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Treasury Committee

Budget 2009: Government Response to the Eighth Report from the Committee

Fifth Special Report of Session 2008–09

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Contacts

All correspondence should be addressed to the Clerks of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk.

Fifth Special Report

The Treasury Committee published its Eighth Report of Session 2008–09, *Budget 2009*, on 6 May 2009, as House of Commons Paper No. 438. The Government's Response was received on 6 July 2009, and is appended to this Special Report.

Appendix: Government Response

The economy

1. The Treasury's forecast in the Budget is for the economy to begin recovering in the final quarter of 2009 before going on to register strong growth of 3.5% in 2011. There is, understandably, considerable uncertainty around the Government's growth forecasts for 2009-2011, reflecting the fact that the UK economy is in uncharted territory. This uncertainty is demonstrated by the large number of independent forecasts which are more pessimistic than the Government as well as the smaller number of forecasts which are more optimistic. In particular, we note that the IMF believes the UK will continue to contract in 2010. Whilst it is possible that the Government will meet its growth forecasts, on the available evidence, this is an optimistic assumption. We question the decision to assume that the economy will begin registering positive growth as early as the fourth quarter of 2009, and that the economy will register such strong growth in 2011. (Paragraph 11)

The Budget 2009 forecast reflects the balance of key forecasting judgements. These relate to the strength of the negative effect of the global financial crisis and private sector retrenchment and the positive effect of large-scale macroeconomic support, both domestically and internationally, on growth. Commodity prices have fallen from their peak in 2008 and sterling depreciation will further support demand. The forecast is also underpinned by the assumption that G20 authorities deliver on policy commitments and that financial conditions ease as a result.

The extent of macroeconomic stimulus, and the assumption that this stimulus progressively takes hold during 2009 and 2010, underpins the Budget 2009 forecast for an earlier, more sustained and stronger recovery than seen in the 1980s and 1990s. Experience of those recoveries points to the possibility that recovery can deliver strong growth rates for a number of years as spare capacity is brought back into productive use. While there is considerable uncertainty over the extent to which the current downturn will ultimately prove to have been the result of cyclical or structural factors, it is clear that considerable spare capacity is likely to have emerged during the second half of 2008 and 2009.

2. It is clear that the recession has acted as a catalyst for the rebalancing of demand in the UK economy. This rebalancing entails a shift away from consumption with a concomitant rise in the savings ratio, with net trade also playing a more important

contributory role to growth over the 2009-2011 period. We note, however, that the contribution net trade will make to growth is contingent upon a speedy recovery in the UK's major trading partners and on the fulfillment of commitments made at the G20. Consumption is forecast to recover sharply in 2011 but we are concerned that this may be too optimistic given that the UK economy will only just have emerged from a sharp downturn. Additionally, the strong rebound forecast in consumption growth from 2011 onwards has important implications for whether the rebalancing of the UK economy is merely a short-term phenomenon or whether the Government should take steps to ensure such changes prove more durable. Savings will need more encouragement. (Paragraph 15)

Prospects for recovery in advanced economies are closely linked to the delivery and effectiveness of macroeconomic stimulus. Large monetary policy stimulus is already in place, but there are uncertainties over the effectiveness of historically low interest rates in encouraging spending when confidence has been severely affected by the global financial crisis. If confidence remains low, consumers may increase saving for precautionary reasons and businesses may continue to cut back investment due to uncertainties over demand; if confidence is quickly restored, supportive financing conditions could deliver a more rapid rebound in spending. A significant proportion of planned global fiscal support is yet to be delivered. The Budget forecast is based on the assumption that it will be delivered as planned, so delays or reversals could represent a risk that the recovery will be weaker or later than forecast.

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. Since mid-2008, net trade has made a substantive positive contribution to GDP growth. 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 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.

Rebalancing is expected to continue throughout the forecast period. In 2009, consumer spending is forecast to contract by 3 per cent in the year as a whole. Consumption is then expected to recover over 2010, and grow by ¼ per cent 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 ¼ per cent. 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.

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.

