HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

TREASURY COMMITTEE

BUDGET 2013

TUESDAY 26 MARCH 2013

RT HON GEORGE OSBORNE MP, SIR NICHOLAS MACPHERSON and JAMES BOWLER

Evidence heard in Public Questions 333-452

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Oral Evidence

Taken before the Treasury Committee

on Tuesday 26 March 2013

Members present:

Mr Andrew Tyrie (Chair)
Mark Garnier
Andrea Leadsom
Mr Andrew Love
Mr Pat McFadden
John Mann
Mr George Mudie
Mr Brooks Newmark
Jesse Norman
Teresa Pearce
Mr David Ruffley
John Thurso

Examination of Witnesses

Witnesses: **Rt Hon George Osborne MP**, Chancellor of the Exchequer, **Sir Nicholas Macpherson**, Permanent Secretary to the Treasury, and **James Bowler**, Director of Strategic Planning and Budget, HM Treasury, gave evidence.

Q333 Chair: Good afternoon, Chancellor. We had understood that you were coming just with Sir Nicholas, the Permanent Secretary, but you seem to have brought along someone else. Perhaps you could introduce your team.

Mr Osborne: This is James Bowler, who has appeared before this Committee on these occasions. He is the Director of the Budget.

Q334 Chair: Let me begin with Cyprus. Were you and was the Government given any opportunity to comment on these proposed Cyprus deals prior to the announcements that have been made on them?

Mr Osborne: We were aware of the various discussions before the Eurogroup and IMF discussions a week ago, but obviously we were not at the meeting because we are not a member of the Eurogroup and, although we sit on the board of the IMF, we are represented by the Managing Director of the IMF, like all other countries. Once it was clear, a week ago, that the initial plan put forward by the Cypriots involved bailing in the insured depositors, we took steps to make it clear we thought that was a bad idea.

Q335 Chair: I just want to be clear on timing. Prior to the announcement of any of these deals, were you told about them and given an opportunity to offer a view?

Mr Osborne: As I say, we were aware of the discussions, but we were not present at the meeting just over a week ago where the Eurogroup and the troika met with the Cypriots, nor were we aware, like I think some people in that meeting were not aware, of the Cypriot proposal. Once the Cypriot proposal became clear, the Foreign Secretary spoke to the

President of Cyprus, I spoke to the Managing Director of the IMF, and the Prime Minister spoke to the President of Russia.

Q336 Chair: Was this before the announcement?

Mr Osborne: This was after the announcement of a week ago when the initial proposal was to include the insured depositors, and I have to say I think that caught everyone by surprise, including those in the Eurogroup.

Q337 Chair: Did you have any prior notice of this announcement?

Mr Osborne: What is “this announcement”?

Chair: The announcement to take money off depositors.

Mr Osborne: We did not have prior notice, as I think most of the eurozone did not have prior notice, of the decision that the Cypriots took that they would include insured depositors. Once that became known to us and everyone else involved in this process we made strong representations to the various bodies involved and the Government involved that we did not think that was a sensible step and we are pleased to see that that has not been a feature of the final agreement reached at the beginning of this week.

Q338 Chair: Well, that is very diplomatic, but would you tell us in very straightforward language what damage you think has been done to the credibility of deposit insurance?

Mr Osborne: I think if they had proceeded with the proposal, very considerable damage would have been done to deposit protection insurance or the principle of deposit protection insurance. They were, of course, actually proposing a tax, but it has the same practical effect as bailing in the insured depositors, which is why we made these strong representations. I think it has not been well handled over the last 10 days, but—

Q339 Chair: Would you disagree with me if I said it had been very badly handled indeed?

Mr Osborne: I would use my own language. I don’t think it has been well handled, but I think you have to respect the fact that you have a sovereign Government facing some incredibly difficult decisions, a newly elected President facing some incredibly difficult decisions that he has to present to his Parliament and the Parliament have to present to the people who elect them. You have a eurozone that is keen to prevent contagion—and to be fair to them, there was not a significant adverse market reaction, and the market gave them a bit of space to come to a solution—but also to protect their own national taxpayers. From our point of view, I think it is important to note we are not part of the bailout, and that is because of the conscious decision of this Government to get out of the EFSM, the EU bailout mechanism, and not to extend a bilateral loan to Cyprus, so we made sure that British taxpayers were not directly on the line for the bailout.

Q340 Chair: Given the scale of the demands being made of the Cypriot economy, do you think that this second deal will stick?

Mr Osborne: As with all these situations, of course there may be future developments, but I have to say I think it is likely that the elements of the deal agreed at the beginning of this week will remain in place, particularly the restructuring of the two principal banks, the Bank of Cyprus and the Popular Bank of Cyprus.

Q341 Chair: What about the loan and the loan terms?

Mr Osborne: The loan terms from the eurozone?

Chair: Yes.

Mr Osborne: I think you would have to get a response from eurozone Finance Minister rather than an EU Finance Minister. Again, to be fair to the eurozone, I think they have sought to learn the lesson of some of the previous bailouts. The IMF held their feet to the fire on this. Debt sustainability has been a key part of this. They did not want to leave Cyprus with an unsustainable debt situation after the bailout, which is what they did with the first bailout of Greece and then had to come back and revisit the terms of that bailout. So I think they were very focused, and we were pretty supportive of the IMF approach, which was, "Let's make sure this is a credible bailout, that it resolves some of the problems in the banking system and leaves Cyprus with a sustainable debt situation."

Q342 Chair: What reassurance can you give to holders of London-based accounts at branches of Cypriot banks?

Mr Osborne: There are two banks, and they are the two banks involved in the restructuring. The Bank of Cyprus has a subsidiary here. It is covered by the UK deposit protection scheme, and it is FSA-regulated. Like all entities that are regulated by the FSA and given a bill of health by the FSA, we can be relatively confident in our own regulatory system. The Popular Bank of Cyprus has a branch here, and of course depositors in branches in this country are covered by the deposit protection scheme of the parent country, in this case Cyprus. Part of the Cypriot deal is to make it clear that insured depositors are protected, but I can say that the Treasury is working with the Cypriot authorities on a British solution in terms of the branch of the Cyprus Popular Bank. Those discussions are taking place at the moment. I can't say a great deal more about them, but we are engaged in negotiations to try to avoid the branch of the Cyprus Popular Bank in the UK becoming sucked into the Cypriot resolution process.

Q343 Chair: Chancellor, you have been very diplomatic so far about all this, but by general agreement this a God-awful mess, really atrocious, about as appalling mismanagement as it is possible to imagine. Can you at least give us reassurance that you are conveying in somewhat less diplomatic language privately what you, I hope, think about this terrible farrago?

Mr Osborne: We have made clear where we think the different authorities have made a mistake but we also, of course, are trying to help those in a difficult situation. One of the Permanent Secretaries at the Treasury, Tom Scholar, is currently in Cyprus providing advice to the Cypriot Government. Unfortunately the British Treasury has quite a lot of recent experience of dealing with banking crises and hopefully that experience will be valuable to the Cypriots, and that is our understanding. As I say, we are trying to work with the Cypriots on a British solution to the Cyprus Popular Bank branch issue in the United Kingdom. So, yes, of course we will make clear where we think mistakes have been made, and we have made it very clear that we thought it was a mistake to try to bail in the insured depositors over the last week, but we are also here to try to resolve this situation. In the end, as we have discovered to our cost over the last couple of years, developments in the eurozone have a very direct impact on the British economy, and if financial markets become concerned, that also has a direct impact on the global financial system. As I say, the better news is that there has not been a particularly adverse market reaction to the events of the last couple of weeks. Unfortunately, for the Cypriot people, I think this is just the beginning. They are facing a sharp contraction in GDP, and no one would wish that on anyone.

Q344 Chair: Anyway, I am sure it is heartening for the Cypriots that you have sent our best man for bank crises out there with a first-aid kit to help sort it out.

Mr Osborne: Mr Scholar is one of our outstanding public servants. I would also say we have a direct interest in our sovereign military bases in Cyprus. Over this last weekend, we flew out additional cash in euros to help pay the people who work on the base and to have a contingency fund there. €13 million was sent out to Cyprus this weekend to help with our military presence there and to provide, if we need it, hardship funds. We also have many British people in receipt of pensions living in Cyprus: public sector pensions, public service pensions, as well as the basic state pension. Over the last couple of days we have written to those people directly and phoned many thousands of them and given them the opportunity to switch the pension payments into a British bank account, not least because the Cypriot bank system remains shut.

Q345 Jesse Norman: Chancellor, just to persist with Cyprus a little bit, are you absolutely comfortable that other nations were not aware of the Cyprus situation? It must have been in negotiation with its creditors for some time. That being the case, isn't it true that the plan that was hatched is not just a Cypriot plan; it was a shared plan, and therefore there is a genuine risk that the cat has been let out of the bag over depositors?

Mr Osborne: We were aware, as were other countries, including those in the eurozone, that there was talk of bailing in depositors. Indeed, there was open speculation in the newspapers, and this had been talked about for several months. The thing that caught people by surprise, on I think it was a Friday night just over a week ago, was the decision by the Cypriots to reject a plan that had been put to them to simply bail in the uninsured depositors and to instead bail in the insured depositors as well. I think that came as a surprise—it came very late in the process—and that surprise was reflected in the reaction of members of the Eurogroup but also more broadly of the international community.

Q346 Jesse Norman: Do you think there is a template here for how the eurozone is going to be treating other countries now?

Mr Osborne: Each of the eurozone bailouts has been different in character to reflect the different nature of the economies and the economic problems. Cyprus has a banking problem, Spain has had a competiveness problem and so on, so they have had different solutions for different problems, but I think it is clearly the case that we all would have been better served over the last couple of years if the eurozone had moved more swiftly to deal with its problems and been more confident in dealing with them. It has been a painstakingly slow process. and unfortunately the British people and many other countries have suffered as a result.

Q347 Jesse Norman: States like Luxembourg and Malta are also very highly leveraged and therefore potentially exposed within the eurozone.

Mr Osborne: I don't want to comment on individual countries. What I would say with Cyprus is we have known for some time, well over a year, that this has been a problem, and again one of the frustrating features of this is that it was a well-identified problem a long time in the making and that attempts to resolve it did not work. I think it is fair to say that the previous Cypriot President had proved an obstacle to some of the solutions, and so they had to wait for a new Cypriot President, who only took office a couple of weeks ago and had quite a honeymoon.

Q348 Jesse Norman: They have now imposed capital controls on the flow of euros within Cyprus and out of Cyprus. Do you think it undermines the euro as a monetary project that you can't exchange euros across a single monetary zone?

Mr Osborne: In effect, they have had capital controls because their banks have been shut for some time now. Historically, this is one of the longest periods of bank closures ever in any place. The European Treaty provides for capital controls, so I don't think we have a question about the legality. I think we do have a question about how this is done. If it needs to be done, we would like it to be done in as short, as temporary and as limited a fashion as possible. If it could be done without serious capital controls, I think that would be better, but obviously that is a judgment for the people on the ground, because the imposition of capital controls in a single currency is quite a moment.

