax rate starts? Even though that would break the commitments given around ‘A’ day, it would be a simple and easily workable system.

The final comment has to be to question how much money these changes will raise. A PMQ\(^{17}\) in 2006 produced an estimate for the value of the total of higher rate relief of individuals’ and employers’ contributions to be £4.5 billion.

6. The contribution of the volume of changes made in this year’s Budget to the complexity of the UK’s tax system has already been noted. One way of evidencing this is to look at the profusion of marginal tax rates\(^{18}\) that are expected to be within the system from 2011. On current income points (which may well change by 2011) we will see rates as follows:

Employed earner working 30 or more hours per week, one qualifying child over one with no eligible childcare costs

<table>
<thead>
<tr>
<th>Income (£)</th>
<th>Effective rate of tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0—5,715</td>
<td>0.00%</td>
</tr>
<tr>
<td>5,715—6,420</td>
<td>11.50%</td>
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<tr>
<td>6,421—6,745</td>
<td>50.50%</td>
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<tr>
<td>6,746—18,023</td>
<td>70.50%</td>
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<td>18,024—43,875</td>
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<tr>
<td>43,876—50,000</td>
<td>41.50%</td>
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<tr>
<td>50,001—58,170</td>
<td>48.17%</td>
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<tr>
<td>58,171—100,000</td>
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<tr>
<td>100,001—112,950</td>
<td>61.50%</td>
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<tr>
<td>112,951—150,000</td>
<td>41.50%</td>
</tr>
<tr>
<td>150,001 +</td>
<td>51.50%</td>
</tr>
</tbody>
</table>

There are of course other rates, including the 30% that many pensioners of reasonable means face and the little understood savings rate.

\(^{17}\) 26 April 2006 at Col 1175W

\(^{18}\) Table 5.2 of the Red Book highlights an area that is always of interest to the Treasury Committee; the contents of that paragraph are not included here.
7. The announcement of a new “pensioners tax-back” campaign, involving contacting all 2.7 million pension credit recipients is clearly welcome.\textsuperscript{19} It meets a call that LITRG have regularly made and is particularly necessary now the 10\% savings rate is in place, necessitating as it does a reclaim for anyone eligible to benefit from it. The logistical demands of this exercise are significant; proper resources need to be devoted to carry it through and early and genuine consultation on the general approach is needed.

European influences

8. The changes to furnished holiday lettings (Red Book para 5.116) and agricultural property relief (BN 50) are clearly driven by the need to make the UK tax system EU compliant. The route chosen, of, after a transitional period, abolishing the furnished holiday lettings is not altogether surprising, though it will mean a reversion to the old position of lengthy arguments with HMRC over whether the landlord is running a trade. The transitional period is short and may result in a flurry of attempts to sell affected properties so that owners can benefit from the entrepreneurs’ relief.

Why was there no proper announcement by way of a Budget Note about the furnished holiday lettings change? Some will see this as an attempt to hide the abolition away.

An arguably bigger area of concern under this heading is that of charitable donations where Gift Aid covers only UK charities. There are arguments that this needs to be extended to European charities; we need an update on HMRC’s thinking in this area.

HMRC powers and administrative aspects

9. BN 62 (“Corporate transparency: personal tax accountability of senior accounting officers of large companies”) is already causing a great deal of concern. It is understood that HMRC thinks this is a minor administrative routine, but it needs to be stressed that for many businesses it will require a considerable effort to document procedures so that there is full evidence and an audit trail of what is already happening, sufficient to satisfy the signing officer and indeed HMRC.

This is a very wide-ranging imposition, covering as it does all taxes (there are over 20 that can affect business). The impact is also well beyond UK public companies: many private companies will be impacted and they are unlikely to have the sort of systems established that are envisaged by the requirement. The UK operations of overseas multi-nationals will also have problems—they are unlikely to have local control systems of the sort of level HMRC seem to require.

In short, whilst one cannot argue with the spirit of this provision, ie that businesses should take proper responsibility for tax, the impact of this requirement is likely to be far greater in terms of administrative burden than envisaged.

10. The idea of “naming and shaming” deliberate tax defaulters (BN 63) might also seem hard to argue with as a route to helping improve attitudes towards tax compliance. It is a route that has been followed in other countries, notably Ireland. But the proposition naturally raises concerns over ensuring that it is only used in appropriate circumstances. These include:

i. It should be framed in terms of tax evasion—those who deliberately default and conceal.

ii. There must be no risk of a genuine dispute with HMRC about the treatment of some tax matters leading to HMRC using this new power as a threat to settle.

iii. The amounts involved of £25,000 are clearly small where defaults over a number of years accumulate—there needs to be a proper system of judgement that the offence really warrants such a sanction.

iv. What controls will there be over ensuring that someone who is affected by an HMRC mistake does not get into this sanction? If HMRC do make a ‘naming’ mistake, would proper compensation be paid?

