Government response to the Committee’s Twenty-Sixth Report: Budget 2018

Tenth Special Report of Session 2017–19

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The Treasury Committee

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The current staff of the Committee are Peter Stam, Marcus Wilton, Dan Lee, Aruni Muthumala (Senior Economists), Adam Wales (Chief Policy Adviser), Nicholas Berry (Committee Support Assistant), Maciej Wenerski (Senior Committee Assistant), Matt Panteli (Senior Media and Policy Officer), Anne Stark (on secondment from HM Revenue & Customs), Tom Ludlow (on secondment from the Bank of England), Yasmine Raza (on secondment from the Financial Conduct Authority), Ria Gill-Williams (on secondment from the National Audit Office), Sarah Goodwin (on secondment from the Prudential Regulation Authority) and Andrew Young (Hansard Society Scholar).

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Tenth Special Report

On 12 February 2019, the Treasury Committee published its Twenty-Sixth of Session 2017–19, *Budget 2018* (HC 1606). The government response was received on 29 March 2019.

Appendix: Government Response

**Budget 2018**

Since 2010 the government has worked to build a stronger, fairer economy—returning the public finances to health, helping people into work, and cutting taxes for individuals, families and businesses. Employment is at a record high and real wages are rising.

Budget 2018 showed that we have reached a turning point in the public finances and this was further confirmed at Spring Statement 2019. Thanks to the hard work of the British people, and the government’s continued commitment to fiscal responsibility, borrowing has been reduced by four-fifths and debt has begun its first sustained fall in a generation.

In line with our balanced approach, at Budget 2018 the government also took further steps to improve public services, support businesses and boost living standards across the country, including by:

- setting out a new path for public spending ahead of the Spending Review, with day-to-day departmental spending now growing in real terms for the first time since 2010
- funding the NHS for its new five-year settlement and providing local councils with additional funding for social care
- delivering early on our commitment to increase the Personal Allowance and the Higher Rate Threshold, so that people can keep more of what they earn
- boosting the National Living Wage and increasing the Universal Credit (UC) Work Allowances, to ensure that work pays and to help families with the cost of living
- increasing the National Productivity Investment Fund (NPIF) from £31bn to £37bn
- backing business with further incentives to invest in the short and long term, with a temporary increase in the Annual Investment Allowance to £1 million and the introduction of a new allowance for investments in non-residential structures and buildings
- ensuring that large, established, digital services companies pay their fair share by announcing a 2% tax on the revenues of search engines, social media platforms and online marketplaces, reflecting the value they derive from UK users.
The late provisions of policy decisions to the OBR

1. The creation of the independent OBR has led to much higher standards for the forecasting process, and it is important that these do not slip. At this Budget, the Treasury failed to keep to the timetable it had agreed with the OBR at the outset of the forecasting process, with the result that the economy and fiscal forecasts are not fully consistent. The forecasting round had been particularly challenging due to a compressed timetable and relatively large underlying forecast revisions and policy changes. (Paragraph 8)

2. It is not enough to say, as the Chancellor did, that these problems are unlikely to recur since future and policy revisions are unlikely to be as large in future. In fact, the scale of the revisions was not unprecedented even in the short history of the OBR. There is no excuse for the Treasury taking a chaotic approach on timetabling and policy discussions. The Committee expects the Treasury to engage with the OBR on its suggestions for reviewing and improving the forecast timetabling process. The Committee will consider the detail of this review as part of its scrutiny of the 2019 Spring Statement. (Paragraph 9)

As the OBR set out in their Economic and Fiscal Outlook foreword at Budget 2018, the process of confirming decisions at the Budget unfortunately took a little longer than usual. We are grateful to the OBR for their forbearance.

The slight delay was the result of several factors. Firstly, there was a relatively large move in the pre-measures forecast, relative to Spring Statement 2018. Secondly, the policy package for Budget 2018 was unusually large in fiscal terms—mainly as a result of the NHS settlement announced in June last year. Assessing the economic and fiscal impact of the package was therefore a more complex exercise than usual, requiring a number of judgements by the OBR’s Budget Responsibility Committee, which in turn had knock-on consequences for the policy package. The OBR have rightly been clear that everyone was working together in good faith.