Q349 Jesse Norman: The final question is for Sir Nicholas. Are you comfortable that you are managing potential exposure in these other states that are at risk from a similar kind of eurozone bailout: Luxembourg, Malta, France—

Sir Nicholas Macpherson: We keep our position in relation to all these countries under review. We have been doing contingency planning, as I think the Chancellor announced some time ago, about potential outcomes in the eurozone, and one of our main focuses is on exposure either through the banking system or through other mechanisms.

Q350 Andrea Leadsom: It is great news, Chancellor, that you have announced your consultation on a new payments regulator today. My first question is: what is the change of heart? The Treasury Select Committee, as you will recall, had a review of the Payments Council's handling of the announcement that they were going to abolish all cheques and they were forced to reverse that decision, and at that time the Treasury was not so enthusiastic about looking at new competition in the banking sector. Is the change of heart a reflection of the fact that self-regulation is finally dead?

Mr Osborne: I am not sure it is a change of heart. I think it is just a recognition that we need to do more to bring new entrants on to the high street and allow challenger banks to expand. We have listened to the concerns of some of those challenger banks about the authorisation, the capital requirements and the payment system, the plumbing of the banking system, and how they often have to piggyback off one of the larger competitor banks, one of the established banks, for those payment services. They are often frustrated in not being able to offer the kind of modern banking services they feel they want to. I think the concept of regulating the Payments Council has been around since the Cruickshank report about a decade ago, which was commissioned but rejected by the previous Government. I felt that our response had not been radical enough, and so we have turned up the dial and what you see today is the result of a considerable amount of work, both from the Treasury and in the FSA, because it is an FSA paper as well. But I have no doubt that we are going to have to go on pushing the system to allow for new banks, challenger banks, to grow, finding the obstacles to competition and challenging the oligopolic practices of some of the existing banks.

Q351 Andrea Leadsom: I am sure you are aware that some of the agency banks are paying up to 10 times as much per payment as a clearer who accesses the payment systems directly. Is changing the regulation to an independent regulator a sort of stalking horse for making the payment systems themselves owned in common as opposed to owned by the banks? That surely is one of the best examples of oligopoly practice, where you have such differential pricing if you can access it directly versus indirectly.

Mr Osborne: I think we need to consider whether developing and commonly owning a single payment system is the best way forward. Firstly, it would be a very considerable expense, which I guess would be passed on to consumers; secondly, it is a formidable IT challenge, to put it mildly; and, thirdly, there is a question of whether you want a bit of competition between the payment services so that they keep each other on their toes. Before we go for a monopoly payment provider, even it is commonly owned, I think we should at least see whether a bit of independent regulation of the existing payment system will improve things quite considerably.

Q352 Andrea Leadsom: In terms of the payments regulator's new mandate, will it be specifically tasked with the challenge of looking at what the right ownership should be for bank systems? Already the consultation talks about the need to ensure free access, for example, to payment systems, which there is not at present. Will the payments regulator also be looking at the ownership structure of payment systems?

Mr Osborne: I don't want to pre-empt the consultation, but one of the issues we are asking people about is whether we should give the payments regulator the powers to change the ownership structure or demand changes in the ownership structure. Rather than our taking the decision, we think it is more sensible to create the body that can look at the industry and make its own decision on that. But we absolutely intend this to be rather like some of the more successful utility models, where we have allowed real competition, and we absolutely want this body to have the full powers it needs to break up oligopolic practices.

Q353 Andrea Leadsom: Timing-wise, do you intend to have a Government amendment to the Bank Reform Bill so it will happen in the lifetime of this piece of legislation?

Mr Osborne: The short answer is yes. I think we should use the opportunity of the banking legislation before Parliament to effect changes to it. Wearing a different hat, I know Mr Tyrie no doubt has other proposals for that banking legislation.

Chair: All in good time.

Q354 Andrea Leadsom: The final question is: will the Government consider enabling legislation to allow the regulator to introduce full bank account number portability, should that be the right solution, to avoid the need for future legislation on that subject?

Mr Osborne: I am very happy to discuss that idea directly with you. I felt, as did John Vickers, that the switching service that will be operational from September will be a vast improvement, but we have also made it clear that we will look at going beyond that if we need to.

Q355 Mr McFadden: Chancellor, in the Budget you announced changes to the MPC regime. What do you think was wrong with the old regime?

Mr Osborne: I think it is perfectly reasonable, after all that has happened in our economy over the last five years, to examine whether the MPC remit is appropriate. The MPC themselves, in their last minutes in February, had already signalled a change of practice. I thought it was right to review the monetary policy framework. We also have a new Governor arriving, and I thought it was appropriate to start that review process under the existing Governor to show that this is not just about when a new person turns up; this is about continuity, and it does not depend on new individuals. Mervyn King thought this was a good idea and engaged very strongly in it. I think it is reasonable to look at what has happened to the financial system, the relationship between the MPC and the new Financial Policy Committee, which will become a permanent feature of our system as of next week, and to look at the way in which other central banks around the world, in Canada, in the United States and elsewhere, have developed monetary policy and see whether there are any lessons for us here. I have to say the new remit is very clearly rooted in price stability, in a 2% inflation target, but it also asks the MPC to consider intermediate thresholds of the kind that the Federal Reserve has used. It also provides for greater clarity on the use of extraordinary monetary instruments so that we don't have the situation that my predecessor encountered where he had to develop a whole new regime for quantitative easing, which I think is a good regime, but the remit did not really provide for that and he had to work with Mervyn King to develop that.

Q356 Mr McFadden: When Dr Carney came to give evidence to this Committee a couple of months ago he talked about the re-examination of the remit, but he stressed that in Canada the process of discussing this had itself been valuable. You have not really had a process; you just announced it. Why did you do this in a different way from the way that he advised this Committee had been beneficial in Canada?

Mr Osborne: First I would say that there has been a pretty lively debate in this country. I remember being asked about this when I came before this Committee after the Autumn Statement, and I said there should be a debate and there was a pretty lively debate, with academics and others engaging in that.

Q357 Mr McFadden: Sort of op-ed pieces and things like that?

Mr Osborne: Well, more than that. Second, we considered whether to launch a consultation and, perhaps at either the Mansion House or in the August *Inflation Report*, conclude that consultation. I think we felt that that would create too much uncertainty, that we were pretty clear about the direction we wanted to head in and that both Mervyn King and Mark Carney were clear. The MPC, by the way, had an opportunity to input into that discussion as well. So, we were clear about the direction we wanted to head in and at a time like this if you can reduce uncertainty, you should. We took the decision, we knew which direction we wanted to head in. The principal people at the Bank and the new Governor were happy. One area where we have left it open for the MPC to do further work and to consider whether anything is appropriate is on the issue of intermediate thresholds. They can go away and discuss that, but it is an operationally independent decision for them whether they want to make use of thresholds.

Q358 Mr McFadden: Can I just be clear on something you said in your answer there about who was consulted? We have seen the letter from the current Governor to you saying that both he and Dr Carney were content with what you announced, but I think you said that other members of the MPC were also consulted. Is that right?

Mr Osborne: You would have to speak to Mervyn King as well, but my understanding is that Mervyn King met with the MPC and discussed with them what was being proposed, so they had an opportunity at that point to engage in the discussion.

Q359 Mr McFadden: In terms of the content of the new remit, the Bank has already been taking a flexible approach to the 2% inflation target. Inflation has been above 2% for the past three years. The only signal in your remit was that they could look through—to use the jargon—current events even more widely than they have been doing up until now. What do you think that will mean for inflation, given that it has already been above target for the past three years?

Mr Osborne: The OBR provides an inflation forecast, as does the Bank. Partly the remit was catching up with the practice that the MPC had themselves developed, and so in their February minutes they themselves talked about looking through the inflation target when there are exceptional pressures and strains. Of course Mervyn King has also delivered the same message over the last couple of years when he has talked about, for example, inflation from imported prices.

Q360 Mr McFadden: How big a change is this? That is what I am driving at.

Mr Osborne: We have partly been adjusting the remit to developing operational practice over the last few years. We have partly asked the Bank to look explicitly at the kinds of things that, for example, the Federal Reserve have done and come back to us with a judgment on that. We have partly sought to make sure the arrangements are clearer for the use of unconventional instruments, and we have asked the Bank to look at communicating the trade-off that is inevitable when you set monetary policy. In the United States they use intermediate thresholds, and they have lower inflation than us, so I don’t accept the implication of your question, which is that this is a licence for higher inflation. We are absolutely clear we have an inflation target that is 2%, and that is right at the front and centre of the remit we are giving to the MPC.

Q361 Mr McFadden: Roger Bootle appeared before us in some other context yesterday and he said that, overall, the measures in the Budget in relation to the whole economic situation appeared very timid; a penny off beer here, a bit on fuel duty, a bit on tax allowances and so on. What do you say to the charge that the emphasis on a changed MPC remit is your saying, “I’ve not been able as Chancellor to deliver growth, and we have a new Governor coming, so I am passing the baton to you, Dr Carney”?

Mr Osborne: I have always made it clear, and I made it clear in the Budget speech, that our approach to the economy is to have fiscal responsibility and credibility, monetary activism and to push further on the supply side. I would say on all three counts the Budget delivered. On monetary activism, I would also point to—and no doubt we will come on to discuss it—engagement in the mortgage market to help with the transition mechanism there, and obviously we can talk about the measures on fiscal credibility, the supply side. I think achieving a 20% corporation tax is quite a historic thing for this country; a £10,000 personal allowance. I understand that when the CBI came before you they said that, basically, I had done as much as could reasonably be expected at this point in the cycle of a Chancellor to help a private-sector recovery.

Obviously there are people who would take a different view. There are those who would argue we should dramatically increase spending, put our deficit up into double digits, run the risk of loss of financial confidence in order to deliver—the classic phrase—a fiscal stimulus, and then there are others who say you should borrow a huge amount for dramatic cuts in taxation. I think neither of those risks are risks worth running. We still run a budget deficit that is too high. We have to ensure our fiscal credibility, and that anchors low interest rates. We have just been talking about Cyprus. Of course Britain is not Cyprus, but I do remember my first appearance before this Committee and I was told, “Well, Britain is not Greece”. Then in the period I have been Chancellor, Ireland, Portugal and Spain have got into trouble, there have been concerns about Italy, and now of course Cyprus. I think it is a lesson to us all that a difficult economic situation could be a lot worse if we lost the confidence of the rest of the world.

Q362 Mr McFadden: I am talking about the balance of what the Government does and what the Bank does. What I am saying to you is: is it fair to expect the Bank of England under any MPC remit to deliver the economic growth that the Government has failed to deliver over the past three years?