3. It remains too early to judge whether the November 2008 fiscal stimulus—and in particular the VAT reduction—has been successful. There has been much discussion of whether a subsequent fiscal stimulus separate from the stimulus provided by the automatic stabilisers was necessary, but ultimately the Government decided against introducing a further large-scale fiscal stimulus at the time of the 2009 Budget. No doubt the debate around the need for a further fiscal boost to the UK economy will continue, particularly if growth in the economy fails to pick up. Any discussion of additional stimulus must take into account both the implications for the public finances of such a boost and the credibility of the Government's plans to bring the budget back into balance. (Paragraph 21)

To promote economic recovery while protecting fiscal sustainability, Budget 2009:

- focused on targeted and cost-effective measures to support those most affected by the downturn and to ensure a sustained and sustainable recovery, including support for employment and investment. These measures will have a temporary, rather than a permanent, impact on government borrowing; and
- building on the fiscal consolidation announced in the 2008 Pre-Budget Report, set out plans to deliver a sustained fiscal consolidation once the economy emerges from the downturn, including a combination of adjustments to tax and spending that reduce borrowing by a further £26.5 billion by 2013-14.

Several independent commentators have supported the rate reduction. In February, commenting on the strength of retail sales, Goldman Sachs stated, "it appears that the VAT cut was instrumental in driving this strength".

4. There is a strong possibility that unemployment will rise above three million, with some economists warning that it is possible that unemployment could rise as high as four million. Approximately 40% of the unemployed are likely to be young people aged under 25. We agree with Professor Blanchflower that this necessitates measures focused on assisting young people and, to this end, welcome the Government's approach of targeting resources on this group. That said, it is too soon to judge whether the Government proposal that all young people who have been on Jobseeker's Allowance for 12 months will be guaranteed a job, work placement or training opportunity, together with the monetary and fiscal stimuli, are a sufficiently timely and substantial response to the scale of the unemployment challenge. (Paragraph 27)

The Government welcomes the Committee's support for its announcement that all young people who have been on Jobseeker's Allowance for 12 months will be guaranteed a job, work placement or training opportunity. The additional £1.2bn for this policy, together with the additional £3bn for the Department for Work and Pensions over the next two years, and the £500m package of support for the long-term unemployed announced in January, constitutes a major response to rising unemployment, and will help maintain a quick return to work for the vast majority of those who become unemployed. The Government will keep the effectiveness of these policies under review.

5. The Asset Purchase Facility is a crucial tool of monetary policy, given the currently low level of Bank rate. We note the heavy bias towards the purchase of gilts under the facility. We note the concern of some that not enough is being done to provide adequate liquidity in the corporate debt markets. We expect the Bank of England to take every opportunity to use the £50 billion allotted to the purchase of corporate debt under the Asset Purchase Facility to ensure the effective operation of those markets. We also recommend that the Debt Management Office and the Bank of England develop strategies for the Bank to dispose of its increasing holdings of gilts and corporate debt. (Paragraph 35)

The Asset Purchase Facility is designed to improve the flow of credit to businesses and to enable the Monetary Policy Committee to purchase assets for monetary policy purposes. The processes for commercial paper and corporate bond purchases complement private sector provision of these instruments. The Bank of England is consulting with market participants on proposals for facilities for secured commercial paper and supply chain finance. These facilities are intended to support the financing of working capital.

The timing and pace of disposal of assets held by the Asset Purchase Facility will be determined by the Monetary Policy Committee, to support the operation of monetary policy. The Bank have stated that they will consult with the Debt Management Office on their strategy for selling gilts from the Asset Purchase Facility portfolio.

Public finances

6. The Chancellor's forecasts for public borrowing and national debt make sobering reading. By any measure, those forecasts along with those of many other OECD countries, are extremely high: they have exceeded the fiscal rules from which the Government departed in PBR 2008 by a wide margin and these figures represent the worst fiscal outlook since the Second World War. We are very concerned about the state of the public finances. What is now of critical importance is that the public, and crucially the markets, believe that the Chancellor is working to an adequate, and credible, plan to restore the public finances to good health. The credibility of any attempt to restore the public finances will depend on an acceptance that the structural deficit must be addressed as well as the consequences of the current extraordinary circumstances. We discuss this plan in the next section of this Report. (Paragraph 44)

The Government has set out its commitment to address the structural deficit. This commitment is underpinned by the temporary fiscal operating rule, which requires the Government to set policies to return to cyclically-adjusted (i.e. structural) current balance once the global shocks have worked their way through the economy in full. The plans the Government set out in Budget 2009 are consistent with the temporary operating rule, and with closing the structural current deficit and placing debt on a declining path by 2017-18.