Following Budget 2018, the Treasury has worked closely with the OBR to review the forecasting process. New processes have since been established to improve and support smooth delivery of the forecast in light of the challenges faced at Budget 2018. These involve the earlier delivery of policy and forecast information. The OBR noted the improvements in the foreword of the Spring Statement 2019 Economic and Fiscal Outlook, saying “these changes have made the process smooth this time around” and “we are satisfied that the Treasury recognises the importance of the changes we have made to the process.”

3. The forecast the OBR prepares for the 2019 Spring Statement may be the first opportunity it has to make a more detailed assessment of the UK’s short-term economic prospects after Brexit than the broad-brush assumptions it has made to date. It will also need to make its usual assessment of the impact of global developments on the UK’s growth prospects, on this occasion including the recent slowdown in the Eurozone. It will be even more important than usual that the Government co-operates effectively with the OBR and provides it with the resources and information it needs in a timely fashion. The Committee will seek assurance that it has done so. (Paragraph 10)

The OBR is independent of government and at Spring Statement 2019 their assessment of the UK’s economic prospects after EU exit was made entirely at their discretion. As is customary, the OBR wrote to the Treasury ahead of Spring Statement 2019 to request
information regarding government policies related to EU exit, to which the Treasury provided the latest available information to inform the forecast. The Treasury provided all relevant information to inform the OBR’s forecast according to the agreed timetable.

The economic outlook and Brexit

4. The Budget includes some policies to support over-indebted households, but the Treasury has once again failed to make an assessment of the overall state of household finances and household savings, and the implications for wider economic stability. This is despite the fact that the OBR forecasts the household cash savings ratio to fall further and into negative territory. It is concerning that the Treasury has no obvious strategy in connection with household finances. The Committee re-iterates its recommendation that the Treasury should report on these issues and set out a clear strategy for addressing them at future Budgets. (Paragraph 15)

The government works through the independent Financial Policy Committee (FPC) of the Bank of England, to guard against financial stability risks and support the resilience of the UK financial system. The FPC is responsible for monitoring and removing or reducing systemic risks, and routinely assesses developments in household finances. This includes the levels and growth of mortgage and consumer debt. The FPC has taken policy action in the housing market, including introducing a loan-to-income flow limit, and an affordability test, which has guarded against a significant increase in the number of highly indebted households. The Prudential Regulation Authority (PRA) has also taken action on underwriting standards in consumer credit lending, following an FPC assessment of risks to financial stability from developments in the consumer credit market.

Since the financial crisis, households’ financial positions have strengthened: household net financial wealth as a proportion of income remains significantly above pre-crisis levels; household debt as a proportion of income has stabilised over the past year, significantly below pre-crisis levels; and debt interest payments as a share of income remain near record lows. In addition, real household disposable incomes are now 5.4% higher than at the start of 2010.

As for the savings ratio, estimates have been volatile and subject to revision in recent years, as the OBR acknowledged in their Economic and Fiscal Outlook. The outturn estimate has been revised upwards on multiple occasions. While the government does not actively target policy at achieving a higher saving ratio, the government has introduced Help to Save to support people of all incomes and at all stages of life to save. This offers a 50% bonus on monthly savings of up to £50 to those in receipt of Working Tax Credit, and to Universal Credit claimants above a monthly earned income level. As of 31 January 2019, over 90,000 accounts had been opened. In addition, for savers, since the introduction of the Personal Savings Allowance and the increase in the adult ISA subscription limit to a record £20,000, over 95% of people with savings income pay no tax on that income.

The government is committed to support working people to keep more of what they earn, and to take action to help with the cost of living. Amongst other measures, this includes raising the Personal Allowance to £12,500, and the Higher Rate Threshold to £50,000, from April 2019, one year early; freezing fuel duty for the ninth consecutive year, which by

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1 These assessments are published in the biannual Financial Stability Report and in the FPC’s quarterly Meeting Records.
April 2020 will have saved the average car driver a cumulative £1,000; and doubling free childcare for eligible working parents of 3 and 4 year-olds, which will save parents who take up full entitlement around £5,000 a year per child.

The government has also implemented a range of measures for the challenges facing borrowers. This include increasing levels of financial support to the Money Advice Service, with an increased budget of over £56m for 2018/19—enough to support 530,000 people; legislation requiring the Financial Conduct Authority to introduce a cap on the cost of payday loans, which came into force in January 2015 and has led to total savings of £150 million each year; and the creation of a Single Financial Guidance Body—making it easier for people to get help with matters related to money and finance.