Mr Osborne: The job of monetary policy is clear. They have to ensure price stability and support demand, and I think that is what the current MPC is delivering. I think the new remit helps clarify existing practice and allows them to look at other things. I have every confidence that Dr Carney will continue the good work.

Q363 Mr Newmark: Chancellor, I want to drill down a little bit more on the growth issues and then turn back to Mr Carney as the saviour of the nation. Are you surprised by the lower forecast growth that we have seen in the past couple of years?

Mr Osborne: Sitting here a couple of years ago I didn't expect, nor did our independent forecaster expect, that GDP would have been the level it has been, but equally many things have happened that few people anticipated over that period. I have just detailed some of the problems in the eurozone but there has also been the imported inflation story. I think we are all coming to terms with the impairment to our own economy caused by the damage to the financial system.

Q364 Mr Newmark: Looking forward, where do you see the growth coming from, given to date there seems to be little real evidence that business investment, consumption or net trade appear to be growing, and what do you see as the downside risks going forward?

Mr Osborne: I think it is important also to recognise, because this relates to your question, that there has been a strong employment story. We are talking about business confidence and business activity. They have had the confidence to go and hire people—over a million new jobs in the private sector—and while the GDP forecasts have disappointed as coming in under forecast, the employment forecasts have come in above forecast. So I would say out there you see companies taking a risk, hiring people, betting on the future, and everything I tried to do in this Budget has been to support those decisions through tax changes, regulatory changes, help for small businesses with the new employment allowance and so on. Of course it is a difficult economic situation, and you only have to look again at almost every Western nation to see that we are all facing a tough economic situation, but I think in the UK you do see a private-sector recovery in the employment numbers.

Q365 Mr Newmark: I agree with you about the figures in terms of our constituents. Those of us who sit here have more men and women in work than ever before, more jobs being created, more businesses being set up and everything, but when I drill down into the statistics—and this is what I am trying to look at, because this is what a lot of economists are looking at—the reality is that business investment is low. There is £750 billion still locked up in corporate balance sheets today, so businesses are not spending money. Individual consumption is low; net trade is low. So, I guess I am asking you that given that the papers, the media, the statisticians, the economists all look at these figures and sigh heavily to themselves—they don't look at the same things that we may look at, which is whether people have a job, are they paying low interest rates on their mortgages—if growth doesn't look like it is going to achieve what people are saying out there in the near future, do you have a plan B or a plan C, because obviously this falls as plan B? Do you have a plan C?

Mr Osborne: I am clear that the economic plan we are following is the right one. I would ask you to look at what is happening in our economy with employment growth and ask you to look specifically, because we publish lists in the Red Book. If you look at our economy excluding energy and financial services—we have a secular decline in the North Sea and of course we have the impact of the crisis on financial services—you can see that our performance is considerably stronger than that of many other countries and relative to other countries. If you look at our forecast GDP growth compared to that of France and Germany, using the IMF forecast, it is stronger than that. Has our GDP number come in below what we hoped for and expected a couple of years ago? Yes, it has, but there is not a single G7 Finance Minister you could get to appear in front of this Committee who wouldn't also have to say the same thing, because that is what has happened. I completely agree with you, we want to instil confidence in companies that want to invest. Of course the resolution of the problems in the eurozone is probably the biggest single thing we can do in this respect, because—

Q366 Mr Newmark: Do you see that as the biggest downside and risk going forward?

Mr Osborne: Last summer—we can talk about it now—there was the threat of the collapse of the European financial system and the exit of very large countries from the eurozone. Thankfully that never came to pass, but it had an absolute shock on our economy and others.

Q367 Mr Newmark: Chancellor, there are a lot of smart economists out there who all see the same things that you and I do. I agree with you; there have been those dramatic shocks, but those economists are still highly critical. They all tend to be Keynesian economists like Danny Blanchflower and Mr Posen and so on, but there are a lot of people out there who see the same things that we all see and still think that you should be pursuing a different strategy. What do you say to that?

Mr Osborne: Of course there are economists, and indeed politicians, who disagree with this approach, and there are economists who very strongly support it as well. There is a set of people who believe—they tend to believe this in good times and in bad—that the answer to both good years and bad years is more public spending. I would argue we have a problem. The essential difference is that in the end I sit in this position and I have to make sure that week in, week out we can sell our debt and command the confidence of the rest of the world in what we are doing. This is not an academic exercise. This is a real-time exercise involving real people and real jobs. I am not prepared to take big risks on the basis of particular academic theories. You equally get from some right-wing economists the argument that we should have some sort of shock therapy for the British economy. I would argue the British economy had quite enough shock therapy three or four years ago, and what we need actually is the confidence that we are dealing with our debts, confronting our long-term competitiveness problems, making sure this country earns its way in the world. If there was some magic solution to the problems that this economy or any of the other Western economies face, then I am sure it would have been found.

Q368 Mr Newmark: The big focus is borrowing for investment, because people look at a return on capital employed as opposed to borrowing for current expenditure. Even people like Professor Rogoff, who I admire a lot, say that is something that we should think about. What would happen if we ended up borrowing more money in order to do that, to try to get a return on capital employed and so on? What impact do you see on our cost of borrowing as a Government? Would that go up? Would interest rates go up? What is the risk that you see in that?

Mr Osborne: Well, of course, we are borrowing for investment. We are borrowing more than anyone would have done in a normal situation because of the high budget deficit, even as it has come down. I have not tried to eliminate the deficit in one year, and I have allowed the automatic stabilisers to operate. Indeed, I did not chase the debt target in this Budget. What I have done, however, is increase the amount that we are due to spend on capital, and I have increased it in each year of this Parliament at various Autumn Statements and the like. We are spending more than the previous Government’s plans for this Parliament.

Q369 Chair: I note that there is a Division in the House. Does anybody want to vote in that? No? We have no takers for voting. Just carry on. We will assume we are all paired. There is a Government majority on this Committee and it has been pointed out to me that this is a Labour Division, so I think what we are going to do is have a balloon debate and volunteer one member of the Government to go and vote. Mark, you wouldn't like to go and vote, would you? David, thank you very much. David is going to go and vote.

Mr Ruffley: A huge personal sacrifice. The Captain Oates of the Treasury Select Committee.

Mr Newmark: I want to go on to Mr Carney. Chancellor?

Mr Osborne: Just on capital, of course in this Budget we also made sure there was no fiscal cliff with capital spending in 2015. Capital spending and investment will be higher as a percentage of our national income over this decade than it was in the entire 13-year period of the Labour Government.

Q370 Mr Newmark: If I can have one final question, because I appreciate I have nine minutes, I just want to focus on Mr Carney for a moment. Given there are long lags in monetary policy, is there any chance that Mr Carney can actually deliver before the 2015 election?

Mr Osborne: I don't accept the way you portrayed Dr Carney in your earlier question. Dr Carney's job is to come here and be an excellent Governor of the Bank of England and deliver on his remit, and I have every confidence he is going to do that. The only timetable he is working to is the timetable that he and the MPC set themselves within the confines of the remit.

Q371 Mr Newmark: Your point specifically on monetary lags: is that something that is an issue in our ability to actually deliver?

Mr Osborne: Obviously there are lags in monetary policy, but there are a number of instruments that the MPC has available to it.

Q372 Chair: In practice there is a plan B, isn't there, de facto, with the huge expansion of QE and allowing the automatic stabilisers to kick in? It is just a question of terminology, isn't it?

Mr Osborne: No, I don't accept that because QE has operated under both Administrations. We have spelt out time and again over the last five years—we spelt it out when we were in Opposition as well—that our policy is monetary activism anchored by fiscal credibility. I remember giving a speech to the London School of Economics about it in 2008.

Q373 Chair: We won't go back through all your speeches this afternoon, Chancellor, but we will take you as far back as *The Sunday Times* last Sunday, which tells us—and I would like you to confirm or deny this—that you are going to eject Michael Cohrs and Robert Jenkins from the Financial Policy Committee. Is that correct?

Mr Osborne: We are today making the announcement of the new permanent external members of the Financial Policy Committee and they are Clara Furse, Donald Kohn, Richard Sharp and Martin Taylor. They will be the new permanent external members of the FPC.

Chair: The question was about Michael Cohrs and Robert Jenkins.

Mr Osborne: Obviously by implication they are not serving on the new permanent FPC.

Chair: So they are being removed from the FPC?

Mr Osborne: We have had a proper appointment process. I don't know whether Sir Nicholas wants to say anything about that process, but we have had a proper appointment process. I am not going to go into who applied for the position, but I can confirm that those four were, both in view of the committee and in my view, the right people for the job.

Q374 Chair: It had nothing whatever to do with the fact that Robert Jenkins, for example, was a strong critic of the decision to hold the leverage ratio unchanged and not to push for a higher leverage ratio, and it had nothing whatever to do with the fact that he wants full bank separation?

Mr Osborne: Martin Taylor was on the Vickers Commission, and they proposed a higher leverage ratio.

Q375 Chair: It has nothing whatever to do with the fact that Michael Cohrs, although he has not said it is a waste of time, has suggested that the proposals of the Vickers Commission certainly need to be buttressed by a good deal more? He said that Vickers will not make banks much less likely to fail.

Mr Osborne: I think it is invidious to discuss individuals. By the way, I praise the work that both of them have done and the service they have given, but we have to make a judgment on who we think are the right people. We had a lot of very good applications. Those four individuals are some of the most qualified people in the world to do this job, and I think that the fact that they want to give up their time and serve on the committee demonstrates that we have a committee that commands respect, and a new mechanism, that was sadly lacking five years ago, of a body that is going to look at overall systemic risks in our economy and spot things like the build-up of debt, which were clearly not identified in the run-up to the financial crisis.

Q376 Chair: What you have announced is a new external section to the FPC today. It was quite a major announcement, particularly in view of the responsibilities of that body. Of course, the remarks I am making are in no way impugning the reputations of the people you are bringing on, some of whom are known to the Committee and well respected by us. I was talking about the people you have taken off.

Mr Osborne: Again, I think it is a bit invidious. There is one member of the committee who served on the interim committee. I think if I had simply reappointed the entire committee, or almost the entire committee, it wouldn't have said much about our open application process and encouraging people to apply to it. As I say, in Clara Furse, Don Kohn, Richard Sharp and Martin Taylor we have four absolutely outstanding individuals, and I don't think anyone would question their expertise or experience.

Chair: Well, we will take a look at them.

Q377 Mr Mudie: Chancellor, I think I heard you say to my colleague Brooks that you were disappointed with the level of growth. If that is so, why such a modest Budget?

Mr Osborne: I am not sure I accept it is a modest Budget.

Mr Mudie: In terms of growth.

