



Treasury Committee

Oral evidence: Budget 2014, HC 1189

Thursday 3 April 2014

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

Questions 359-442

Witness[es]: **Rt Hon George Osborne MP**, Chancellor of the Exchequer, **Sir Nicholas Macpherson KCB**, Permanent Secretary, HM Treasury, and **James Bowler**, Director, Strategy, Planning and Budget, HM Treasury, gave evidence

Q359 Chair: Thank you very much for coming to give evidence this morning, Chancellor. We have a great deal to get through, not least because you have been very active recently on a good number of fronts. One of the documents that you publish at our request with every Budget is a document called the distributional analysis with details of the impact on individual households. We would like to thank you for producing what is an outstanding document. It is quite new that Government should produce it. In fact there has been Treasury resistance to producing such a document for the whole time that I have known anything about this subject. Would you confirm that you are intending to stick with it and that you are intending to stick with the same type of analysis, with the same tools, so that we can get a good time series for the evidence you are producing?

Mr Osborne: First of all, Mr Tyrie, thank you, and I should introduce my colleagues, Sir Nicholas Macpherson, the Permanent Secretary to the Treasury, and James Bowler, the Director for the Budget. The short answer to your question is yes. There are methodological improvements that are made sometimes, often through interaction with the IFS or other external groups that take an interest in this, but these are always very clearly flagged up and I do not think anyone has accused us of using those changes to—

Chair: Not this year, but we just need to keep an eye on it.

Mr Osborne: Indeed. I want a continuous data series. By the way, what it confirms is what other bodies like the IFS confirm, which is that although of course this fiscal consolidation has been difficult for the country, the most well off in the country have borne the greatest proportion of it in terms of their income, and in cash terms too.

Q360 Chair: The Budget presentation seems to have gone pretty well this year, to put it mildly. There were a very good first few days after it, perhaps the best of any of your Budgets. Do you think that had something to do with the fact you did not leak it?

Mr Osborne: As I have explained to you, I think, on previous occasions, I try very hard to make sure that the contents of the Budget do not leak. It is clearly not in my interest for them to do so. I have given commitments to this Committee and to the Speaker of the House of Commons about changes to tax rates and thresholds. Sir Nicholas Macpherson conducted an inquiry into the leaking of the Budget last year.

Q361 Chair: Is it the unofficial view that previous leaks are things that we should finger the Liberal Party for?

Mr Osborne: No. Last year was an error by a newspaper, for which they apologised, and we ended the pre-release of Budget information to newspapers and broadcasters. This was the first Budget under this Government and the previous Government where that had not happened. As I have explained to you before, although this is a subtle point to get across, in the past Chancellors of the Exchequer had the Treasury working with them and then they had to square the Prime Minister and that is how the Budget was put together. I am Chancellor of the Exchequer in a Coalition Government. That inevitably means there are more people involved, more officers involved.

Q362 Chair: This is where the Liberal Party comes into the frame, isn't it?

Mr Osborne: There are just more people involved and more people know about the Budget in advance than would have been the case for any of my predecessors. I think what is refreshing about this year is that everyone could see across Government, on both the political side and the official side, that Budget secrecy should be maintained, that we have made a commitment to Parliament about that and that it was to everyone's advantage that that was the case. I think it is also worth noting that the set of announcements on pensions, which I am sure you will ask me about, were highly commercially sensitive.

Q363 Chair: Did you wave the big stick, Sir Nicholas? Did you tell them that this was highly market sensitive, these leaky politicians who keep on slipping things out despite your best efforts?

Sir Nicholas Macpherson: Interestingly, I don't recall any conversation on those lines. There was an agreement last year about the way we were going to approach the Budget, especially about not pre-briefing the main elements of it, and everybody was extraordinarily well disciplined, which was really important in the context of the pension proposals that, as you know, were very market sensitive.

Q364 Chair: While we are on the subject of market sensitive pre-briefing and leaking, can I ask you one question about the exchanges that have been taking place with respect to the FCA's apparent pre-briefing of the *Telegraph* of their business plan? Are you agreed, Chancellor, with this Committee that we need a wholly independent inquiry that is as independent of you as it is independent of the FCA, and that might even include the need for that independence of the non-executives of the FCA?

Mr Osborne: The short answer is yes. As I set out in the letter to the Chairman of the FCA that I published, I was profoundly concerned by the way very sensitive information had been pre-briefed to one newspaper. It turned out it was also inaccurate information. That clearly had a big impact on financial markets. The integrity and reputation of our financial markets is very important, not just for Britain as a country but also because there are many millions of people who depend on that integrity and reputation for their pension products and other savings and financial products.

Q365 Chair: You have to stand by standards that are at least as high as those they set for the industry.

Mr Osborne: Indeed. We rightly demand very high standards for the treatment of confidential information of participants in that market. We should expect the same standards of our regulator. I think the Chairman of the regulator and Martin Wheatley understand that, judging from the Chairman's reply to my letter. Let me reassure you, and it is set out in my letter, that there will be an independent report by a wholly independent third party. This report will be received by the independent non-executive directors of the FCA.