It is reassuring to see that making a full disclosure to HMRC will avoid this sanction, as is the possibility of an appeal to the Tribunal against publication. These are very necessary safeguards to maintain a balance.

11. The continuing work on HMRC’s powers, deterrents and safeguards seems in general to be progressing well, although LITRG has doubts about how well HMRC are integrating income tax defaults with the concomitant tax credits issues. Concerns over the ability of HMRC’s systems to cope with the volume of change seem to have been recognised by the delay in some changes. However, there are also concerns over the whole package having a proper balance—that there are appropriate safeguards for taxpayers and obligations for HMRC built in. (An example might be the area of payments—taxpayers are understandably penalised if they are late making payments; but is there really an adequate structure on HMRC to make repayments promptly?) The proposed HMRC Charter is an important step in gaining a proper balance but the draft included in the recent consultative document was very disappointing and somewhat misguided.

\textsuperscript{19} Hopefully it will also encourage take-up of pension credit; a further campaign to encourage take-up of working tax credit is also indicated.
Housing

12. A small additional point on the housing package: the rent-a-room relief has been fixed at £4,250 since April 1997. Raising this would help some people trying to get onto the housing ladder and, indeed, some who are struggling to stay on the ladder.

Savings

13. As a final point, whilst the increase in the ISA investment limit is welcome, the decision to introduce it on a split basis seems an unnecessary complication. A simple increase for all from next April is surely all that is needed; to ask ISA providers to have to explain the under 50/over 50 split, monitor the age of investors, control split investments and answer inevitable questions about the changes is another admin burden too far. If the over 50 split remains, it would be better to provide to those who will be 50+ by 5 April 2010, rather than have them wait until their birthday.

April 2009

Supplementary memorandum from HM Treasury

FURTHER MATERIAL REQUESTED AT THE EVIDENCE SESSION ON 28 APRIL 2009

If you can provide us with a further paper on that [referring to earlier discussion on the role of consumption in the growth forecast and the rebalancing of the economy], that will help inform our report because it will be a significant part of our report. (Q 101)

The tightening of credit conditions facing households and companies, and the depreciation of sterling since mid-2007, provide the conditions for a significant rebalancing of demand in the UK economy. This macroeconomic adjustment is likely to entail increased saving by households, increased investment by companies as they respond to new opportunities, and a rebalancing of domestic and external demand. In the near term, it will involve a significant stock-adjustment cycle in the company sector, and a substantial increase in public sector net borrowing, that will have the effect of smoothing the private sector adjustment to a more balanced economy.

Developments in the second half of 2008 suggest that this adjustment may be taking place at a more rapid pace than many had expected. The second half of 2008 saw a slightly larger than expected fall in consumer spending but a slightly smaller than expected fall in investment. Reflecting the downturn in world trade, both exports and imports fell sharply, but imports fell further, beginning to rebalance demand between domestic sources and net exports.

The depreciation of sterling will help to continue this rebalancing. Over the forecast horizon, the expected positive contribution to growth from net trade is similar to that seen between 1993 and 1995, a period that also followed a significant sterling depreciation.

Growth in consumption declined progressively through 2008, while at the same time estimated real income growth picked up. Therefore the saving ratio is currently estimated to have risen rapidly from a low of –1.4% in the first quarter to 4.3% by the final quarter of the year. However estimates of the saving ratio can be revised quite heavily as new data on income and spending become available. The pace and extent of the adjustment currently reported are therefore subject to considerable uncertainty.

Rebalancing is expected to continue throughout the forecast period. In 2009, consumer spending is forecast to contract by 3% in the year as a whole. Consumption is then expected to recover over 2010, and grow by 1.4% in the year as a whole. This forecast recovery is towards the upper end of external forecasts, who on average are expecting a further contraction in consumption of around 1.8%. This reflects a judgement that monetary policy stimulus and support to incomes from discretionary fiscal action and the automatic stabilisers will feed through to a stronger recovery in consumer spending than some forecasters are expecting. But the Treasury forecast is not an outlier, with a number of forecasters (including Barclays Capital, Citigroup, Credit Suisse and Goldman Sachs) forecasting similar or stronger consumption growth over 2010.