Mr Osborne: If you see what we have sought to do, to give ourselves the most competitive business access to the G20, to give people £10,000 of their income tax-free, to go some way to addressing the concerns people have about the cost of things like fuel and—I am sure we will come on and talk about it—take some major steps to support the housing sector and support construction, along with the decisions we have taken on infrastructure and the new remit for the MPC, I think it was a Budget that had a lot in it. But from memory the second line of the Budget said there is not a miracle cure and it never pretended that it was a miracle cure, just the hard work of putting right what went wrong.

Q378 Mr Mudie: I never regarded you as one, so I am not accusing you of being a miracle worker, but if you had all these measures in the Budget, why did the OBR forecast the Budget would result in 0.6% growth?

Mr Osborne: I have answered this kind of question before the Committee before. I think the OBR quite rightly take the view that they want to see how things work. They did not, as I understand it, model any of the monetary policy changes, they did not model some of the housing policy changes, or rather they just said it underpinned some of their existing forecasts. I am very happy to under-promise and over-deliver.

Q379 Mr Mudie: You certainly have under-promised. Well, no, you have not under-promised; you have under-delivered. When you stood up as Chancellor in your first Budget, you promised the British people 2.9% growth this year. Now you are talking about delivering, after a range of wonderful measures, 0.6%. It is neither a miracle nor living up to your promises. Is that a useful paper your colleague has passed you?

Mr Osborne: The paper, which I am very happy to show the Committee, shows you what has happened to the forecasts of every G7 economy over the last two or three years. It is a bit insular to think that we alone made forecasts in 2010 of growth that turned out not to have been achieved.

Q380 Mr Mudie: Chancellor, who wrote your Budget speech in 2010? I can read your figures for debt; the deficit. You said to Brooks, "Never mind growth, we are dealing with the deficit". The deficit sits at £120 billion, and the OBR pointed out it has stayed at £120 billion and will stay in the region of £120 billion for three years. You have under-delivered on your promises. You have not met one of your GDP promises, your growth promises, and this is now coming up to four years. You are not even projected by the OBR to meet your pre-Budget promise of growth, so you have totally not delivered. Do you know, Chancellor, that Alistair Darling's projections for his Budget, that were scorned by you, would have been delivering in the year of the election a lower deficit than you are going to deliver? This past year you promised the British people you would borrow £80 billion. You borrowed £120 billion. Next year you promised you would be down to £60 billion; you are borrowing £120 billion. Does that not strike you as dangerous complacency on at least two of the important things in the Budget?

Mr Osborne: First of all, I was borrowing or I inherited borrowing of £159 billion.

Mr Mudie: Yes, that is it.

Mr Osborne: I sometimes hear it said in Parliament that borrowing has gone up. When I came to office this country was borrowing £159 billion a year and that is higher than £120 billion, or £114 billion, depending on which measure you use. As I say, of course the forecasts have disappointed. They have disappointed for every single major Western economy because of what has happened. The idea that the plan from the previous Government, which of course had no detail about what would actually be cut, would have been entirely unaffected by all that has happened over the last couple of years to the oil price and to the eurozone is somewhat fanciful. As I say, there are some bright spots with the employment forecast, which has actually done better than when I set it out a couple of years ago.

Q381 Mr Mudie: Can we just stay on your growth figures and your deficit figures?

Mr Osborne: I know you don't want to focus on the employment numbers, but I am just pointing it out to the Committee.

Q382 Mr Mudie: In terms of yourself, you mentioned the last two years, and yes, facts change, circumstances change, that is accepted, but what was asked about—and you scorned the Chairman when he said could this not be regarded as plan B when he was very helpfully saying some of the things that might help. The Business Secretary said, "When the facts change, I change". What we have seen with this Budget is the facts may have changed, you may have Europe to use as an excuse, but you are the Chancellor, you made a Budget with the help of your colleagues, brought it to the House, and it is such a marvellous Budget it is going to deliver about half a per cent. It is accepted that things have changed, but you have not changed, you have not responded with a Budget of vigour, a Budget that offers the British people a return to what you promised them in 2010.

Mr Osborne: As I say, I don't accept that. In this Budget we pushed further on delivering a competitive business tax system. No one forecast a couple of years ago we could have a 20% rate of corporation tax in this country. We have delivered a major housing package. We have delivered help for small firms. We have delivered—

Q383 Mr Mudie: Chancellor, surely you used that corporation tax—it is a point made by Budget experts yesterday—to get businesses actually coming and businesses investing—

Mr Osborne: That is not a bad objective.

Mr Mudie: —despite that corporation tax not taking effect, if I remember, for a year. But despite that, you can't get away from it that with your Budget, with all these wonderful measures, you are making a bigger and bigger hole for yourself. Every one of these beautiful measures results in 0.6% and £120 billion deficit.

Mr Osborne: As I say, the OBR themselves say they have a wait-and-see approach to the Government's measures, which I think is perfectly reasonable in an independent forecasting body. The CBI, which is after all the voice of a section of British industry, made it very clear when they came before your Committee that in this Budget I had done as much as was reasonably to be expected of a Government at this point in the cycle with the constraints of the public finances. Would our life be a lot easier if we had gone into this financial crisis with a surplus, like some other countries? Of course. Would it be a lot easier if I had not arrived in office with an 11.2% budget deficit? But that budget deficit has fallen, the structural budget deficit has come down more than in any other G7 nation. It continues to fall. As a percentage of our economy, which is a perfectly reasonable way of assessing the deficit, it continues to fall. Employment continues to exceed expectations and we have had a record number of people in work. So, in difficult circumstances we are doing everything we can to support a private-sector recovery and deal with our debts. As I say, it is not as if in the days since I delivered the Budget anyone has come forward with some alternative credible plan that has any support.

Mr Mudie: Chancellor, after three years and making promises to the British people three years ago, if you had been a football manager, you would have been sacked, and deservedly so. You have made all these promises; you have failed to live up to them. The sooner you do something to get a plan B in there the better for your own survival, I would have said, but there you are.

Q384 John Thurso: Chancellor, can I turn to the banks and credit? What assessment have you made of the continuing lack of credit on growth going forward?

Mr Osborne: I think it remains one of the biggest challenges for the British economy and that is why I have sought to help with the supply of mortgage finance, to help people purchase their home and get credit for that. But when it comes to small-business lending, that is why we have taken extraordinary action, for example, the kind of action you would not imagine taking in calmer times, to create a business bank, to create with the Bank of England a Funding for Lending Scheme that tries to bring down bank funding costs. We are taking extraordinary interventions to help with credit, but there is absolutely no doubt that one of the problems facing the British economy has been this long hangover from the financial crisis.

Q385 John Thurso: Clearly the Funding for Lending Scheme is helping to lower bank costs, but the other side of that is their appetite for risk, and it is clear that they continue to have very little appetite for risk domestically. To what extent do you think that is because of their concern—particularly the nationalised banks—that the less than first-class assets they own require them to be less open to lending to the domestic markets and particularly SMEs?

Mr Osborne: The capital position of the banks is assessed by the FSA, and they have taken the view that our banks are well-capitalised, but of course these banks are deleveraging after the explosion of their balance sheets in the run-up to the financial crisis. Look at what has happened at RBS. They have had to dramatically shrink their balance sheet. That is one of the huge headwinds we have in the British economy, and other economies face similar headwinds. But that is why we intervene in a way that you would not normally do to correct market failure, to try to bring down the costs of funding for banks, which the FLS has done; intervene in the mortgage market; intervene in small business lending and the like with business banks and other ways of finding non-traditional bank channels for getting money to small and medium-sized businesses. But I think we basically agree that this remains one of the most acute problems for the British economy. Certainly personally speaking, I spend more time on banking issues than any other issue.

John Thurso: I think we share that with you, yes.

Mr Osborne: I guess if we all reflect on the fact that we have been doing this for five years, that we have been spending all this time collectively on these problems and there is not a straightforward solution, but I think you do see some evidence that costs have come down, particularly in the mortgage market, and we want to see the FLS delivering a better and stronger result with the small business sector. I said in the Budget that we are working to increase the activity of the FLS or discussing with the Bank of England how to do that, so I am absolutely open to suggestions of what more we can do in this space, but I have certainly done more than most expected.

Q386 John Thurso: If you look at the net lending figures, it is quite clear that the banks that have been in a lot of trouble have the least helpful figures in that they are failing to lend more than anybody else. If you look at the banks that did not get into trouble, they are increasing their net lending to the SMEs, but RBS, for example, is not, and even if you disaggregate the core from the non-core, they are still not particularly good. So, there was a reasonable hypothesis put forward to us in evidence by quite a number of experts that there is a drag on lending ability from the banks, and, given the size of the market, RBS has around 40% of the SME market. If they are not lending, then that is quite a big drag. What a number of experts have put to us is it is simply the fact that they are concerned about their balance sheets and the suggestion that has been made by a range of people is, “Why not lift all these nasties out of the balance sheet and do what we did with others; stick them into a bad bank? You then have a good bank with no further problems.” Whatever you do with it, whether you split it up, keep it intact, whether you sell it to the public, give it away to the public, whatever, the point is we take the bad bit out and let the good bit roll. This will have an impact on lending right the way through and would be a relatively quick boost to growth. That sounds to me like a fairly attractive proposal. Is there something wrong with it?

Mr Osborne: First of all, we are very focused on doing this with the management of RBS, getting them to be a UK-focused retail and commercial bank, with a greatly smaller investment bank than the plan that was in place when I became the Chancellor, and disposing of their operations, for example, making sure that they get on with selling Citizens, which is their American bank. I want them absolutely focused on supporting the British economy. Now that plan is in place, and it is being accelerated. I think the question is whether the approach that you have put forward—and of course you are right, many people have suggested it—would indeed be swift and whether the boost to growth would be delivered in the way that you would hope. I know it is a question that the Banking Commission is looking at as well. The experience of restructuring these banks, both in this country and elsewhere, is not an overnight process at all, and so, while of course we can discuss the merits or demerits of a good bank-bad bank split, I don't think it could be very swiftly delivered. I think the experience of the previous Government was it took over a year simply to value the RBS assets for the purpose of their asset protection facility. I do not know whether—

Sir Nicholas Macpherson: When we set up the Asset Protection Agency, we did look at the option of a good bank-bad bank, and it may yet be the right way forward, but it does take time, and you only have to look at the Irish experience with issues around valuation of the assets affecting the transfer to see that it is far from simple. So it may be the right thing to do it, but you should be under no illusion that it will take quite a lot of time.

Q387 John Thurso: But given the work you have done—a lot of the work that was not done two years ago you have done, so you are much further forward in your ability—if that was a decision the Chancellor decided was correct, you have considerably more information.

Sir Nicholas Macpherson: We are further forward, and I think RBS has a far better understanding of its balance sheet, but it will still take quite a lot of time. This is not like splitting up Northern Rock, because Northern Rock had a very simple business model. It may have been the wrong business model, but it was a very simple one and therefore relatively easy to effect the change; but even in that case it took us a good period of time. So I think we have a much better grip of RBS than we had, as has the management, but it is still a fiendishly complicated organisation.