5. The OBR already assumes in its forecast that the UK makes an orderly transition to its new economic relationship with the EU. Therefore, no “deal dividend” over and above the existing forecast could be attained simply by avoiding a disorderly outcome. Beyond this, there could be some improvement to business confidence and investment following an orderly transition or a resolution of Brexit-related uncertainty that is not currently forecast by the OBR. It is not credible that this be described as a dividend. (Paragraph 26)

The government notes the Committee’s acknowledgment that business confidence and investment may improve as uncertainty is resolved on EU exit, and that some of this improvement may not have been forecasted by the OBR. Uncertainty is weighing on business investment, which fell by 0.9% in 2018, but the fundamental drivers of business investment are in place, including robust rates of return on capital and limited spare capacity. Businesses also have significant cash holdings.

Both the Bank of England’s February 2019 Inflation Report and the OBR’s Spring Statement forecast expect a pick-up in GDP and business investment growth in the medium term. The Bank’s February Inflation Report also presented sensitivity analysis of GDP growth and inflation, to uncertainty, financial conditions and the exchange rate. This showed that, all other things equal, lower uncertainty and looser financial conditions could boost GDP growth in 2020 and 2021 by 0.7 and 0.4ppt respectively. All of this suggests that we may expect a strengthening in business investment compared to current outturns once uncertainty dissipates.

**The ‘end of austerity’**

6. The Chancellor said that the “era of austerity is coming to an end”, which he told the Committee meant more generous funding of public services, real wage growth and a lower proportion of income going into taxation. This is an expansive but also imprecise definition. At the next Budget and Comprehensive Spending Review, the Chancellor will have the opportunity to set out his meaning in more measurable terms. This could include, for example, a plan for the overall levels of government revenue and spending as shares of GDP. (Paragraph 40)

7. This Budget did announce the largest discretionary fiscal loosening since the founding of the OBR, dominated by the NHS funding settlement. However, many decisions await the

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2 Compared to pre-2010 plans

3 Approximation, according to the FCA’s July 2017 Feedback Statement
Budget 2018 marked a turning point in the public finances and so the Chancellor set out a new path for public spending that implies 1.2% average annual growth of day-to-day departmental spending from 2019–20 to 2023–24. This compares to average cuts of 3.0% per year from 2010–15 and planned cuts of 1.3% per year from 2015–20.

At the Budget—and again at the Spring Statement—the Chancellor confirmed that once the risk of a “no deal” exit from the EU is removed, he will be able to reduce the minimum level of fiscal headroom that he is keeping and make some real choices on how to share this between increased spending on public services, capital investment in Britain’s future prosperity and keeping taxes low—while keeping debt falling.

The conclusion of the Spending Review is the point at which the government will set departmental budgets for future years. The government has already made clear that the NHS is our number one funding priority, through the five-year settlement announced last year. Day-to-day departmental spending outside the NHS is also set to rise in line with inflation. But all Spending Reviews are about prioritisation and efficiency, and it would be odd to define ending austerity as meaning that every department sees an annual real terms increase in its budget. That was not the case before 2010. For example, at the 2007 Spending Review, overall departmental spending was growing but many departments—including Work and Pensions, Business and Justice were allocated annual average real terms budget reductions of -5.6%, -2.6% and -1.7% respectively. Similarly, Spending Reviews in 2004 and 1998 included planned real terms cuts for some departments.

The government will use the Spending Review later this year to look at how we invest in our economy, so that we continue to fund public priorities. As set out at Budget 2018, this means a renewed emphasis on delivering high-quality outcomes—the focus should be what we achieve for public money, not just how much we spend.

While the government will continue to drive efficiencies to deliver more for every pound of taxpayers’ money, ending austerity isn’t solely about higher public spending—it’s also about delivering wage growth and leaving more in people’s pockets. Over 3 million more people are in work since 2010, and regular wages are growing at their fastest pace in over a decade. On 1 April 2019 the government will increase the National Living Wage by 4.9% to £8.21, which is projected to benefit over 1.7 million people, and with the Budget 2018 announcement to increase both the Personal Allowance and the Higher Rate Threshold, this government has delivered on our manifesto commitments early and provided tax cuts for 32 million people since 2015/16.