Q366 Chair: I only raise this because the third paragraph of your letter of 1 April said, "I expect you and the independent directors to consult further with my officials on the arrangements" and then the last sentence of that paragraph said, "I would like to discuss the emerging conclusions of the work with you". We would like clarification that that does not mean that there will be any intervention or involvement of the Treasury in any way that could compromise the independence of the work of the reviewer.

Mr Osborne: You have my assurance that will be the case. What this sentence means is that of course there will be an independent report, reporting to the independent members of the FCA. That I imagine—I don't want to prejudge it—will make a number of recommendations. I think those are recommendations that we would want to discuss with the FCA before they are put into practice because obviously the Treasury, and indeed Parliament, has an interest in the good conduct of financial markets.

Q367 Chair: We are going to get into more detail in a moment, but just one further procedural thing. Why have you crammed in the scheduling of the Committee of the whole House next week? What is the rush? Why can't this be done a few weeks later so that Parliament,

including this Committee, has more time to take evidence and think about the considerable changes that you have announced?

Mr Osborne: I was acting on a recommendation of this Committee, but maybe I misunderstood it. Last year you complained that there was only one day's gap and here I therefore created a week's gap. I am very happy to listen to your suggestion that it should be longer than that in future.

Chair: Thank you. That is all you need to say there, Chancellor. I am going to move on.

Mr Osborne: The key word being "listen".

Chair: We are listening as well, you know.

Q368 Jesse Norman: Chancellor, can I start by saying on behalf of my constituents how thrilled I am about the effect of the Budget on Herefordshire. Cider and beer duty, good for the hops industry; pensions, good for older people; all very welcome. One aspect that is extremely welcome that I think will have had more attention almost than any other is the money you are putting into fixing potholes, which are an enormous unbudgeted capital cost for many people who have their axles taken out. Before we get into the full business, can I ask if there might be scope for you to look at incentivising local capital raising for B and C roads for potholes? We are quite good at dealing with the Highways Agency and it would be nice to find a way of invigorating local communities to start taking control of their own roads and fixing them. Is that something that the Treasury might be prepared to look at supporting, given the enormous capital costs that—

Mr Osborne: I am very happy to consider that as long as the local authorities do not run up huge debts that ultimately fall back on the national Government.

Jesse Norman: They will be at the moment, as you can imagine.

Mr Osborne: We have given local authorities much greater responsibilities for their local finances. We have removed lots of ring fences. We have made sure that they can keep parts of their business rates receipts and council tax receipts. This is all about making sure that local communities are in charge of their locality and are held accountable by the local public for that.

Q369 Jesse Norman: What I am suggesting might be a way of avoiding future costs for the Treasury, so I offer it in that spirit.

Can I turn more directly to some of the Budget items you have raised? I am moving around slightly because of the wide spectrum of issues that you have covered. One that comes immediately to mind is the issue of the 55% flat rate on DC pension withdrawals on death. Obviously there is a perverse incentive here because the inheritance tax encourages people to push money out of pensions and into non-pension savings. I think you said that you are planning to look at that. Could you tell us more about whether or not you recognise the perversity and might be minded to look at that?

Mr Osborne: We do. In the pensions document that we published alongside the other Budget publications we specifically flagged up the issue of this 55% rate. We said it was likely to be too high, that it was designed for a different regime where they were encouraging people to have exhausted their pension savings by the end of their life. As I say, we have a new regime. We are going to consult on that 55% rate but I would anticipate it being lower.

Jesse Norman: Being reduced?

Mr Osborne: Yes.

Q370 Jesse Norman: That is extremely helpful. Some columnists have suggested that the OBR has been a little over-confident in the way it is forecasting a rise in investment over the next few years. Could you talk about the kinds of things that you think the Government ought to be doing if this investment does not grow in the way that perhaps you are anticipating? Obviously that is a central part of the process of rebalancing the economy that I know the Government is committed to.

Mr Osborne: It is fair to say that investment has disappointed compared with previous forecasts, except recently. Over the last four quarters business investment grew by 8.5% and the OBR are forecasting something similar for this year and next year. The measures in the Budget were designed to encourage further private sector investment, most notably the doubling of the annual investment allowance. Then if you look at the response from the various business groups, John Cridland, Director General of the CBI, said, “The Budget will put wind in the sails of business investment”, and that was representative of the other business groups. I guess a central part of the Budget narrative was to say things are improving in the British economy, the deficit is coming down, jobs are being created, GDP is growing, but there are some historic weaknesses in the UK economy that we can’t ignore—investment, exports, manufacturing and the like. The Budget sought to address those things and business investment was squarely in that category.

The annual investment allowance is the principal measure but measures to cut the cost of manufacturing is another important package and smaller changes too, for example making the seed enterprise investment scheme permanent, are all part of the package designed to encourage business investment. It sits alongside capital investment, which we have sought to protect and made difficult decisions on current spending to do that. The investment you see in transport, roads and railways and the like are evidence of what I think public sector investment can do alongside private sector investment.