Q388 John Thurso: You have told me the difficult bits, but what assessment has been made of what could be delivered if it were done? You cannot weigh the bad and the good without knowing both sides, so what assessment has the Treasury done of what the impact on growth would be if credit became more available? The problem is not cost; it is availability. I am asking what assessments you have made.

Sir Nicholas Macpherson: As the Chancellor indicated, perhaps more of Treasury senior time, both ministerial and senior-official time, is spent thinking about credit, banking and so on, and there are number of dimensions to that. A lot of the monetary policy changes ultimately are about facilitating the better transmission of credit. Clearly resolving or changing the strategy in relation to RBS will have an effect if you do it, although there are always swings and roundabouts. No doubt if you put zillions of pounds into RBS, it would find borrowing easier, but then the Government might find borrowing slightly more difficult because it would have to fund RBS's balance sheet.

Q389 John Thurso: Sorry, can I just check you on that, because nobody was suggesting that. The suggestion is that you take the dodgy assets—if I can give them an un-technical term—out of the bank and put them into a separate institution where they therefore do not have an impact on the capitalisation of the bank, which then allows the bank to use its capital far more efficiently and it regains its appetite for lending into the market.

Sir Nicholas Macpherson: That is indeed true, Viscount Thurso, but even in transferring the bad assets, at that point the good bank would incur a capital loss and that would create a hole in the organisation's balance sheet. There may be ways through—

Q390 Chair: But there is a crude hole there now, so it is just a question of whether you realise it or not, and, since the Government own 86% or 83% of it, it doesn't strike me that it is a dramatic extra burden that is going to find its way on to the Government's balance sheet.

Sir Nicholas Macpherson: You would have to get the 18% shareholders, unless you nationalise it.

Q391 Chair: That is quite a different question from the one that John Thurso was asking you a moment ago.

Sir Nicholas Macpherson: It is a different question, but, as I say, you would have to recognise a loss. My point was simply that in recognising a loss something would have to be done to fill the hole, either taxpayers' money or ideally, if one was going to go down this route, selling assets at a profit, like Citizens. So, this obviously is an option. We have looked at this option very many times. There may come a point when it is the option that the Treasury would recommend and the Chancellor would—

Chair: I notice that you said at the outset, Sir Nicholas, "There may come a time", and that was in your opening line on this, so perhaps you would like to take another look at it and think harder and perhaps give the Chancellor even more advice.

Q392 Mark Garnier: Chancellor, can I turn to rating agencies? You have obviously come in for a great deal of flak as a result of the downgrading of the UK sovereign debt by Moody's on AAA rating, and yet this Committee has looked at the rating agencies and been less than impressed with them. I refer back to an article written by that well-known independent commentator, Jonathan Portes, in December 2011, just after Moody's changed its rating or put a negative watch, where he said, "The misdeeds and incompetence of the credit rating agencies in the run-up to the financial crisis has been well documented. What is less well understood is that when it comes to rating sovereign debt, they simply do not know what they are talking about. Worse than that, they do not even understand what their own credit rating means." In the light of what has happened, do you have any regret that you tied your colours to the mast to the credit rating agencies?

Mr Osborne: Unlike Mr Portes, I don't dismiss the credit rating agencies and I think they are an important benchmark, but obviously they are only one benchmark. There are others, and ultimately the test of our credibility is there in the market every day with our bond yields and our ability to raise money. So, what I have noted from the various rating agencies when they have either downgraded us or put us on negative watch is that they have all said that one of the things that is still very important for the creditworthiness of the UK is the commitment of the Government to a credible fiscal consolidation plan. That is what Moody's have said and what Fitch have said most recently. Of course I am clear that it is something you should have a regard to, but surely the lesson from what has happened is not to abandon plans to deal with your debts but to redouble those plans.

Q393 Mark Garnier: You mentioned our ability to borrow in the international markets. At the time of the downgrading or just before the downgrading, the UK 10-year gilt yield was 211 basis points. Today we are fully 30 basis points cheaper than that. We can borrow money if we go into the market at 181 basis points. Is that not the more relevant measure of what it is you are doing in terms of what the markets are looking at?

Mr Osborne: You would certainly notice if we started to lose the credibility of the international markets. Obviously it means if we lose a credit rating or get downgraded or whatever, it provides a difficult day for me in the House of Commons. If you lose the confidence of international markets, every family and every business in the country starts very quickly to feel that and pay the price for that. That is why it is absolutely essential that we go on commanding the support of those markets, and I am pleased to report that we do.

Q394 Mark Garnier: You mentioned household debt, and I would like to turn to that, if I may, on a couple of questions. Over the past couple of days, people have appeared before us to give the background to this meeting, and I have asked a number of them about household debt, and it has been surprising that their attitude seems to be rather sanguine about the crisis. What I have been putting to them is that we have seen in real terms household debt that has gone up from £565 billion in real terms in 1990 to £1.47 trillion today, or, to put it in perhaps a more relevant number, 1997 UK mortgage debt as a per cent of household income was standing at just under 80%, now it is closer to 140%. Do you not see, or agree rather, that this level of household debt is potentially, firstly, an incredibly big drag on consumption growth and therefore recovery and, secondly, potentially a crisis in the making should interest rates start to go up?

Mr Osborne: The rise in private-sector debt was one of the big issues in the build-up to the financial crisis, so it wasn't just the high structural deficit that the Government started to run. There is a striking chart in the Red Book of what happened to private-sector debt over the last 20 years, with a particularly sharp spike from 2006 onwards. The good news, the better news, is that private-sector debt has fallen by 40% of GDP since its peak in the first quarter of 2010. There is a deleveraging process taking place. Of course, some of that is bank debt as well as private-sector debt, or household debt, rather, and I would say that is one of the headwinds. Just as I said it is not ideal to be running one of the highest deficits in history recovering from a financial crisis—and, having gone into that crisis with the highest structural deficit of any major G7 economy—equally it is not ideal to have households that became over-extended and are drawing in their horns. That is one of the reasons why consumer spending and the like has been not as strong as people had hoped, although interestingly private consumption last year was stronger than forecast, and it was exports that disappointed. But I would agree with your overall analysis that this is yet another of the big challenges facing the UK.

Q395 Mark Garnier: My final question, and it is really a question about your thoughts as to when interest rates start rising; I know that is unlikely in the short term, but from where we are the moment with 10-year gilt yields at around 180 points, obviously the base rate at 50 basis points, it is unlikely that interest rates are going to go down, and at some point when interest rates do start moving it is going to be up. Given the fact that we have a nation that is now five years into this crisis, is now very used to these very low interest rates and also at the same time, although debt has come down a little bit, as indebted as it has ever been over history, do you have any feelings as to contingency plans in order to help households at that point in the future when interest rates do inevitably start rising?

Mr Osborne: This brings me back to the discussion we were having with Mr McFadden about the remit. One of the things that the Bank of Canada and the Federal Reserve has done is that they have provided more communication about the future path of interest rates, and I think one of the potential advantages of that is it gives households and businesses perhaps a clearer idea of that future path of interest rates so they have more time to adjust. They also have more time if they want to make investment decisions while interest rates are low. I think one of the interesting things about so-called forward guidance, which obviously Dr Carney has done and used in Canada, is that it addresses that question of how long interest rates are going to stay low.

Q396 John Mann: Chancellor, in all your Budgets, in all your Autumn Statements, you have raised broadband as a top priority, but in this Budget you have not updated us on progress towards your previously explicit target of 90% having superfast broadband by 2015. Could you update us, please?

Mr Osborne: I don't have the precise figure of what it is today, but my understanding is we are on track to have the fastest broadband in Europe. Indeed, I think we have done well on that, and the reason that it was not included in the Budget is that it will feature in the spending review, the spending round, that will take place in June. In previous Budgets I have had a list of transport projects and the like and capital investments. That did not feature in this Budget because we have the June spending round.

Q397 John Mann: You have been precise previously that the target is 90% of all properties getting superfast broadband, as you defined, by 2015. How far has that target slipped?

Mr Osborne: I held a meeting in my own constituency about broadband just recently, and there is good progress going on in connecting various towns I represent, and no doubt towns you represent, to superfast broadband. There is a challenge, that BT acknowledge, of having one supplier who is the dominant supplier, but compared to every other European country, we are doing pretty well. Indeed, with the exception of the Koreas and Japan, we are doing well compared to the rest of the world.

Q398 John Mann: With respect, you are not answering my question. The target was explicit in 2011, so let me ask the question in a different way. I have a letter from BT that I took the trouble to check yesterday and had it reconfirmed in writing from BT. BT, as the main deliverer of this policy, say that the 90% target that was explicit last year will not be met in 2015 or 2016 but not until 2017.

Mr Osborne: We had a very ambitious scheme, vastly more ambitious than the one we inherited. It is being delivered. The constraints on delivering it are not lack of money, and I think BT would acknowledge that. They are often issues around planning, and we are in the process right now of changing the planning laws governing the provision of broadband. We have had situations where some councils have objected to almost every single piece of broadband infrastructure going into their locality, and that has delayed the delivery of projects there. One London council rejected 90% of the applications for broadband cabinets in its area, from memory. So, absolutely there is more that needs to be done to deliver this, but it is being delivered, and the obstacles are not a lack of Government money.

Q399 John Mann: It is two years late, despite the fact it is a key priority in every single Budget and in every Autumn Statement; but you raised planning, so let us go on to planning. You quoted the second line of your Budget, although you had the wrong line. The second line of your Budget says, "The Budget will help those who aspire". There is a woman in suburbia, Surrey actually, who this month wishes to knock down her house and build a new one, but because of the stealth taxes that you introduced in your last Budget, reinforced in half a page in this Budget, she has been charged £28,495 in new taxes. Would you like to justify that tax on her aspiration to rebuild her own home on her own land?

Mr Osborne: I am happy to look at the particular case, but obviously since you have not provided the details to me in advance, I don't know all the details.

Q400 John Mann: She lives in Market Harborough. There is a woman who this month has been asked to build a new home for £34,800; in Melton Mowbray, a couple who have been asked to pay £40,533. That is the Community Infrastructure Levy that you brought in and added to with the AHL levy, a second stealth tax in the National Planning Guidance that you trumpeted in a page in your Budget. How many authorities so far have brought in these new stealth taxes?

Mr Osborne: I think it is, from memory, a relatively small number.

Q401 John Mann: It is 10. How many are bringing them in this year?

Mr Osborne: I do not have that number.

Q402 John Mann: It is 127 so far. It is a legal process, so 127 more. What is the average tax from just one of those, the Community Infrastructure Levy; the average tax for every single new home built in Britain this year in those authorities?