8. The Chancellor’s record to date has been to loosen fiscal policy when the public borrowing forecast falls, but not to tighten policy when it rises. If continued in the long run, this approach would lead to a ratcheting up of debt levels. (Paragraph 49)

9. The Chancellor was fortunate at this Budget, in that the OBR’s reassessment of the structural level of the tax revenue to GDP ratio enabled him to fund increased spending plans and some tax cuts without an increase in the borrowing forecast. However, the UK faces risks to its growth outlook, including Brexit and the recent slowdown in the Eurozone,
that could lead to less favourable revisions to its growth outlook. More difficult choices will likely lie ahead at future Budgets about the UK tax base, and how to fund the Chancellor’s pledge to “end austerity”. (Paragraph 50)

Since 2010 the government has made considerable progress in restoring the public finances to health and Budget 2018 showed that we have now reached a turning point. Borrowing has been reduced by four-fifths since its post-war high and debt has begun its first sustained fall in a generation.

It is not the case that the government has been fortunate. The OBR’s reassessment is because of the government’s careful management of the economy and the hard work of the British people. Continued strong employment and improved earnings performance can be seen in the strength in receipts across major taxes. The government takes a balanced approach to the public finances, reducing debt while supporting our vital public services, investing in the economy and keeping taxes low. In line with this approach, increases in funding for our public services were made alongside continued progress towards our fiscal objective, with debt and borrowing lower in every year of the forecast compared to Spring Statement 2018.

Spring Statement 2019 showed that the public finances have continued to improve since the Autumn. Borrowing and debt are lower in every year of the Spring Statement 2019 forecast compared to Budget 2018.

The government will continue with its balanced approach, repairing the public finances in a way that is fair to the British people and responding to the needs of the economy.

**The fiscal rules**

10. *At this Budget, the Chancellor could have met the fiscal objective to reach a balanced budget without further fiscal tightening, but instead he chose a fiscal loosening. Furthermore, the Chancellor told the Committee that securing economic growth was a better way of reducing the public debt-to-GDP ratio than running a budget surplus. Given that the Chancellor both appears to be disregarding the fiscal objective and has told the Committee it is not the best way of reducing the public debt, it is now clear that the fiscal objective now has no credibility, so it cannot be used by Parliament to hold the Government to account. The Committee recommends that it be replaced before the next Budget with something that accurately reflects Government policy and priorities, which clearly do not include running a budget surplus.* (Paragraph 58)

The Charter for Budget Responsibility, approved by Parliament in January 2017, sets out the government’s fiscal rules. The government’s objective for fiscal policy is to return the public finances to balance by the middle of the next decade. The forecast currently stretches to 2023–24 where public sector net borrowing has fallen to 0.5% of GDP, the lowest level since 2001–02, showing that, subject to the choices the government makes, we are in touching distance of meeting this objective by the middle of the next decade.

The government has two interim targets to reduce the cyclically-adjusted deficit to below 2% of GDP by 2020–21 (the fiscal mandate), and to get debt as a share of GDP falling in 2020–21 (the supplementary debt target). At Spring Statement 2019, the OBR confirmed that we have met both our interim targets early.
As the Chancellor remarked, the government is committed to investing in the economy and improving our productivity. This will support reducing debt as a proportion of GDP, but it is not inconsistent with targets to reduce borrowing and to get debt falling through careful management of the public finances and continued fiscal responsibility.

The government remains committed to meeting its fiscal rules and reducing debt in order to enhance the UK’s economic resilience, improve fiscal sustainability, and lessen the debt interest burden on the next generation.

11. The Chancellor is maintaining a £15 billion margin against the fiscal mandate in his official spending plans, but he is suggesting that all or part of it will be spent both in orderly and disorderly Brexit scenarios. This means that there is an inconsistency between the spending totals he has submitted to the OBR and those he has described to Parliament. (Paragraph 63)

At Budget 2018, the Chancellor set out that when a deal is reached, there could be a ‘deal dividend’ from an improvement in public finances and releasing some of the fiscal headroom that he is holding in reserve. There is no inconsistency in Chancellor’s expressed desire to release headroom and the spending totals. In line with the government’s balanced approach, the Chancellor has stated that the headroom could be shared between reducing debt, supporting public services, investing in the country’s future and keeping taxes low.