7. One of the important determinants of the restoration of health to the public finances is the extent to which tax revenues are able to rebound from their current low levels. It should be recognised that even before the current crisis the UK was running a structural deficit, although the scale of that deficit has been disputed and has been justified by the Chancellor on the grounds that this was a necessary investment. In our view, any restoration is not merely contingent on the economy meeting the challenging growth projections set in this year's Budget. What is also of importance is the composition of that growth. We note the inevitable shift away from the UK economy's dependence on financial services, and the Chancellor specified several industrial sectors which had promising futures. But it would be wrong to assume that these, or other sectors, will necessarily be as profitable as financial services. We recommend, therefore, that future Pre-Budget Reports and Budget documents provide a sectoral analysis of tax revenues, so that the basis of Treasury forecasts in a changing economy can be scrutinised. The Treasury already has the means to provide this information, as evidenced by its commentary on the financial and housing sectors, so to do this should not be particularly onerous. (Paragraph 49)

The Government is committed to transparency in its approach to fiscal policy and provides detailed information on forecasts of tax revenues. Budget 2009 published the main components of public sector receipts to 2009-10 and changes since the 2008 Pre-Budget Report in Table C6 of Chapter C on the public finances. The table is accompanied by a tax-by-tax analysis, which explains the underlying assumptions behind the changes in the projections of the individual taxes. In addition, Table 2.9 of *Budget 2009: the economy and public finances – supplementary materia*l provides projections of individual taxes over the five-year forecast period.

8. In the medium term, the options for returning the public finances to balance present uncomfortable choices for the Government and consequences for the public, the broad alternatives being substantial tax increases, unprecedented cuts in public services, or a combination of the two. We recommend that in the Pre-Budget Report 2009, the Government sets out a range of options for closing the projected fiscal gap. (Paragraph 52)

The Budget sets plans that put the public finances on a path to return to cyclically-adjusted current balance by 2017-18 and has set out clear plans for 2013-14. The

Government is committed to sustainable public finances and is demonstrating its ability to deliver a sustained but fair consolidation at the pace required.

The Government keeps all of its plans under review, and will publish updated economic and fiscal forecast in the 2009 Pre-Budget Report, as normal. Detailed decisions on spending priorities will be taken in the normal way at the next Spending Review.

9. We do not see how the Temporary Operating Rule acts as any kind of constraint at all on the current fiscal decisions made by the Chancellor, and we struggle to imagine any course of action he might have taken in this year's Budget that would have been inconsistent with it. For this Rule to have any bite whatsoever, the identification of the point in time at which "the global shocks have worked their way through the economy in full", cannot be left to the judgment of the Treasury alone, but should be subject to parliamentary scrutiny. It is clear to us that the only real financial discipline that is currently imposed on the Chancellor is the opinion of the gilt market on the sustainability of the public finances. (Paragraph 56)

10. We believe that the Chancellor should now engage in what we regard as a crucial debate about the future of the UK fiscal framework. The majority of our expert witnesses found fault with the Golden Rule and Sustainable Investment Rule, so an eventual return to an unreformed framework would seem misguided. We sense that there is little consensus on what the best framework might be, which is all the more reason to commence a thorough analysis of all the options, drawing on international best practice, practical experience and academic theory. We are not suggesting that a new framework should be implemented now, but that the Treasury should open up a debate. To this end, we renew our recommendation made in our Report on PBR 2008 for a full public consultation. (Paragraph 60)

The Government's objectives for fiscal policy in the face of the major economic shocks remain unchanged. The immediate priority has been to support the economy, while setting a path to ensure fiscal sustainability in the medium term.