Rebalancing is also expected to feature in the medium term, with the growth of consumer spending forecast to be slightly below that of GDP as a whole. This reflects the ongoing rebalancing of domestic demand in the economy as households adjust their finances and increase saving to more sustainable rates. As such, the saving ratio is forecast to pick up further in 2010 before settling close to the average ratio of the past 20 years in 2011.
**With regard to the stamp duty exemption, how many people have benefited since 3 September? (Q 211)**

On 2 September 2008 the Government announced a one-year SDLT holiday. The holiday aims to support those homebuyers who need it most at a time of difficult conditions. Budget announced that the SDLT holiday would be extended until 31 December 2009.

During the period of the holiday over 60% of residential property transactions will be exempt from SDLT. This means that around 90,000 transactions have already benefited from the holiday. Looking ahead we expect that a total of 210,000 transactions will benefit from the holiday, and that around 60,000 of these will benefit as a result of the extension announced at Budget.

These figures do not include those who would already have been exempted from SDLT by the permanent starting threshold of £125,000.

**What facts are known about the number of people who put themselves outside the UK tax jurisdiction as a result of the tax on non-doms and what assumptions have been made about the number of people who have placed themselves outside UK jurisdiction? (Q 238)**

When introducing reforms to the remittance basis of taxation in 2008 we estimated that 3,000 resident non-domiciled individuals would leave the UK as a result of the changes. This remains our estimate and there is no basis for revising it until we receive Self Assessment data for 2008–09, which, as Mr Williams stated, is not yet available.

28 April 2008

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**Supplementary memorandum from HM Treasury**

**Further material requested at the Evidence Session on 29 April 2009**

**Do you have figures now on the amount of personal debt that people have, separate from mortgage debt, personal credit debt? (Q271)**

The Bank of England publishes data on household debt levels, split between mortgage debt and consumer credit. In February 2009 the total stock of household debt was £1.46 trillion, of which £1.23 trillion was secured debt and £232 billion consumer credit. Within consumer credit, £53 billion is credit card debt.

The annual growth in consumer credit has been on a declining trend since the beginning of 2005, and in March the stock of consumer credit was 3.2% higher than a year earlier, the lowest growth rate since August 1993.

**ANNUAL GROWTH IN LENDING TO HOUSEHOLDS (MONTH ON SAME MONTH YEAR EARLIER, NOT SEASONALLY ADJUSTED)**

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<tr>
<th></th>
<th>Total credit</th>
<th>Secured credit</th>
<th>Consumer credit</th>
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<td>14.5</td>
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<tr>
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<td>9.7</td>
</tr>
<tr>
<td>June 2006</td>
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<td>11.0</td>
<td>7.4</td>
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<tr>
<td>January 2007</td>
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<td>January 2009</td>
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<td>2.9</td>
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</tr>
<tr>
<td>March 2009</td>
<td>2.1</td>
<td>1.9</td>
<td>3.2</td>
</tr>
</tbody>
</table>

**What market-testing have you done and what consultations have you carried out to ensure that, when some of these things come forward with a guarantee, the investors will look to invest in them because of course the trust and confidence in asset-backed security was shot through from before? (Q345)**

On 19 January 2009, the Government announced it would establish a guarantee scheme for assets-backed securities, to be launched by the Debt Management Office (DMO) in April.

In the 2009 Budget, the Government announced that the scheme is available, at first until October 2009, for banks and building societies to use alongside the existing Credit Guarantee Scheme, to support their lending to the economy. The scheme extends the funding options available under the existing Credit Guarantee Scheme to residential mortgage backed securities (RMBS). The details of the scheme are available on the Debt Management Office’s website at: [http://www.dmo.gov.uk/index.aspx?page=CGS/ABS_about](http://www.dmo.gov.uk/index.aspx?page=CGS/ABS_about)

Banks and building societies eligible to participate in the existing Credit Guarantee Scheme are eligible to participate in the ABS guarantee scheme.
Following discussions with the industry, the Government has announced two types of guarantee: a credit guarantee and a liquidity guarantee:

— **credit guarantee**: this is an unconditional and irrevocable guarantee of the timely payment of all amounts of contractually due from the issuer for the duration of the guarantee; and

— **liquidity guarantee**: this is a guarantee of the issuer’s obligation to purchase eligible instruments at a specified time, where the participating bank or building society is required to undertake to put the issuer in funds to meet its obligation.

The guarantees will have a maximum term of up to three years (up to one third of the guarantees may have a five year term).