Mr Osborne: The Community Infrastructure Levy replaces the section 106 agreements. It is a new form of allowing local authorities and communities to ask for a contribution to the additional infrastructure that might be required for new commercial developments or new housing development. Obviously, like you, I want to make sure that it is not an obstacle to development, but it has not been raised with me before as an obstacle. Plenty of other things have, and, as I say, I think it replaces the rather opaque 106 agreement process, which has left quite a lot of housing developers with large 106 agreement obligations that were negotiated in good times and make it uncommercial in difficult times.

Q403 John Mann: You would not have heard much of it because only 10 councils introduced it, but all have to, and there are 127 more already this year; but there are two differences from the past. The first is it is all properties, whereas the section 106 was only for larger developments, but there is a second, much bigger difference: it is non-negotiable, whereas section 106 was always negotiable. But the infrastructure levy that you brought—you have brought in two, but the one that you trumpeted in your Budget last year and have half a page on this year—is non-negotiable. So, with an average of £13,000 per property in new taxes just from the CIL plus an average of around £30,000 for the AHL levy, which is the ones that I quoted from Surrey and Market Harborough—and I could give you other examples—how are people going to be aspirants in building homes?

Mr Osborne: As I say, my understanding is the Community Infrastructure Levy replaced an opaque 106 agreement. It has been broadly welcomed by those involved in the industry of building homes as a more certain system. Obviously we have to get the level right, and I want to encourage development. We have seen there a reduction in the cost of building homes, the building standards that we inherited and other costs that were imposed on the design of homes, but also in this Budget there is a big housing package to help people who want to buy a newly built home. I know there has been a lot of discussion of the mortgage scheme, but the Shared Equity Scheme, and I think the mortgage scheme, will help enormously with people who cannot afford the large deposits being demanded. That starts as of next week and will help people who want to buy a newly built home and that will in turn help the construction industry.

Q404 John Mann: Let me come back to my first question, which you did not answer. The woman in Surrey, who wishes this month to knock down her old home and build a new one, environmentally friendly, on the same site as her existing home and you are taxing her £28,495 in new taxes: would you like to justify that in terms of your quote that the Budget will help those who aspire?

Mr Osborne: I am absolutely clear: I want to help people buy their first home. I want to help people who want to move home when they have a larger family, and I think the measures in the Budget support that. I am very happy to look at the details of that particular case and get back to you.

John Mann: Chancellor, last time I raised three issues and you relented on all three. This time just the one issue will do. I will look forward to a U-turn.

Q405 Mr Love: Chancellor, can I now come on to the measures in the Budget to stimulate the housing market? There is more than a little concern out there that the Mortgage Guarantee Scheme in particular would have the effect of pushing up house prices. How do you respond to that concern?

Mr Osborne: What I wanted to do was help people to afford homes who cannot currently do so because of the large deposits, and what we want to see in our country is people with decent incomes and sustainable family finances be able to afford their own home. I think the mortgage scheme corrects a market failure. Again, it is not the kind of intervention you would take in more normal times, if I can put it like that. It is the kind of intervention you take when the mortgage market is not operating as it should and people are being asked for deposits that are much larger than they can reasonably afford.

Q406 Mr Love: The reality out there is that there are major supply-side constraints in the housing market. Indeed, we have the lowest level of house building almost on record. There was some surprise that you did not take any measures to address those supply-side constraints. Why not?

Mr Osborne: First of all, we are addressing supply-side constraints with the new planning guidance, the requirement on local areas to have new plans with the change of use class and the like. Those are associated with planning. We talked about building regulations just now, but I would also say that mortgages and the availability of mortgages are not just a demand issue. They are also a supply issue. It is difficult for house builders to build new homes if they are not sure there are people out there who can afford them, and that is why I think this is a sensible and proportionate intervention in the mortgage market. I was quite encouraged by some of the evidence that was given to your Committee by the Council of Mortgage Lenders. If you look at some of the biggest house builders in the country, Persimmon said, “The Budget will result in increased building levels by Persimmon. It allows us to build more homes,” and Barclays said, “The biggest problem has always been the mortgages and this is a meaningful number. We will be able to build extra homes because of this.” As I said, the Council of Mortgage Lenders made a similar point before you. So I think we are addressing supply by partly addressing mortgage finance, and until now that has been a missing piece of the picture.

Q407 Mr Love: Let me ask you about that. We understand that with the Equity Loan Scheme you have to buy a new house and therefore that will spark construction, but that is a much smaller scheme than the Mortgage Guarantee Scheme. How much do you expect housing supply to be stimulated by the proposals in the Mortgage Guarantee Scheme?

Mr Osborne: Inevitably, these can only be broad estimates, and we have not provided all the details of the scheme. The estimate is that it will support 190,000 mortgages a year. Lloyds Bank, independently of us, have suggested that of course some of that will help people who are already getting out a mortgage, but it is very expensive for them. There will be 50,000 extra mortgages a year.

Q408 Mr Love: There has been quite a lot of speculation that perhaps the reality of this policy is that it is intended to increase house prices, because there are, of course, economic effects to changing from slowly declining house prices to increasing house prices. Was that part of your consideration? Was the wealth effect of increasing house prices part of the objective in this policy?

Mr Osborne: No, it was not, and the house prices have risen over the last year modestly, but, again, the evidence that you have received as a Committee from the Council of Mortgage Lenders is they don’t think in the current circumstances we are going to get a housing bubble. If you look at the UK housing market at the moment, the number of first-time buyers has halved, the amount required for a deposit has trebled and the deposit required from first-time buyers has doubled as a percentage of their income. Those create economic problems because people find it more difficult to own their own home and to move. Frankly, I think it also creates a social problem in that people are unable to aspire to home ownership and the cost of home ownership is outside their reach. The package of housing measures is designed to address that.

Q409 Mr Love: But isn’t there any concern there that if one of the impacts is to increase house prices, then instead of their having difficulty raising the deposit or being able to afford the mortgage, you will replace that problem with one of rising house prices, making getting your first home or moving to a larger home unaffordable?

Mr Osborne: As I say, the big obstacle for many people has been the size of the deposit required. The OBR have an estimate of house price increases in their forecast, and I think what they say is that the policy underpins that forecast, but the forecast was worked on before the policy was brought forward. The purpose of the policy, I am absolutely clear, is to help people who are currently priced out of the housing market because of the cost of mortgage finance. The cost of mortgage finance is a consequence of the impairment in our financial system.

Q410 Mr Love: Let me come on to the specifics of the Mortgage Guarantee Scheme. Apparently it rules out accessing funds for buy to let and for interest-only mortgages, but there seems to be ambiguity in regard to building or purchasing second homes. Can you explain that?

Mr Osborne: As I have explained from the first interviews I did after the Budget, the absolute clear intention of the scheme is to help people buy their first home or move home as their family grows. That is the purpose of the policy; that is who it is aimed at. Of course the mortgage scheme is a complex thing, and we have to make sure that we don’t design a scheme that has an adverse effect on people getting divorced, who might find they have two mortgages, people moving house who find for a very short period they have two mortgages. So, I want to get this scheme right, but the intention of it is absolutely clear.

Q411 Mr Love: I have to say, Chancellor, it is not clear, because when the Treasury was rung up and asked whether there was a possibility of using cash for second homes, their reply was they admitted that it probably is the case, as things stand, there is an ambiguity there. You can clear up that ambiguity here today in this Committee by giving a definitive statement. Will this mortgage scheme be allowed to buy second homes?

Mr Osborne: I can clear up the ambiguity by repeating what I said on the television and radio the morning after the Budget, which is that the clear intention of the scheme is to support people who want to buy their first home or who want to move home as their family grows. That is what the scheme will be aimed at, and that has been made clear by me and everyone else who has spoken about this.

Q412 Mr Love: You are leaving an ambiguity there, because the reality is should the taxpayer be on the line for people who are purchasing second homes? Is that an appropriate use of taxpayers’ funds?

Mr Osborne: There is not a direct relationship with the individual. This is a scheme that works with the mortgage market and with the banks to support mortgages. Where we have the direct scheme, which comes into effect next week, is the Shared Equity Scheme. Obviously, because it is coming into effect next week, the rules are there. We are working with the industry to get this right with the mortgage scheme, and the intention is absolutely clear and couldn't be clearer, but I have to say that this Committee has regularly complained to me, and to my predecessor, when we have made schemes too complicated and not understood the perverse consequences of some of our decisions. I have just pointed out that in the mortgage market there are cases where people have two mortgages, not because they want a second home but because their family is breaking up, they are moving job—as I say, it is important that this scheme works and works well, and that is what I am intending.

Q413 Mr Love: But this is a Mortgage Guarantee Scheme. The taxpayer could be on the line if anything goes wrong. Is it an appropriate use for taxpayers' money to fund the purchase of second homes?

Mr Osborne: The taxpayer and the Government will charge a fee, and of course we have to get the price right for that fee, but that is expected to cover any losses in the scheme. We have also, very importantly, given a lock to turn off the scheme after three years. But the intention of the scheme is absolutely clear, and I think the evidence you have had to this Committee from the house builders and from the industry has been very positive and we want to get behind a scheme that is going to help people to afford mortgages.

Q414 Mr Love: What would you say, Chancellor, when the first person who purchases a second home gets into difficulties, the taxpayer is on the line and you are asked, "What was the public benefit of the taxpayer subsidising someone to purchase a second home"? How will you answer that?

Mr Osborne: Let me repeat: what I said on the radio and the television on the morning after the Budget is—

Chair: You have already repeated it here.

Mr Osborne: I need to go on repeating it, then. The clear intention of the scheme is to help people buy their first home and move home as their family grows. We are going to get this scheme right.

Q415 Teresa Pearce: Chancellor, there are two strands to this. There is the Help to Buy and the Mortgage Guarantee Scheme. As I understand it, there is nothing in the Mortgage Guarantee Scheme that restricts how much a bank or a lender can charge for that mortgage. So we, as the taxpayers, could be putting up an amount towards that loan, but there is no cap on how much the lender can charge. You have mentioned that people are being priced out of the market. Isn't that another way they could be priced out of the market, if they could not afford another type of loan but had to go for that, but there is no cap on what the bank will charge?

Mr Osborne: As I say, the scheme is designed to become operational at the beginning of next year. It is a complex thing, the mortgage market, but our intention is very clear, which is to increase the affordability of mortgages, not to decrease the affordability of mortgages, and we are working with some of the country's largest mortgage providers. They are absolutely clear that their intention and the consequence of our policy will be to reduce the cost of mortgages rather than increase it, and that is what we are absolutely determined to deliver.

Q416 Teresa Pearce: So, as part of that assisting them in lending, would you not consider a cap?

Mr Osborne: I am not sure that a cap is the right instrument, but I don't want to prejudge the discussion with the industry, because obviously mortgage rates in the market vary all the time. What we want to do is to increase the availability of higher loan-to-value mortgages, not the 120% Northern Rock mortgages or anything like that but the mortgages that have been available for decades but are no longer available to many people, which are the 80% to 95% loan-to-value mortgages. At the moment, people are being asked to find very large deposits and in effect, therefore, being priced out of the housing market.