Q371 Jesse Norman: It is interesting you said the CBI, because the CBI has also suggested that this issue of low investment is really a structural problem rather than a cyclical one. Have you and the Treasury looked at whether or not the annual investment allowance rise, which is enormously welcome, might be made a permanent feature rather than just a temporary one?

Mr Osborne: I agree with you that there is a structural issue for the UK here and there are a whole range of things that we can do to try to improve that, such as reforms in the

financial system, to the way things are financed—we might come on to discuss this later—by trying to get pension funds invested in infrastructure, trying to make sure we have a predictable regime for energy investment, our levy control framework for renewable energy and the like. All of these things help to address that structural problem, but I am the first to say I don't think we have all the answers today.

The annual investment allowance was given a temporary boost—and I have boosted it still further and extended it—in order to try to kick start investment at the beginning of the recovery. The question whether it would be made permanent really is for a future Budget. It is an expensive thing to do, so it would have to be weighed against other priorities.

Q372 Jesse Norman: But it is something that you might consider giving some forward guidance on as part of a process of rebalancing towards a capital investment driven economy rather than one quite so reliant on services?

Mr Osborne: Of course services also make important investments. It is a useful tool particularly for small and medium-sized businesses and that is where I wanted to put my firepower, if you like. There are other things we are doing, like the reduction earlier this week of the corporation tax rate from 23% to 21%, which I think send a broader message about the UK's attractiveness as a business location and a place for investment. I hope over time that we start to get all-party support for that reduction in corporation tax, which sadly we don't have at the moment.

Q373 Andrea Leadsom: Good morning, Chancellor. First off, although not really relevant to the Budget, there is the excellent news of the appointment of an extremely capable woman, Dr Shafik, to the MPC. Would you like to put on record some words of encouragement, shall we say, to the Bank of England to do more to create role models for women who are contributing enormously to the value of our economy and really need to see that women can get to the top?

Mr Osborne: Dr Shafik, or Minouche as everyone calls her, is an excellent addition to the top team at the Bank, sitting alongside some other excellent additions like Ben Broadbent the new Deputy Governor for the macro-economy. There is an interesting challenge that the Treasury has been engaged in over a period of time, which is how to make sure that more women come forward in the economics profession and that they are encouraged to apply for these sorts of jobs when they come about. I don't know whether Sir Nicholas wants to say anything about it, but it is something that we have engaged with a number of leading female economists on. I think our effort has been directed at what we can do with the economics profession to make sure that we have very talented women able to do these very important jobs, and in the case of Minouche we have that.

Q374 Andrea Leadsom: Great. Thank you. On a completely different subject, in your Red Book you announced that you were bringing forward the creation of the payments regulator and hence a review of all fair access to payments in the interests of creating more competition in the

banking world. It is something that this Committee, as you know, has prioritised over the years. Can you comment on why you have brought forward the creation of the payments regulator? Very importantly, what will you be pressing the FCA to do to ensure, given that they are going to establish this payments regulator as an independent body, they prioritise that and in addition look carefully at the prospects for full account number portability? As you know, we believe that could be quite a game changer for the competitive sphere for banking.

Mr Osborne: It is up to them to determine their priorities. What I hope they look at, and one of the principal reasons for creating the payments regulator, is to make it easier for new entrants into the banking system to be able to have full access to the payment system but also to be able to innovate with the payment system and offer new products and better services. What happens at the moment, as you well know, is that a new entrant has to piggyback on to the system of a large competitor who, even if they don't consciously want to squash their new competitor, maybe subconsciously does, and also will often prevent a new competitor from offering a better service, more round the clock access to your account or faster access to your account or faster payments. So, it is a barrier to entry. It is something that was raised with us by all the new entrants. It is something that was recommended a decade ago to the previous Government but never implemented and so it is something that is long overdue.

On account portability, where you have been the prominent champion of this in Parliament, we are now conducting a full investigation of the merits of that, or the FCA and the payments regulator are. I think we will see whether it delivers all the benefits it has the potential to deliver. It obviously would be a big change. The banks, as you well know, claim it is very expensive, so here we are going to have a chance to assess the benefits. We already have the switching service that came in last year and is already proving pretty effective and has confounded some of the critics.

Q375 Andrea Leadsom: Thank you. Changing subject again and moving to trade, it is the one area of the British economy that has been extraordinarily disappointing in that our exports have not picked up as we would have liked, bearing in mind how sterling depreciated quite significantly. Do you think that that is simply a function of the eurozone's failure to pick up? What do you put it down to and what more can you do? I think the export finance guarantees increase in the Budget is good news, but is there more that the Government should be doing to try to encourage trade with overseas organisations?