When the economy faces significant shocks, the role of the fiscal framework is to ensure fiscal policy has the flexibility to respond to those shocks, while remaining committed to transparent long-term goals. The temporary operating rule introduced in the 2008 Pre-Budget Report is designed to underpin a sustained fiscal consolidation once the economy is recovering, and the Budget sets out plans to deliver a sustained fiscal consolidation once the economy emerges from the downturn.

As there is considerable uncertainty over the path of the economy and the public finances in the short-term, the rule allows Government flexibility to adjust to unanticipated developments in the economy, while constraining fiscal policy to deliver sound public finances—achieving a balanced structural current budget and getting debt on a downward path—in the medium term.

The Government is committed to transparency and responsibility in its approach to fiscal policy, consistent with the *Code for Fiscal Stability*. Transparency promotes understanding of the Government's objectives and allows external commentators to monitor whether policy decisions are consistent with those objectives. Since the 2008 Pre-Budget Report the Government has taken further steps to improve the transparency of fiscal policy-making, including by providing detailed information on its forecasts of tax revenues, as set out above. Further, Budget 2009 set out both its baseline fiscal projections, excluding liabilities and unrealised losses from financial sector interventions, and projections for borrowing and debt that include the high end of a provisionally estimated range for the net impact of unrealised losses, equal to 3½ per cent of GDP.

In advance of the public finances reaching cyclically-adjusted current balance, the Government will set out how it will apply the fiscal framework in future to continue to deliver its objectives.

11. We note the reaction of the debt markets to the Treasury's ambitious borrowing plans. We believe there are strong reasons why the costs of financing the Government debt could well remain low. But if the gilt market were to lose its appetite for Government debt, which is by no means impossible, the cost of financing that debt could climb to perilous levels. Financial markets can be very volatile, and, as we have recently learnt in the financial crisis, can be quite poor at pricing risks initially, with any subsequent pricing corrections being sudden and unexpected. Under these circumstances, we consider that it would be prudent for the Treasury to work up contingency plans for a weakening of demand for Government debt. (Paragraph 68)

HM Treasury and the Debt Management Office (DMO) are confident that the 2009-10 financing remit, although challenging, will be successfully delivered. Demand for gilts, particularly from pensions funds and insurance companies, is strong and sustained.

HM Treasury's annual consultation held in January 2009 with dealers and investors showed continued high demand for gilts of all maturities and particularly for long maturity and index-linked gilts. The Government has responded accordingly. Planned issuance of long maturity and index-linked gilts in 2009-10 has been further increased, enabling the Government to respond to ongoing structural demand and thereby contributing to minimising cost over the long term.

The Government remains committed to gilt auctions as the primary mechanism to issue gilts but has also taken into account the views of market participants on additional distribution methods. Following consultation by the DMO with the dealers and investors in the latter part of 2008-09, the Government has decided to use two supplementary methods to issue gilts in order to facilitate the effective delivery of the remit and meet investor needs. These methods are: syndication and continued use of mini-tenders. It has also decided to introduce a post auction top up facility for successful bidders to increase their allocation of gilts.

The DMO meets regularly with gilt market participants including holding quarterly formal consultation meetings at which the DMO obtains a market assessment of demand for gilts that informs its issuance decisions for the forthcoming quarter. Continuous informal bilateral dialogue between the DMO and gilt market participants is also an important source of information about market conditions that informs DMO's operational decisions about gilt issuance.

Paragraph 5.23 of the *Debt and reserves management report* 2009-10 allows for any aspect of the DMO's remit to be revised during the year in the light of exceptional circumstances.