Q417 Teresa Pearce: You mentioned earlier the number of new mortgages; you thought 50,000 extra mortgages.

Mr Osborne: That was a Lloyds Bank estimate.

Teresa Pearce: I have tried to find how many people this would help, and there are different figures all over the place. There is 74,000, 60,000—how many households do you think this will help?

Mr Osborne: The 74,000 is an estimate for the Shared Equity Scheme over three years. The best estimate is 190,000 a year will be supported. Of course that will include some people re-mortgaging, people who are currently trapped on high SVRs because they cannot move off the high loan-to-value mortgage, and they cannot get another high loan-to-value mortgage that they had four or five years ago. Again, if I can help family finances with helping people get lower mortgage costs, then I want to do that as well.

Q418 Teresa Pearce: So, that is the aim: to help this number of people with cheaper mortgages for the first time. How much is it going to cost the taxpayer?

Mr Osborne: As I say, there will be a fee for the scheme, for the guarantee.

Q419 Teresa Pearce: How much have you budgeted overall for both schemes?

Mr Osborne: The Shared Equity Scheme is a direct injection of £3.5 billion into the economy. It is a financial transaction, capital spending, but the mortgage guarantee is a guarantee, and we will set the fee in a way that we believe will cover the costs.

Q420 Teresa Pearce: You mentioned earlier about these being major steps to support housing and housing sector and construction, yet since 2010 you have constantly said that you want to rebalance the economy away from property markets into exports. Have you abandoned that aim now?

Mr Osborne: Yes, we do need to see exports increase, and it is good news that our exports to the likes of China, Brazil and India are up two thirds. Of course, one of our problems has been 40% of our exports go to the eurozone and they have suffered. But as I say, I have read a lot about how there is a concern about the housing boom and so on. If we were in more normal times, you would not undertake an intervention like this, but we are in a situation where, as I was saying, the number of first-time buyers is half what it normally is; the amount of deposits has trebled. House building is not anything like the rate we would want in normal times—I am not talking about the height of the boom—and it is perfectly appropriate, I think, in those circumstances. What you have to be clear about is that you can then turn off the tap. I have set this scheme for three years, and I have given to the Financial Policy Committee in the Bank of England the lock on the scheme; so, an independent body. We were just talking about the members of that. I think is a very important check on the Government and to make sure that this is a temporary, time-limited intervention in the housing market that addresses a market failure.

Q421 Teresa Pearce: I accept that this is not normal times, and I think you would accept that housing is the biggest crisis facing London particularly at the moment. There are over 15,000 people in my borough awaiting housing, and yet you have decided to extend the Right to Buy scheme and, at the same time as extending the Right to Buy scheme, you have not released local authorities to be able to borrow to build more houses. You mentioned earlier about this initiative for mortgages and you said it is also a social problem—and clearly it is when a local authority does not have enough properties to house its residents—and yet your priority is to encourage the sale at a discount of the properties that those authorities do have. How does that help the housing crisis in London?

Mr Osborne: There are several points. First of all, I think it is a good thing for the people you represent and the people we all represent that those who want to buy their own home can afford to do so, and that is what these interventions are about. Second, the planning changes we make are designed to try to increase the number of homes it is possible to build. Third, we are putting more money into social housing. So in the Budget there is an additional £225 million for 15,000 additional affordable homes—

Teresa Pearce: But that is not even enough to meet the waiting list in my borough.

Mr Osborne: —on top of the 15,000 announced in the autumn, bringing a total of around 200,000 over this offer. I agree, social home construction was at a record low when I came to office and we have put more money into social housing. We are also setting long-term social rents, something I don't think any Government has previously done. We will set, at the spending review in June, a long-term social rent out to the 2020s that will give housing associations the certainties they need to borrow money and to build affordable homes. We talked about mortgage guarantees. I am not talking today about the guarantee we have given to social housing providers, because that was a previous Government measure that is coming on-stream now to help them build homes. I absolutely think what we want to do is help all those people who are currently unable to live in the accommodation they want to live in to get a home, and that is a combination of additional affordable homes and additional private homes and additional homes for rent.

Something else I didn't mention but mentioned in the Budget speech is we have increased to £1 billion the amount of money we are putting into the Homes for Rent scheme to help developers build homes for private rent. It is a whole range of things. We are just going to disagree ideologically on the Right to Buy. I think it is right for people who are in social homes to have the prospect of buying their own home. I am proud that we are making that easier for people but we also, of course, have a one-to-one policy that enables the local authority to then build an additional affordable home when that home is sold. I would say it is a range of things, because the housing market, as you know, is complex and people live in different types of accommodation, but it is a range of things and it hits a lot of the right buttons.

Q422 Teresa Pearce: Are you telling me, Chancellor, that this range of policies you have brought in will reduce the number of homeless people in London?

Mr Osborne: It is certainly my intention to house more people who currently do not have a house that they can live in.

Q423 Chair: Can we just be clear about your view of this scheme? First of all, do you agree with the analysis, for example, of the OBR in evidence to us this morning, which is supported by many others, that the primary initial effect will be to raise house prices?

Mr Osborne: Of course, the OBR can come to their own judgment. The objective of the scheme is to, as I say, increase the affordability of mortgages, and with the supply side changes to planning we have seen an increase in planning applications.

Q424 Chair: We are talking here about the early effect. I am trying to narrow down this question to, "What will be the early effect of this scheme?" The early effect of this scheme is to provide, isn't it, a form of subsidy, a shadow subsidy, for housing that will, therefore, enable mortgage companies to offer people finer terms? Hopefully this will be passed on to customers, so customers will be able to borrow more than they would otherwise be able to borrow. Therefore, demand will be increased in the housing market and demand—

Mr Osborne: But if supply is also increased—

Chair: Supply will not increase immediately, will it? The supply will increase later, if at all. The OBR also told us this morning that in the medium term it may stimulate new build a little but much less than the demand effect. I am just trying to clarify whether you agree with the majority of outside analysts that the primary early effect of the scheme will be to raise house prices?

Mr Osborne: I agree with those who build homes. The Chair of Barclay Homes says, "The biggest problem has always been the mortgages. We will be able to build extra homes because of this". The Director of Persimmon Homes says, "The Budget will result in increased building levels by Persimmon. It allows us to build more homes." I do not see mortgage finance as just a demand issue. I see it also as helping on supply.

Q425 Chair: I know. You have already said that. Let us have another go at this question. Do you think—

Mr Osborne: They are home builders.

Chair: Do you think that the primary early effect will be to increase supply?

Mr Osborne: One of the intentions of the scheme is to increase the Help to Buy scheme.

Q426 Chair: I am not asking you what you are intending to do. You have spoken a good deal about your intentions this afternoon. I am asking you for your judgment about the early effects of the scheme; the year one effects and the year two effects of this scheme.

Mr Osborne: Our expectation is that the first component of Help to Buy, which will come into effect in the first week—you talk about the early effects—will be to increase the supply of newly built homes, and that is the forecast we made. The positive reaction from the builders suggests that that will happen. The effect of the mortgage scheme, which comes in later, will be already starting to affect the decisions of our home-builders. That, of course, is—

Q427 Chair: You are not concerned that we are not just ploughing money back into the boom-bust property cycle?

Mr Osborne: As I say, I do not detect that we are in the middle of a housing boom. I think we are in a very unusual situation after the financial crisis where the mortgage market is impaired, where very high deposits are being demanded of people and families are priced out of the housing market, and that is neither economically right nor socially fair.

Q428 Chair: When you were taking this decision, did you take into account the fact that people spent decades trying to get the Government out of subsidies to property?

Mr Osborne: As I say, it is a time-limited intervention. It is a three-year intervention.

Q429 Chair: I think that is an important point, Chancellor, and I would just like to clarify what in fact you mean by a time-limited scheme. You have said that the FPC will have a lock on it. Does this scheme cease to operate unless the FPC comes to you and say, "We want to continue"?

Mr Osborne: Yes.

Q430 Chair: Are you making clear now, when you say it is time-limited, that you are not going to go to the FPC and say, "We want to carry on this scheme"?

Mr Osborne: Of course we will ask them for their opinion, but if the people we have on the committee think it is not sensible, they will make that pretty clear; and if they think it is sensible to continue the scheme, they will make that clear as well.

Q431 Chair: From your perspective, you don't know whether it is time-limited but from their perspective you are expecting them to say that it is?

Mr Osborne: No. What I am saying is, I don't envisage this scheme continuing for more than three years. I have said that very clearly, and I said that if the Government, or indeed any Government, wants to extend it beyond that, the FPC will be in a position to say that is not sensible and have, therefore, a lock on the scheme.

Q432 Chair: Did you consult the FPC before passing the buck?

Mr Osborne: I spoke to the Governor of the Bank, who is the chair of the FPC.

Q433 Chair: Did he consult the FPC?

Mr Osborne: I think you would have to ask him.

Q434 Chair: Did you ask him to consult the FPC? The FPC is a consensual institution.

Mr Osborne: The FPC was in a state of change in the last week, so we are going from a temporary FPC to a new FPC.

Q435 Chair: Even with the removals we still had a sizable number of members.

Mr Osborne: I consulted the Chair of the FPC about whether it was appropriate to give the FPC this decision in three years' time. This is not a decision for them today. This is a decision for them in three years' time, and, indeed, the interim FPC had previously not sought additional powers on mortgages as one of their initial powers. This is something for three years' time, and I think it is appropriate that I consult the Governor of the Bank, which is what I did.

Q436 Chair: In taking account of the risk to the Exchequer, did you bear in mind what is widely considered to be the disguised impairment on the balance sheet of many banks of loans to SMEs often collateralised against property, both commercial and residential; in other words, the risk being that the housing market may well have another leg down in it when that stock of property ends up having to be realised, when those accrued impaired activities are forced to be realised?

Mr Osborne: We have an independent body to make assessments of the state of the housing market and the future path of house prices, and the OBR have done that. As I say, we are going to charge a fee for this. I want to make sure that the fee is not so high that it would make the scheme unworkable or lead to the consequence that it becomes more expensive to get a mortgage. We obviously do not want to have the reverse effect, so we have to get the calculation of the fee right, but the expectation is that it will cover the losses.

Q437 Mr Ruffley: Chancellor, the head of Chartered Steel in Europe complains that in this country we are saddled with a high cost of energy compared with our counterparts in Europe and Asia. How far are high energy prices hindering growth?

Mr Osborne: I think high energy prices have generally had an impact both in the UK and across the world. That has been one of the headwinds that I was talking about earlier. When it comes to our own energy policies built up over many years, I think we have to have a regard for the impact of energy costs on high energy using industries, which is why during my period as Chancellor I have come forward with a scheme to exempt or mitigate the impact of those high-energy costs on those kinds of companies. Indeed, to the obvious pleasure of the Member for Stoke-on-Trent Central, I have taken action in this Budget to help the ceramics industry and other industries that use similar processes from high-cost energy. Little noticed in the Budget, I did also say that I was going to extend the protection for higher energy users into 2015-16, which had not previously been said.