Mr Osborne: Britain's export performance has been disappointing. I think you can find short-term reasons for that, the weakness of our European markets being the most obvious and we have been very badly hit by that. The more encouraging news is that non-EU exports are up almost a quarter since 2010, exports to China are up two-thirds. Clearly it is working in the sense of trying to connect ourselves to non-European markets but, frankly, I think that the UK found itself in a situation where it was overly dependent on mature markets, the European Union, the European markets, the United States. We were not connected into China, India, Brazil and the new growing markets of the world. I think that

was a huge strategic error by Britain over the last 15 years, not an error made by other European countries, most notably Germany but also countries such as Sweden.

Of course, ultimately you have to have competitive British companies making products that people want to buy but you can certainly give them a lot more help. The transformation of UKTI, the money we have put into overseas chambers of commerce, now the much more competitive export finance we are offering are all part of the picture. I had a very encouraging conversation in Singapore on my way back from the G20 meeting with the British Chamber of Commerce there. What they said to me bluntly was, “Our support has been transformed in the last two or three years and we are now better than many other European chambers here, having been the worst, in terms of the support we are able to offer. We are not as good as the German chamber, which still has a huge amount of support, but we are ambitious about that”. That is what I want to do. I explicitly said in the Budget that I wanted to have the most competitive export offer of any country in Europe, knowing full well that is a very high bar to set ourselves.

Q376 Andrea Leadsom: In my constituency we have the Motorsport Valley, lots of high tech and high performance engineering products of all sorts. I have a business breakfast club who tell me that when they go to trade fairs overseas the Germans have a mobile palace to showcase all of their products and Britain has a tent sort of thing as the equivalent. There is still that need for us to be doing more for British businesses who are wanting to export more outside the eurozone. As you say, there is evidence that we are doing more but perhaps there is more still. As the eurozone recovers and as they consolidate their banking union and so on, do you think that that will turn around or are you still scratching around to understand fully why we are not recovering our export markets?

Mr Osborne: The European markets were flat on their back and they are now recovering. You can see exports to Europe starting to pick up again. I think the determined trade promotion effort is working in the emerging markets. The depreciation point you made in your previous question is a good one. If the UK just banked on the fact that a depreciation in sterling would automatically improve its export performance, as I think people were banking on three or four years ago, that has proved not to be the case. I think that tells us something about modern supply chains. We manufacture cars but too much of the content of the car is imported and we need to build up our domestic supply chain. So the depreciation has not had as big an impact as people expected, even in the adverse global economic conditions.

All I can say is that we need to do much more. As I say, the money into the UKTI, the competitive finance offer, relatively small changes but important for their symbolism too, for example air passenger duty, say something about the UK’s ambition in the world and its determination that it is going to go out there and have “made in Britain” seen around the world. Ultimately, Britain’s economic future cannot be borrowing money from the Chinese to buy the things that the Chinese make for us. That is not a sustainable economic future. We started to head down that path in the last decade but it was a mistake.

Q377 Chair: When the Committee were out there we were told there were more people there from the UK Government telling the Chinese how to change their climate change policies than there were working on investment and export promotion. Are we going to bring some balance to that?

Mr Osborne: I know on climate change we have slightly different positions, Mr Tyrie.

Chair: Not much, I think, these days.

Mr Osborne: But I can tell you that I do think it is important that our British embassies and high commissions are there to promote British business. I think William Hague has done a great job in changing the attitudes of the Foreign Office and the diplomatic service, and you just feel that when you go into embassies around the world. They are all about trade promotion and as a result, to answer your question, there are many more people doing that than was the case a few years ago.

Q378 Mr Love: Good morning, Chancellor. Are you concerned that the independent Office for Budget Responsibility is forecasting that the savings ratio is falling and will continue to fall through the forecast period to 2018-19?

Mr Osborne: I flagged this up in the Budget speech itself. I said in the Budget speech that the savings ratio was set to fall from 5.4% to 3.3% by 2017. To put this in context, it was not 3.3% on the eve of the financial crisis, it was 0.2%, so it has been much lower in our recent history. What I want to do is incentivise saving and that was what a central part of the Budget was all about. I don't think you are going to change this overnight, and I said that, but you have to embark on the journey and I think the Budget did embark on the journey.

Q379 Mr Love: But as you mentioned, the savings ratio has already fallen from 7.2% to 4.9% currently and it is going to fall again to 3.2%, which is well below its long-run average. Surely that, if not ringing alarm bells, must make you concerned about the rebalancing of the economy.

Mr Osborne: When you say it is below its long-run average, it is certainly below the average in decades other than the last decade in the run-up to the financial crisis.

Q380 Mr Love: We would not want to repeat the experience of 2005 to 2008, so isn't that a call for action?

Mr Osborne: I agree with you, we certainly do not want to repeat the experience of 2005 to 2008, and that is my central economic message. I agree with you that we, as an economy, need to save more. The measures I set out are all designed to try to incentivise saving and reward savers but this is a challenge, not just for the United Kingdom, of course. There are other Western countries that have this challenge. It is going to be a long-term response. It can't happen overnight.

Q381 Mr Love: What do you say to those who would criticise the Budget as wanting to get people to save more but actually needing consumption? This is a recovery that is fuelled by consumption. In the context where real wages are not increasing, you have a choice. You can either consume or you can save. You want people to save but you need them to consume.