Other measures in Budget 2009

12. We acknowledge the pressure on Government finances but are concerned by the lack of any substantial measure to combat child poverty in both the Pre-Budget Report 2008 and Budget 2009. On current indicators the Government will fail to meet its 2010-11 target by a significant margin. We are dismayed that, despite our repeated warning in past reports, the Treasury has failed to take sufficient positive action to ensure the child poverty targets are met. We recommend that the Government researches the impact of the recession on the number of children living in absolute as well as relative poverty and brings forward further proposals in the Pre-Budget Report 2009 to ensure that it achieves its targets on halving child poverty by 2010-2011 and then eliminating it. One perverse consequence of the use of a relative measure of child poverty is that a period of recession might reduce the numbers of children deemed to be in poverty even though an increasing number is suffering actual hardship. (Paragraph 74)

Between 1998/99 and 2007/08 the number of children in relative poverty fell by 500,000, and measures announced in and since Budget 2007 are expected to lift around a further 500,000 children out of relative poverty. Over that same period absolute low income poverty fell by 1.7 million children.

There is significant uncertainty about the impact on child poverty of the current economic circumstances, and the extraordinary economic events create additional pressures that mean it will be hard to meet the target by 2010. However, the Government is continuing to work towards the 2010 target and has taken further steps at Budgets and Pre-Budget Reports even in these difficult times.

The Government remains committed to the sustainable eradication of child poverty. To this end, it has introduced the Child Poverty Bill which proposes to enshrine its pledge in legislation. Recognising that tackling child poverty is everyone's business, the Bill includes duties for local authorities and their delivery partners as well as central

Government. It establishes an accountability framework to drive progress towards the 2020 goal at national and local level. The Bill also defines success and makes it clear that tackling child poverty requires a focus both on tackling low income and making sure no child falls behind their peers.

In the 2008 Pre-Budget Report the Government took decisive action to support households, particularly the vulnerable, through the economic downturn by:
- bringing forward increases of child benefit, worth over £22 on average to families, between January 2009 and April 2009; and
- bringing forward the Government's commitment to increase the child element of the Child Tax Credit by £25 above indexation from April 2010 to April 2009, so that the child element increased by £150 a year in April 2009.

Budget 2009 built on this progress and set out the next steps for supporting vulnerable groups through the global economic difficulties including: an additional £20 a year above indexation from April 2010 on the child element of the Child Tax Credit; and additional investment in the social fund. In addition, the flexibility and responsiveness of tax credits is designed to tailor financial support to current circumstances and respond quickly to changing needs.

Child poverty is a result of a number of complex and varied factors. It is therefore difficult to predict the impact of the recession on numbers of children in poverty. However, as set out in *Ending Child Poverty: Making it Happen* the Government uses a number of indicators to ensure a comprehensive and robust approach to measuring child poverty.

13. Hitherto, those claiming the Local Housing Allowance had an incentive to seek competitively priced accommodation in order to maximise their benefit. Such an incentive will disappear in April 2010 which will cause problems for some. We recognise the prevailing economic pressures on the Government but recommend that more thought be given to creating a more stable framework for the payment of this benefit. (Paragraph 81)

The Government acknowledges that families will no longer have the scope to gain financially from the Local Housing Allowances, but in the current fiscal climate it is essential that Housing Benefit continues to represent value for money for the taxpayer. Not only will this change not produce rent shortfalls, but the long lead in time (April 2010 at the earliest) means that families will have time to adjust to the new rules. The Government made it clear in the Budget that it intends to launch a consultation on the measures it can take to improve Housing Benefit in the medium term, which will focus on incentives for those returning to work and reducing total spending, while maintaining access to suitable housing for those who cannot work.

14. The recovery of the housing market is clearly linked to the recovery of the economy as a whole. It is therefore vital that the Government take steps to

reinvigorate the market at this time. However, we note that the resurgence of the property market is particularly dependent on the availability of mortgage credit to homebuyers and we are unconvinced that other schemes to boost the market, such as the stamp duty holiday, will have any marked effect. We call on the Government to report in the PBR on the implementation of the asset-backed securities scheme and to provide a cost-benefit analysis of the effectiveness of the stamp duty holiday. (Paragraph 87)

The stamp duty measure is designed to provide short term support to those homebuyers purchasing properties of £175,000 or less and should be seen in the context of other action the Government has taken to support homeowners, homebuyers and housing supply. It is impossible to estimate the precise impact that the holiday has had on transactions (as it is impossible to say what would have happened in the absence of the stamp duty land tax holiday).