Budget 2018 set out a path for day-to-day departmental spending in years beyond 2019–20. These aggregates at Budget 2018 are indicative but represent the Chancellor’s plans for spending at the time of the Budget. As with any policy choice, the Chancellor reserves the right to change these plans should circumstances change—for example at the Spending Review, when detailed allocations for each department will be set.

**Tax measures**

12. There is evidence in some of the new tax measures that the Government has responded positively to issues raised in consultation. However, there are also indications that the consultation process could be used more consistently. A good consultation process, with effective participation from stakeholders including those likely to be directly affected by proposals under consideration, will help new measures meet the Committee’s guiding principles for tax policy. (Paragraph 72)

The government is committed to the tax consultation process, as set out in 2010 and reaffirmed in 2017’s ‘The new Budget timetable and the tax policy-making process’. In 2018, government published 29 tax consultations, calls for evidence or discussion papers. At Legislation Day on 6 July 2018, the government published more than 200 pages of draft legislation for the Finance Bill introduced in November 2018. As the TSC report noted, this consultation is often to the betterment of tax policy.

The Committee’s report argued that the consultation process could be used more consistently. The government is always trying to improve its approach to consultation. However, the government does not believe the best approach to consultation is ‘one-size-fits all’; it is not always appropriate nor necessary to consult, and the nature of the consultation should be tailored to the specific circumstances. As the government said in ‘The new Budget timetable and the tax policy-making process’, “the government
will generally not consult on straightforward rates, allowances and threshold changes. Other minor and technical changes may also not need or merit consultation. In these circumstances, policies may be announced at the Budget to take effect four months later.”

13. Government is consulting on its proposals for a Digital Services Tax while at the same time taking part in international efforts to reform the corporate tax system. It is to be hoped that a global agreement on a fair and sustainable way to tax digital businesses will be reached soon. But, until or unless that happens, it is important that the design of the Digital Services Tax takes account of responses to the consultation and ensures that there is a level playing field between digital and physical businesses. (Paragraph 73)

The international corporate tax system needs to evolve to address the challenges posed by digitisation. Current rules do not properly recognise the value which certain types of digital businesses derive from user participation. It remains the government’s ultimate goal to secure global agreement on appropriate, comprehensive and sustainable, changes to these rules. The government has led this work at the OECD and the G20, and continues to support this process. Most recently, the OECD has published a public consultation document, to which the government has provided input.

The government is supportive of OECD efforts to secure global agreement by 2020. However, there are significant differences between the views of several countries and, while compromise is achievable, agreement may take some time. Pending global reform, the Digital Services Tax is a narrowly-targeted and proportionate interim measure to ensure digital businesses pay UK tax reflecting the value they derive from UK users, and that all types of businesses make a fair contribution to the public finances.

The government recognises the importance of consulting on major changes to the tax system. That is why the government has held an extensive period of consultation on the Digital Services Tax and will aim to ensure the administrative requirements it places on businesses are proportionate. The government will be reflecting on responses to the consultation ahead of drafting legislation.

**Equalities impact assessment**

14. There is some improvement in the provision of equalities and gender impact assessments in this Budget, but they fall well short of the “robust [...] assessments of future Budgets, including the individual tax and welfare measures contained within them” that the Committee recommended at the last Budget. At the next Budget, there should be quantitative analysis of the equalities impact of individual tax and welfare measures in all cases where data are available. (Paragraph 78)

The Treasury’s distributional analysis publication continues to provide an unprecedented level of transparency, and the government remains committed to continuing this publication at future Budgets.

As previously set out to the Committee, the breakdowns of the impact of individual fiscal measures are unlikely to be reliable. First, many of the measures in this analysis are underpinned by small sample sizes, and therefore the distributional impact of a specific measure is often much more uncertain than the cumulative effect of measures. Second, measures often interact with each other. These interactions mean that the analysis of
individual measures becomes sensitive to ordering effects as the distributional impact of one measure is often contingent on whether it is considered before or after the measure it interacts with, and the ordering of measures is entirely arbitrary. For this reason, a cumulative assessment gives the best representation of the intended overall policy effect.

The Treasury continues to look closely at the methodological issues around quantitative distributional analysis by protected characteristic, in addition to improving its processes to take equalities impacts into account in advance of the Spending Review. For legislation owned by the Treasury, including major income tax measures announced at Budget 2018, it already uses appropriate quantitative data in its published summary analysis of equality impacts, as provided in the Tax Information and Impact Notes (TIINs).