Mr Osborne: I think the important thing—and this comes back to debates we had round this Committee a couple of years ago—is that Britain addresses its fundamental weaknesses, its deep-seated problems. The debate then was, have a plan B, borrow more, spend more in order to get the economy going. I am not being asked that today, but equally I disagree with those who are saying to forget about the savers, just go for consumption. I think you have to address the weaknesses and one of those weaknesses is that Britain does not save enough as an economy. What you see in the recovery at the moment is, of course, a pick-up in consumption from a very low level because of the deep recession. You also see more encouraging signs on investment and, while having disappointed, exports are starting to pick up as well, so it is more broadly based than consumption. I thought the Governor the Bank of England put it quite well recently when he said that all recoveries start with consumption. What you want to have now is a handover to investment, and the Budget is absolutely aimed squarely at trying to achieve that.

Q382 Mr Love: Some people think that the forecasts of the OBR for business investment are heroic, to put it mildly. They will end up with the largest level of business investment on record. What I want to come back on is you proclaimed this Budget as a Budget for savers, yet many commentators have said it is exactly the opposite, that it encourages dissaving. How do you respond to that?

Mr Osborne: First of all on the OBR forecasts, business investment did grow by 8.5% over the last four quarters and they are forecasting 8% this year, so I am not sure that is so far off the recent data. I am not sure who exactly you are talking about with the various commentators, because—

Mr Love: Martin Wolf in the *Financial Times* said it was aimed at encouraging dissaving.

Mr Osborne: Martin Wolf and I have not really seen eye to eye on economic policy for about four years, but Saga said, “Saga welcomes today’s Budget that encourages saving”; Which?, “The Budget brings a welcome shakeup for struggling savers”; Ros Altmann, who quite often has been a critic of the Government, “The Chancellor has delivered a Budget for savers”. Those in the industry and the consumer groups have welcomed these measures. Of course, we now need to get on and implement them.

Q383 Mr Love: The Office for Budget Responsibility that you set up, that is independent, has said, their quote, “The measures contained within the Budget will have no impact on the savings ratio”. How do you respond to that?

Mr Osborne: We have often had this discussion. I think the OBR are right to take the cautious approach. That is because they are the cautious, independent forecasting body and they want to see the proof in the pudding. They want to see that what I announce on Budget day becomes the law of the land and is implemented. I am encouraged by the response from the consumer groups and the industry. I have spoken to a number of people over the last couple of weeks and from what I can see there is a lot of excitement now about developing new savings products, making sure that pension saving is even more attractive. I have been encouraged by that response but, as I said right from the start, this is not a quick fix job. You are turning around a super-tanker, to use the analogy.

Q384 Mr Love: "One of the consequences of the continuing obsession with consumption will be that household debt will rise to pre-crisis levels." That is again a quote from the Office for Budget Responsibility. Aren't you concerned that households are building up the level of debt and how do they get out of that?

Mr Osborne: Household debt as a proportion of income has fallen from 170% to 138%, so there has been a quite meaningful fall in that, and unsecured borrowing as a proportion of income is at historic lows. I think it is important to note those facts. The crucial point here is that we have in the Bank of England now, through the Financial Policy Committee, a body that has that macroprudential responsibility to assess levels of debt, not just in the banking system but in the broader economy, and has macroprudential tools that it can use if it feels it needs to. For example, when it comes to housing, which you might want to come on to, last autumn they exercised some of those tools around mortgage standards, so we do have this toolkit available. We do now have a body monitoring overall levels of debt because, to come back to your earlier point, I completely agree with you that we don't want to repeat the experience of 2005 onwards.

Q385 Mr Love: Commentators say that the Financial Policy Committee is primarily concerned with prudence and good banking and making sure that if there is a problem, the banking system is stable and can deal with it. They are not primarily concerned about the level of household debt. That is what worries outside observers. While I accept that household debt has gone down, it is likely, according to the forecasts of the OBR, to go back up again and to get us into the problems that we have been trying to solve. Aren't you concerned about that?

Mr Osborne: The Financial Policy Committee of course is concerned about the soundness of the banking system—that is another mistake we don't want to repeat—but they also are concerned about overall levels of indebtedness and they are vigilant about house prices. They make this clear in their communications. From what I have read of the transcripts, they also make this clear when they come and talk to you. So they do have these tools, they do have this remit. I am not saying that absolves the Government of any responsibility as well but we do have a powerful new watchdog.

Q386 Mark Garnier: Good morning, Chancellor. If I may continue on household debt as a proportion of household income, you are

absolutely right to highlight the fact that since 2007 household debt has fallen from 170% to around 140%, but were you not struck by the huge increase in household debt between 1997 and 2007, which went up from 100% to 170% or, more importantly, brought £1 trillion worth of extra household debt into the system? Do you have any concerns that the new paradigm of the way our economy works is that in order for us to get sustainable economic growth, households have to be increasing their leveraging in order to be able to achieve that?