Q438 Mr Ruffley: Yes, but would you agree with the proposition that a secure supply of competitively priced energy is crucial for any credible growth strategy? Would you agree with that?

Mr Osborne: I think it is a very important part of our economic future, which is why I have been very keen on the Government developing a gas strategy that did not exist when we came to office. I am very keen on our providing—and it is commercially sensible getting the nuclear power station built in Somerset. I am very keen on our not missing out on the shale gas revolution, which is—

Q439 Mr Ruffley: I want to get to those three parts of the energy sector. Scottish Power's Chief Officer has said that Scottish Power is dismantling their coal power plant fleet. They are saying that they are not mothballing them. They will not be back. He said, "We have three consented sites for three new gas plants in the UK, and we are not doing anything with them." He goes on to say, "There is absolutely no economic signal or incentive to invest in the future of those sites at this time", and he said that on 20 March this year. Isn't that a rather damning criticism of Government policy?

Mr Osborne: We absolutely want to see more investment in gas generation. I have to say, it has been like turning around the proverbial LNG super-tanker, because our country was heading into a position where we were going to get rid of all gas generation over a period of time. We are creating a set of incentives in order to ensure that this country, like many other countries, can carry on with gas-powered electricity.

Q440 Mr Ruffley: Okay, but why is he saying, "There is absolutely no economic signal or incentive to invest in the future of those sites at this time"? Why is he saying that?

Mr Osborne: It is a consequence of the deep recession and the fact that recovery has not been as strong as we wished, that demand has been lower for energy, and so those predictions that were made of under-supply have not been realised in the last couple of years.

Q441 Mr Ruffley: Are you aware that, because of this problem, there is not the investment going ahead? They are saying the D-rated capacity margin could be below 3% by 2015. Does that concern you?

Mr Osborne: My job has been to try to put in place strong incentives for the future development of new energy and by agreeing a levy-controlled framework with a carbon price floor I think we are putting in stronger long-term incentives and clearer price signals than virtually any other country I can think of. If you look at Spain and Germany, they have become more uncertain with their energy policies. I think personally—and I do not think this is particularly a secret—that we were overly dependent for our future energy path on renewable energy and I thought it was imprudent to have gas as a large part of the mix, and we have a gas strategy. I am also, along with anyone else who cares about low-carbon electricity generation, keen to see the nuclear power industry restarted in the UK.

Q442 Mr Ruffley: Let us get on to nuclear. Richard Lambert has reminded us recently that UK energy companies are unwilling to make large investments with a long payback period unless they can be reasonably certain that the rules are not suddenly going to be changed. In that context, he talks about Centrica's announcement to pull out of its nuclear new-build and return £500 million to its shareholders. Doesn't that suggest there are not adequate incentives that the Government has put in place?

Mr Osborne: Let us be clear what these incentives are. They are costs on families and businesses, because those incentives are longer-term commitments of a return. We just have to get that balance right as a country. Of course, we don't want an entirely here-today energy sector that doesn't think about security of supply in the future or diversity of supply in the future. That is why we support the development of offshore wind energy, or that is why we are working on a contract for nuclear power that will provide some certainty about the future costs of electricity rather than just leaving that to the market, but it is important to get that balance right.

Of course, Centrica had to make its own decision about the amount of capital it was able to put upfront for the development of the Hinkley Point station. I think it is reassuring that EDF are clearly committed to that deal, and there is evidence that others around the world are interested in partnering with EDF in that project. I guess you would have to ask the management of Centrica why they thought it was not an economic prospect. I think what they have said publicly is it is a challenge for them putting that much capital upfront with a long-term return, but I think there are companies in the world that are going to help us get our nuclear power industry restarted.

Q443 Mr Ruffley: Where is that capital going to come from? Are you relying on sovereign wealth funds, China—where is this resource going to come from?

Mr Osborne: What we are trying to do in Hinkley Point is something that I think is almost unique, which is we are trying to build a nuclear power station without a very large public subsidy and built by the public sector. I am confident we are going to do that. I think there is one plant in Abu Dhabi that is the only other example in the world of this. I think with EDF we have a strong partner. Obviously we are in a hard commercial bargain between EDF and the British Government about the right strike price and so on, but both EDF and the British Government want to see the project go ahead on the right terms for both of us.

Q444 Mr Ruffley: When do you expect the exploration of shale gas to reduce energy prices?

Mr Osborne: It is clearly not going to happen tomorrow.

Q445 Mr Ruffley: We know it is not going to happen tomorrow, but what is the forecast estimate? What is the Treasury view? When can we expect shale to come on tap?

Mr Osborne: It is a decision for us as a society, because there are going to be planning decisions that need to be taken. What I am trying to do is get us to a position where we have an advantageous tax regime, which we now do; where by the summer we have a simplified planning process in terms of the number of agencies you have to go to; where there is a clear community benefit so that local communities can see the advantage of supporting this kind of development. These are the ingredients that worked in the United States. I am not going to give you a forecast of when this is all about to happen. I just want it to happen as quickly as possible, and I am pulling every lever I can to make sure it does happen as quickly as possible in a way that is sustainable for local communities.

Q446 Mr Ruffley: The Energy Secretary has said, "We do not yet know how much of this unconventional energy"—shale—"is recoverable." Do you have any estimate?

Mr Osborne: There are, unfortunately, quite divergent estimates, and one of the things we need to do—and the Energy Secretary gave permission in a quasi-judicial sense—is to allow Cuadrilla in Lancashire to go on with its exploratory work. That is very important so we can have a better estimate or a clearer estimate of what the supplies are likely to be both in Lancashire and, as an extrapolation, the rest of the country.

Q447 Mr Ruffley: A final question: what is the assumption made in the Treasury model for the increase in domestic energy prices in the next two years?

Mr Osborne: It is not a Treasury model. There is an oil price forecast that the OBR use, and I think they use—

Mr Ruffley: I am merely asking about domestic gas and electricity bills. What assumption is being made?

Mr Osborne: I don't have that number in front of me, and—

Mr Ruffley: Is it an increase?

Mr Osborne: —I am happy to write to you with the number.

Q448 Chair: I would like to end by mentioning a few things that the Committee is very pleased about and one or two things the Committee is not so pleased about. First of all, we are very pleased that the Red Book seems to get shorter and more informative each year, which is a huge step forward. Secondly, we are very grateful, once again, for the fact that you are publishing the distributional analysis accompanying the Budget. It is something that the Committee asked for right at the beginning of this Parliament, and you have maintained it. In fact, you have improved on it, and it offers a lot more detail than has been available in earlier times.

There are some things we are not so happy about. For a start, we asked last year if there could be an interval between Second Reading of the Finance Bill and consideration of the Finance Bill in Committee. You have left a 48-hour gap, exactly as you did last year, and you have just ignored our request that you offer a wider gap. Have you any explanation for why you have ignored us?

Mr Osborne: We published the Finance Bill in draft in the autumn, and so that is plenty of time for this Committee and anyone else to take a good close look at it.

Q449 Chair: I don't think the Committee will find that an adequate explanation, but we will discuss that among ourselves. At least five of us, the Commons members of the Banking Commission, are also displeased with the fact that you have left very little time, so ignored the request of the Banking Commission to leave adequate time between the publication of the bank Bill and its consideration in Committee. You have done the same thing, effectively. We are very unhappy about that on the Banking Commission.

Mr Osborne: I would say two things. First of all, the pressure I have been under is to get the Vickers reforms in place. That is where the parliamentary pressure has come from. Judging by my encounters in the Chamber of the House of Commons, that is what everyone keeps demanding: "Why didn't you bring it in more quickly?" Indeed, that was the principal demand of the Opposition. What I have said to the Banking Commission is that I think, provided the Banking Commission sticks to the timetable that it has set out to produce this report in May, we will have plenty of time to take on board the recommendations, respond to the recommendations and consult on anything that needs consulting and make the amendments while the Bill is in Parliament and give an opportunity both for the House of Lords and the House of Commons to debate this at considerable length, but I do think we have to demonstrate to our citizens and to the industry that we are making progress. After all, this Commission was set up in 2010 and we are now in 2013, and, in my view, we need to demonstrate that progress.

Q450 Chair: Finally, it seems that the Treasury leaked the Budget to the *Evening Standard*. Is that correct?

Mr Osborne: The Treasury briefed the *Evening Standard* and other media organisations, like the BBC and Sky, on the contents of the Budget in a way that has been done in previous years and under both Administrations. I am as angry as anyone else—maybe more angry—at what happened, and I have asked the Permanent Secretary to investigate whether this practice of providing the contents of the Budget under embargo to certain media organisations is appropriate. Of course, this has gone on, in a sense, for decades, because Chancellors used to, until last year, record with the BBC a pre-Budget broadcast hours before the Budget was delivered, which had everything in it. This practice, in one shape or another, has gone on for a long time, but what has happened is completely unacceptable. The fact that the editor of the *Evening Standard* has written to me and written to the Speaker to apologise is good, but, nevertheless, I think we have to seriously question whether any of this pre-release can happen or, if it does happen, under what conditions it happens to make sure that this does not happen again. As I say, there is no one more angry about what happened than myself. I don't know whether—

Q451 Chair: That is very helpful. It would be helpful if you could offer us a view now. Do you think it is a good idea to hand information that could be market-sensitive to anybody in advance of announcing it to Parliament?

Mr Osborne: I don't want to prejudge Sir Nicholas's inquiry.

Q452 Chair: Why not? You are in charge, and you take responsibility for it.

Mr Osborne: Okay, I will prejudge it a little. Clearly the practice that has gone on can't continue because of what happened. There is a question, I think, for the Permanent Secretary to examine about whether we could brief a couple of media organisations and then, in effect, make absolutely sure it does not leak by locking them in the Treasury. The Office for National Statistics does pre-brief some of its statistics, but it has security arrangements in place. Some of those are highly sensitive market announcements. Of course, we have had, with judicial inquiries, the opportunities for some people, including the media, to see some of those things in advance. There are processes that can be deployed that make sure that a leak does not happen while, at the same time, the public are helped in the understanding of the Budget, so the broadcaster is able to keep pace with the announcements and inform the public as they go along. I promise you, I am the first person who wants to stop this happening again, not the last. I don't know whether Sir Nicholas has any—

Chair: I don't think there is any need, because we are going to have a report in due course, and we are going to await that, but we are very grateful for what you said there, which was pretty clear. We too will be looking at the issue and will offer a view. Thank you very much for coming to give evidence to us this afternoon. It has been very informative. It has perhaps been bumpy on occasion, but then these are bumpy times and not the easiest moments to be sitting in No. 11 trying to run the economy. Thank you very much, Chancellor, and thank you, Mr Bowler and Sir Nicholas.