The holiday means that around 60% of all purchasers will be exempt from paying stamp duty and to date around 90,000 transactions have already benefited. Looking ahead, we expect that a total of around 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.

The Government is taking action to support both the housing and mortgage markets. Budget 2009 announced £400 million funding for the Kickstart Housing Delivery Programme (KHD) to unlock sites that have stalled. The KHD programme will help to stimulate housing development in the short-term and boost capacity in the house building industry, now and for the future. The initiative is expected to deliver up to 9,000 new homes in England over the next two years. The funding will be allocated via a competitive bidding process overseen by the Homes and Communities Agency, details of which can be found on their website. Bids from developers were accepted up until 8 June 2009 with the announcement of successful bidders at this expressions of interest stage in late July.

Since then Government has published a plan for Building Britain's Future, reprioritising spending to provide additional investment of £1.5 billion over the next two years to deliver 20,000 new affordable homes, creating 45,000 jobs in the construction and related sectors.

On 19 January 2009, as part of a range of measures taken to support financial stability and lending to the economy, the Government announced it would establish a guarantee scheme for asset-backed securities. The Chancellor announced at Budget that the scheme is available for banks and building societies, extending their funding options under the existing Credit Guarantee Scheme to residential mortgage backed securities (RMBS). The Government will keep the scheme under review.

15. We welcome the help announced in the budget for homeowners. Whilst we welcome the diversity of the schemes, we regret the delays in implementation and the

lack of clarity, in respect of some of the schemes, especially in entitlement to Support for Mortgage Interest. We recommend that the Government takes urgent steps to ensure that clear information is provided for homeowners on the support that is available to them if they get into financial difficulties as a result of the recession. (Paragraph 88)

The Government has put in place a comprehensive framework of support for homeowners during these difficult times, aimed at helping people avoid repossession. On 20 February, the Government launched a new campaign to ensure people are aware of the support available and how to get it at the earliest opportunity, through the DirectGov website (www.direct.gov.uk/mortgagehelp). The website will inform homeowners about the wide range of free practical support and financial assistance available.

Help available to homeowners in difficulty now includes:

- specific information on Support for Mortgage Interest (SMI), available via DWP's website and also the DirectGov website. Frontline staff in Jobcentres and welfare rights organisations have been issued with bulletins explaining the changes to SMI and this information is also available in DWP's leaflet, IS8;
- advice from debt advice agencies. The Government is determined to ensure that every household struggling with debts can access free and impartial debt advice. Debt advice agencies are able to provide tailored help depending on individual circumstances, and advise borrowers on which elements of Government support may be open to them. Since April 2006 the Government has invested over £130 million in a face-to-face money advice project aimed at the most vulnerable households. So far the project has helped 220,000 people with their debt problems. At the 2008 Pre-Budget Report the Government announced further support to allow everyone to access debt advice, which has helped 36,000 extra people since February 2009; and
- FSA advice. The FSA requires lenders to send borrowers in arrears a leaflet, *What to do when you can't pay your mortgage*, which presents some of the options available, and provides information on debt advice (also available at: http://www.moneymadeclear.fsa.gov.uk). Borrowers may also receive copies of a Government-funded leaflet published by the National Homelessness Advisory Service, *Are you worried about your mortgage?* (also available at: http://www.nhas.org.uk).

16. We recognise the importance of the car industry. The vehicle scrappage policy has been welcomed in some quarters. Although it will support 300,000 new vehicle sales, it is likely that only one-third at most will be additional sales. Moreover, of these additional or accelerated sales, just 12,600 could be new UK–manufactured vehicles, although we accept that most other cars sold contain high quantities of UK manufactured parts and that car retailing will benefit. We note the Chancellor's reservations regarding the scheme and await the Pre-Budget report 2009 to assess how effective it has been. (Paragraph 94)

Globally the automotive industry is facing challenging times as it looks to restructure at a time where depressed demand reinforces the need for consolidation in the industry. To ensure the UK's industry is in a position to emerge from the current downturn with the skills and technology base needed to be competitive in the global automotive market, the Government has taken a number of steps. This includes providing support where investment projects that further the UK's lower carbon agenda are at risk through the Automotive Assistance Programme; developing a training package worth up to £100 million which tailors Train to Gain to meet the business need of automotive employers; and, most recently, the temporary vehicle scrappage scheme.