Mr Osborne: Household assets are currently rising faster than household debt. Before Christmas the Governor the Bank pointed out that the consumption that you were starting to see in the economy, coming back to the previous line of questioning, was not debt-fuelled consumption. But we have to stay vigilant, absolutely, and of course the key issue here for individuals and the economy is the sustainability of debt and the improvements to things like mortgage standards are incredibly important in this respect. Later this month there are going to be very important changes to mortgage standards—something we have been working on for a number of years with the regulator—and this will make sure that some of the bad practices of the past, like self-certified mortgages, are things of the past and that there are proper assessments, not just of people's incomes but also people's ability to pay future bills if, for example, interest rates were to rise.

Those are all now part of the tests that are being implemented in the mortgage market and I think it is a good example of how for quite a lot of this stuff there is not necessarily a big macro tool you need to use. There are micro tools and, if you look in this country, mortgage standards was one of the things that broke down in the middle part of the last decade.

Q387 Mark Garnier: You raise the issue of interest rates and you were talking with Mr Love about the influence of the Financial Policy Committee, but obviously interest rates are determined by the Monetary Policy Committee. This is a subject I have been banging on about for a number of years. One of the interesting changes in the dialogue between these sort of conversations with the Bank of England court members and MPC members maybe three or four years ago and now is that three or four years ago it was very much the case that, when asked about rising interest rates, the response was either, "We don't have to worry about that for a few years because it is not going to happen" or, more glibly, "As interest rates rise, it is usually an indicator that the economy has picked up and therefore it is no problem at all". One thing that is noticeable is the change in tone from the current Governor, Mark Carney, in terms of he appears to be having much more concern about the effect that rising interest rates will have on these very highly leveraged households.

Do you gain comfort from that? Clearly rising interest rates could put a huge amount of stress on a number of households who may have less resilience, and estimates are that a two percentage point increase in interest rates could put something like 28% of the value of mortgage debt under a certain amount of stress. Increasing interest rates is going to be an incredibly difficult line to take. My question is, in your conversations privately with the

Governor of the Bank of England, are you comfortable and do you take comfort in the fact that he is acutely aware of the potential pressure on households and that he is handling it in a way that you would be sympathetic with?

Mr Osborne: He and his committee, the Monetary Policy Committee, are completely independent. They need to make judgments about the correct level of interest rates and in doing that, as is clear from their published minutes, take into account a wide variety of factors, including the impact of interest rates on people in the economy. That is their independent judgment and they must be left to make that independent judgment. The question then is do mortgage standards, when people take out a mortgage, take into account the fact that interest rates can go up and down? There were changes made before Christmas to some of those standards. There are important changes coming this month as well as part of the mortgage market review. It is one of the tools that the Financial Policy Committee have to deal with some of the issues that you are asking about and Mr Love was asking about. That is part of the macroprudential toolkit.

The reason we brought all of these things together into the Bank of England is so that there is a single entity that is making these judgments and trade-offs and there is a single person in the form of the Governor sitting above it. As the previous incarnation of this Committee under John McFall reminded us, the tripartite system fell apart in 2007.

Q388 John Mann: I had a little bet, Chancellor, that you will duck all the answers to the questions, but we will see whether I win the bet or not. So, eyes down, we are playing for a line, five and nine, two little ducks, page 106, line 24 of the Red Book. How many new immigrants will enter the labour market between now and 2018?

Mr Osborne: The OBR uses the ONS statistic of around 100,000 net but obviously it is the Government's stated policy, and the Prime Minister's ambition and mine and others in the Government, to reduce migration into the tens of thousands.

Q389 John Mann: The answer to my question is—?

Mr Osborne: I have just given it.

John Mann: I will ask another question. How many—

Mr Osborne: Have you lost your bet?

Q390 John Mann: You failed to answer the first three questions, so we will ask another question. How many people who are not currently liable to care home fees will become liable for care home fees because they take their pension early?

Mr Osborne: We have explicitly flagged this up as something we have to deal with in the consultation on the measures I announced in the Budget. The current social care means test does not take into account, obviously because it was devised before the Budget, the changes to the flexibilities around pensions and so we need to change the social care means test to take that into account. I am absolutely clear that we want to make sure that this does not have an impact.

Q391 John Mann: Table D3. Gordon Brown, in his 10 years as Chancellor, grabbed an extra £201.8 billion in tax take. How much in the comparable 10-year period, which would take you to the end of your Red Book projections, are you going to be taking as Chancellor?

Mr Osborne: I am reducing taxes on pensions and savings and, as any good Conservative will understand, sometimes when you reduce taxes on things you get more revenue.

Q392 John Mann: I will ask the question again. You have not answered any of them, but how much more revenue might it be? Gordon Brown, £201.8 billion, but your tax grab increase will be £261.6 billion, an extra £60 billion in the 10-year period above Gordon Brown.

Mr Osborne: I don't think you are looking at chart 1.11 on page 45 that shows the revenue effect of the pensions measures, which show that there is a revenue gain in the first 20 years, as people take money out of their pension and pay at their marginal tax rate. That is what happens when you reduce a penal tax rate that was in place under Gordon Brown's Chancellorship. Then there is a revenue cost to the Exchequer in the 2030s onwards.