The guarantees will attach only to instruments rated AAA by at least two rating agencies (on the basis that they do not carry a guarantee). The Government also has recourse back to the participating bank or building society and the issuer of the securities, thereby protecting the taxpayer. Both the bank or building society and the issuer will be required to sign counter-indemnities obliging them to reimburse the Government for all sums paid out under the guarantee.

The DMO will require that data relating to the loans backing the securities is provided on a regular basis.

The fees payable to the government will be based on a per annum rate of 25 basis points plus 100% of the participating institution’s median five-year Credit Default Swap spreads from the period from 2 July 2007 to 1 July 2008.

The Government is setting high quality eligibility criteria, and encouraging high quality reporting standards, in order to lay the foundations for stronger markets in the future, building on recently published new reporting standards for European RMBS published by the European Securitisation Forum.

The scheme will run initially for a six month period subject to any extension at the discretion of the Government.

*When you look at issues about housing, because you can be cash-poor and you can be asset-poor as well, you said just now that, when people lose their jobs, after 13 weeks they will get SMI, but that is only if they are on income-based Jobseekers’ Allowance, is it not? (Q358)*

Everyone who claims a qualifying means-tested benefit, or who is receiving a qualifying contributory benefit and can establish their eligibility to an means-tested benefit, and has a relevant outstanding mortgage liability, can receive Support for Mortgage Interest (SMI) for eligible housing costs after claiming their qualifying benefit for 13 weeks.

SMI helps pensioners and the out of work with their mortgage interest. SMI is means tested as an integral part of the income-based benefits system. The qualifying benefits for SMI are Employment and Support Allowance (income-based and contribution based), Jobseeker’s Allowance (income-based and contribution based), Income Support and Pension Credit. It is paid as part of Income Support (IS), Employment and Support Allowance (income-based), Jobseekers’ Allowance (income-based) and Pension Credit.

Prior to 5 January 2009 those of working age had to serve a 39 week waiting period before they could become eligible to SMI. There was a shorter waiting period, of 26 weeks, for those who had taken out their loan prior to 2 October 1995. Any period that a working age claimant spent on IS, Employment and Support Allowance (ESA) and Jobseeker’s Allowance (JSA) counted towards the waiting period. In the case of JSA and ESA, this was regardless of whether the claimant was in receipt of the contribution-based version or the means-tested version of the benefit. In other words, time spent on contribution-based JSA or ESA counted towards the 26 or 39 week waiting period for SMI, but only those on the means-tested version of the benefit at the end of the qualifying period would become eligible at that point. The exception to this is that those who remained in receipt of a contribution-based JSA or contribution-based ESA, could establish their eligibility to the income-based version, would also become eligible at that point.

Contribution-based JSA can only be paid if a person has paid enough National Insurance contributions in the past two tax years before they claim. And it can only be paid for six months. After six months, the claimant may be entitled to income based JSA provided that they meet the qualifying criteria for that benefit. If they do not meet the qualifying criteria (ie the “means test”) then they will remain entitled to claim “Credits Only” Jobseeker’s Allowance, which covers National Insurance contributions but provides no financial support to the claimant.

Given the six month limit on contribution-based JSA, it would not be possible for a contribution-based JSA claimant to still remain on contribution-based JSA by the time they become potentially eligible for SMI—ie. at the point at which they had completed their 39 week waiting period. This means that there were no situations in which someone could be both claiming contribution-based JSA, and potentially eligible for SMI.

Since 5 January 2009, new SMI measures were introduced which, among other changes, reduced the waiting period to 13 weeks. This has changed the position and made it possible for some claimants to both be in receipt of contribution based JSA and potentially eligible for SMI, having completed the waiting period.
After the 13 week stage, if the contribution-based JSA claimant meets the qualifying criteria for income-based JSA (and housing costs will now be taken into account in the assessment), they can be awarded SMI. If they are still entitled to contribution based JSA they will continue to receive this, with income-based JSA as a top up until their six month period is completed, at which point they would be transferred to income-based JSA. Note that income-based JSA, unlike its contributory variant, takes into account both savings, and the financial circumstances of any partner. A person on contribution based JSA with significant savings, or a working partner, may therefore not be eligible for income based JSA.

Does your revenue projections of what will be raised with the 50 pence tax, does that include any impact on the revenues from indirect taxes and the high earners spending less? If you do not have that answer right now, which I do not think you will have, maybe your officials can convey it to us. (Q367)

Table A1 of the Budget document set out at Line 44 the estimated yield from the Income Tax measure: increase the additional rate to 50% from £150,000 and increase trust rate to 50% from 2010–11. As described in footnote 3 to the table, this yield is in addition to the yield published at PBR 2008 for the 45% additional rate commencing from 2011–12, with the total yield in 2012–13 from the 50% additional rate being £2.4 billion.