Thirty-eight manufacturers have already registered to participate in the vehicle scrappage scheme and, while estimating the number of additional sales is difficult, the industry is already noting the boost to consumer confidence the scheme has provided. Although only around one-third of sales, as suggested, could be additional, this could mean that the scheme could lift sales by approximately 5% relative to the baseline level of sales that would have occurred in its absence. This would be line with the nature of the scheme which is primarily designed to provide a timely, targeted and temporary boost to the automotive industry and restore consumer confidence.

17. We believe there are considerable uncertainties over the yield to be raised by the new 50% top rate of income tax. We therefore recommend that the Treasury, in the 2011 Pre-Budget Report, should report on the revenue raised, both nominally and as a percentage of the theoretical maximum revenue, by the new top rate of income tax. We also recommend that the Treasury assess at that time the yield obtained from the higher rate against its disadvantages. If the higher rate were to be continued it would be appropriate to consider what further reforms would be needed to prevent further leakage of potential revenue from this measure. The Treasury should indicate if it would revise the rate in the event that the estimated revenue yield fell well below their forecasts. Finally, we were concerned that the Chancellor lacked a robust basis for selecting the threshold from which the new top rate of tax would apply and for choosing what that rate should be. (Paragraph 100)

The costings of the 50 per cent income tax rate are based on careful assessment of the impact, including any behavioural responses, on all relevant receipts and revenues. As the Government has made clear to the Treasury Select Committee, the Government has accounted for a proportion of high income individuals using various methods to reduce their tax and NICs liabilities. The Government believes that this represents a fair estimate of the impact of this measure.

The Government is committed to ensuring that everyone continues to pay their fair share whatever their income. As with all taxes, the Government will keep the additional rate under review. HM Revenue and Customs update each year income tax information contained on their website.

18. We note that this budget marks a departure from the long-standing principle that tax relief for pension contributions should be given at an individual's highest marginal rate. We urge the Treasury to monitor the effect of this change on pension savings and to keep under review the possibility that a cap on annual contributions might be a more equitable way of reducing the percentage of tax relief that benefits the highest earners. (Paragraph 104)

The measure to restrict pensions tax relief is specifically targeted at individuals with incomes above £150,000, since they currently benefit disproportionately from pensions tax relief. In 2008-09, individuals with gross income of over £150,000 represented 1.5 per cent of pension savers, yet received a quarter of tax relief on pension contributions (£6.1 billion). Without these changes the Budget 2009 personal tax changes—with a new 50% top rate of tax—would have made this skew of pensions tax relief towards those with the highest incomes even greater.

The Annual Allowance is related to the size of someone's pension contributions, rather than his or her income. A significantly lower Annual Allowance would bite for some people much lower down the income scale, and outside the target group—sometimes well outside the target group—for this measure. It would also less directly address the fact that individuals with incomes above £150,000 would be eligible for tax relief on pension contributions at 50%. So it would not be so effective at addressing the disproportionate benefit derived from pensions tax relief by those on the highest incomes.

A significantly lower Annual Allowance would also mean that many more individuals would be faced with the need to calculate whether they were caught by the allowance. In some cases, particularly for those in Defined Benefit schemes, this would require individuals to carry out complex calculations in order to ascertain the value of their contributions. This could be particularly difficult for those with low levels of financial literacy or little access to financial advice.

The Annual Allowance, alongside the Lifetime Allowance, does however have an important role to play in rationing tax relief. As announced at the 2008 PBR, both allowances will be frozen from 2010-11 to 2015-16. The maximum tax relief available in any one year for pension savings will therefore be limited to the higher of 100 per cent of a person's earnings and, from 2010-11, the Annual Allowance of £255,000. The vast majority of pension savers will continue not to be affected by these limits, and many of those affected by the restriction of higher rate relief will be able, or will have been able, to benefit from full tax relief within these limits at some point over their lifetime. As such pensions will continue to represent a highly tax-privileged means of saving.