Q393 John Mann: You are going to get in the England cricket team, you are ducking that much. Gordon Brown—

Mr Osborne: Another one of your pre-prepared lines.

John Mann: These are pre-prepared figures. They are your figures, Red Book, table D3, page 108. Gordon Brown, £201.8 billion extra tax take; George Osborne £261.6 billion. Of the 34 categories of tax takes, which one goes down as opposed to the 33 that go up?

Mr Osborne: You can tell me which one.

John Mann: Swiss capital tax goes down. Am I correct in saying that, for example, national insurance contributions go up 20% under your Red Book projection?

Mr Osborne: I think you are confusing here tax rates with receipts you get as the economy grows and people get paid more. Tax receipts will increase in cash terms as GDP increases.

Q394 John Mann: So we will do the per capita figure then, including real terms. In real terms, because you have raised it, what is the percentage increase in tax take in your projections under you over that 10-year period, in real terms, as an approximation?

Mr Osborne: We are forecasting a small reduction in tax take as a percentage of GDP over the coming years.

Q395 John Mann: You are now not ducking the question; you are getting it wrong. The increase in tax take under you in real terms, percentage terms, is 26.7%. So you are increasing the tax take in real

terms by 26.7%, in cash terms more than Gordon Brown; 33 out of the 34 categories you are increasing, including national insurance contributions; and you are not prepared to say how many of the new employees coming into the labour market will be immigrants. The public can make its own judgment on that.

Mr Osborne: I should point out that of the jobs, because I see you have been making this point in the hearings, 86% of the increase in employment over the year has been jobs taken by British nationals. That is an almost exact reversal of the situation when you were a Government MP.

Q396 John Mann: In the next six years, the OBR projection is 750,000 net, not new but net, immigrants. I asked you how many new immigrants entering the labour market. These are your figures. You are not prepared to give the answer and the public will have to make a judgment on that. I don't know why you are ducking the answer.

Mr Osborne: I think I have given you answers to all your questions. If you were concerned about the level of taxes you would not vote against tax reductions, as you did when the Budget came for a vote last week, and if you were concerned about the levels of immigration in this country you would not vote against the measures, as you do, to control immigration. We are all accountable for our votes in this Parliament.

Chair: One last quick question and then we must move on, John.

Q397 John Mann: I am concerned about many things in this hearing. Is it or is it not the case that you are going to be increasing the tax take in your 10 years significantly more than Gordon Brown did in the 10 years when he was Chancellor?

Mr Osborne: Tax take as a percentage of GDP is set to fall.

Q398 Mr Ruffley: Chancellor, house prices. There is a lot of talk in the media about a house price bubble. We know in London that nominal prices now are just above their pre-crisis peak. I would like to ask you, as my first question, whether you have any concerns about the rate of house price inflation across the country?

Mr Osborne: I say we have to be vigilant. I think we have to keep a close eye. Clearly house prices have started to rise, but that is why we have created the Financial Policy Committee and there is, of course, quite a regional variation in this. You should at least draw a distinction between some of the phenomena you see in central London, which are caused by international money and the like coming into central London property as a form of investment, and what you see in most of the places represented by the members of this Committee. That is just a fact of our housing market.

Q399 Mr Ruffley: The IFS, impeccable in its independence, like us all want to keep an eye on house prices, but they said after the Budget,

"A more definitive assessment of the sustainability of the UK and London housing markets is clearly needed, one that goes beyond historical comparisons—which we always get obsessed about—and is based on more sophisticated modelling of supply and demand for housing". What work has the Treasury done on a more sophisticated modelling of supply and demand for housing?

Mr Osborne: The Treasury devotes quite a lot of its efforts to looking at what more we can do to support supply in the housing market. That is something where more resource has been committed within the Treasury and the result has been things like the Help to Buy shared equity scheme that is linked to the construction of new homes.

Q400 Mr Ruffley: Forgive me, Chancellor, a more definitive assessment than we currently have available in front of us is what the Institute for Fiscal Studies think we should have. Are you going to respond to that proposal?

Mr Osborne: I am happy to. I will take a good look at what they recommend and get back to you. On the face of it, we want better data and better models, so if we can achieve that we will seek it out.

Q401 Mr Ruffley: In relation to the FPC, would you say they are primarily responsible for stopping house price inflation getting out of control, turning into a bubble? Are they the primary body that we should look to make accountable?

Mr Osborne: I think the Government and Parliament are accountable for housing supply inasmuch as it is affected by things like planning laws and the allocation of money to things like Help to Buy or social housing. The FPC have the tools given to it by Parliament to deal with issues like mortgage standards. I have said before many times my view is that Britain needs more homes and that is obviously a long-term issue. It has been a challenge over the last 20 years at least and you are now beginning to see an encouraging pickup in construction and the construction of new homes, but ultimately I want to live in a country where people who have the aspiration and can afford to buy their own home are able to do so. That means that we have to build homes for them.