This costing includes direct behavioural effects, eg those associated with labour supply decisions, including around migration, and use of tax reliefs, including those on pension saving.

As described in paragraph A188 of the Budget, “The net Exchequer effect of a Budget measure is generally calculated as the difference between applying the pre-Budget and post-Budget tax and benefit regimes to the levels of total income and spending at factor cost after the Budget”. This means that the costing of the income tax measure in Table A1—as with all other measures set out in that table—excludes indirect effects that the measure may have on levels of income and spending. Instead, such indirect effects are accounted for in the economic forecast, which incorporates post-Budget levels of income and spending.

This approach to costing the income tax measure is consistent with that used to cost other measures in the Budget and in previous Budgets.

Your first question again in terms of the money for the banking bail-out, the automatic stabilisers and the other discretionary spending, I was not too sure with absolute clarity on that, so could you provide us with some answers on that again? (Q368)

Fiscal support to the economy of around 4% of GDP over 2009–10

Fiscal policy will provide support to the economy of around 4% of GDP over the course of 2009–10. This support is made up of:

— the automatic fiscal stabilisers, forecast to amount to 2.6% of GDP in 2009–10. This is the difference between the forecast for net borrowing (12.4% of GDP) and the forecast for cyclically-adjusted net borrowing (9.8% of GDP).

— The fiscal stimulus announced in the PBR, worth around 1% of GDP in 2009–10. This includes the temporary cut in VAT from 17.5% to 15% and the bringing forward of £3 billion of capital spending from 2010–11.

— Targeted fiscal measures announced in the Budget, with a value of 0.4% of GDP in 2009–10, including: further support for businesses facing cash flow problems and support for key growth industries of the future; further support for households hit hardest by the recession, including savers and pensioners and additional measures to support employment; further investment in infrastructure and the housing sector; and measures to support a move to a low carbon economy.

Fiscal implications of measures to ensure financial stability

The Government provisionally estimates that losses may lie within a potential range from £20 billion to £50 billion (1.5 to 3.5% of GDP). As Box 2.3 of Budget 2009 sets out, this provisional estimate is a cautious judgement, made for fiscal policy purposes. It is not an estimate of scheme-by-scheme losses over time, as it is impossible to set out accurate overall costs with any degree of certainty at this point.

The estimate covers all interventions by UK authorities to support financial stability. In reaching an estimate of the scale of potential net losses, the Government’s judgement has been informed by:

— potential income from fees (for example on the Special Liquidity Scheme and Credit Guarantee Scheme) and investments;

— data from stress-testing and due diligence exercises undertaken by the Authorities in relation to various schemes; and

— the Government’s assessment of economic conditions.

Setting out estimates of losses on financial sector interventions is inherently difficult in current market conditions. However, in setting plans to meet the Government’s fiscal objectives in future it is prudent to make allowance for the potential for such losses.
The estimate recognises the losses in the 2008–09 financial year, in a manner similar to the principle of provisioning for future costs in commercial accounting. This does not reflect cash borrowing in 2008–09, but is instead a recognition that transactions undertaken, and commitments entered into, in that year are expected to have consequences of this magnitude in the future.

Impact of discretionary measures on public sector net borrowing in 2013–14 over both the 2008 Pre-Budget Report and Budget 2009

Table 1.1 of the 2008 Pre-Budget Report gives the impact of discretionary measures\(^{21}\) announced in the PBR on the forecast of public sector net borrowing for 2013–14 at 1.6% of GDP, equivalent to £29.5 billion.

Table 1.1 of Budget 2009 gives the impact of discretionary measures\(^{22}\) announced in the Budget on public sector net borrowing for 2013–14 at 1.5% of GDP, or £26.5 billion.

The combined effect on the forecast of public sector net borrowing for 2013–14 of discretionary measures in both the 2008 Pre-Budget Report and Budget 2009 is set out in the table below.

<table>
<thead>
<tr>
<th>Impact on public sector net borrowing of discretionary measures</th>
<th>£ billion</th>
<th>Projections 2013–14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008 Pre-Budget Report</td>
<td>−29.5</td>
<td></td>
</tr>
<tr>
<td>Budget 2009</td>
<td>−26.5</td>
<td></td>
</tr>
<tr>
<td>Total PBR and Budget discretionary measures</td>
<td>−56</td>
<td></td>
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1 May 2009