Q402 Mr Ruffley: You have asked the FPC to be particularly vigilant against the emergence of potential risks in the housing market. In practice, how is that vigilance manifesting itself at the moment?

Mr Osborne: The FPC publish their minutes and they come and appear before this Committee to take evidence, and it is very clear that they are keeping a very close watch on house prices. Before Christmas they took action on some of the assessments made for taking out a mortgage, so they are clearly looking at this. I think they have been very balanced in the comments they have made on the housing market.

Q403 Mr Ruffley: What would you say are the principal indicators of signs of a housing price bubble? What are the indicators that you and the Treasury look at most frequently when you are being vigilant?

Mr Osborne: I think you would look at headline house prices across the country and, as I say, try to separate out the central London phenomenon from what is going on around the country. On the central London problem, one of the measures in the Budget, for example, was a new tax on properties bought as investment vehicles through corporate envelopes that are not rented out. So you look at overall levels of house prices, the sustainability of household debt and I guess you look at housing starts. Those are all issues you would want to keep your eye on.

Q404 Mr Ruffley: Have the Treasury done any monitoring of the impact of the mortgage guarantee part of Help to Buy on house prices? Is there any evidence that it has pumped them up or has it had a sobering effect?

Mr Osborne: I have not seen any evidence to suggest that. In fact, despite the considerable controversy that surrounded the announcement of the Help to Buy mortgage scheme and the opposition of some parties in Parliament to that scheme, the evidence is that three-quarters of the homes bought through it have been outside London and the south-east, the average house price bought by it has been below the national average and the great proportion of those using the scheme have been first-time buyers. So it has not been the fuel to house prices that the parliamentary critics of the scheme thought it would be.

Q405 Mr Ruffley: The very welcome pension liberalisation was a stunning coup, if I may say, and will have benign effects, I am sure. In respect of the investments that retirees might want to make in the housing market now that they have more freedom to use their pension pots as they decide, has there been any modelling or any work done on the impact of buy-to-let purchases on the housing market as a result of pension liberalisation? There is quite a bit of informed speculation that it might actually pump up the housing market. Has your pension liberalisation been taken into account in the forecasts on house prices to the end of the forecast period 2018-19?

Mr Osborne: The OBR was aware of the policy when they did the house price forecasts and the impact of buy-to-let historically, although you made the point about the future, has been a bit more limited than perhaps the hype would lead you to believe on house prices. But as I say, I don't think that would be a reason to not go ahead with pensions flexibility. In the Financial Policy Committee, we have a body with the tools and the responsibility to address mortgage standards and levels of debt in the economy. That is their responsibility. I think our responsibility is to support people who have worked hard and saved hard through their lives and to trust them to be able to look after their savings.

Q406 Teresa Pearce: Good morning. On Budget day you told Parliament that no one will have to buy an annuity going forward. When did you tell the FCA that?

Mr Osborne: The FCA were aware in advance of what we were planning to do and we had consulted them. I am happy to give you an exact date but it was not like the day before. We had engaged with them in the weeks leading up to the Budget.

Q407 Teresa Pearce: The FCA undertook a thematic review of the dysfunctional annuity market, which was meant to be published last autumn but was actually published on 14 February. They then undertook, and are undertaking, a market review of the annuities market. Were they not surprised that you were pulling the plug on their review and the fact that they were halfway through it?

Mr Osborne: First of all, I would not say I am pulling the plug on the review.

Teresa Pearce: Rowing back on the review.

Mr Osborne: I think it is important to say that annuities would be the right product for many people after these reforms. They are not the right product for everyone. Some people want the certainty that annuities can provide. I hope the changes we have instituted will lead to more competition in the annuities market, potentially more flexible annuity products. I do not think I am telling tales out of school when I say that the leadership of the FCA was supportive of the pension proposals in advance of the Budget when we talked to them about this. Obviously they came and asked me about this one, I think because they wanted to make sure, and I was absolutely agreed with them on this that we get the guidance right for people, so they have an interest in that. They have been supportive of this, but you would have to ask them. I suspect one of the reasons they are supportive is because they do not think the current annuities market is providing great value for money for all those who use it.

Q408 Teresa Pearce: I think it is very clear that the current annuities market does not provide value for money. It provides very poor value for money for a lot of people. Given that the FCA was late in producing this thematic review, the thematic review resulted in another review. From your point of view, is it not a vote of no confidence in the FCA to regulate this market, the fact that you are saying that it is not possible for them to regulate the market or improve it, and it will never be the right product for a number of people?

Mr Osborne: No, I am not saying that. I have had a concern about the behaviour of the FCA and the particular issue over the last five days. Let me be clear, I have confidence in the FCA as an institution. It is able to help and protect consumers and I think the fact that they were on to this poor value for money in the annuities market was a sign of that.

As I say, going forward, although the estimates vary, I still believe there are going to be many people who want an annuity. We have to make sure that is still a good value product and that there is as much innovation in that market as possible.

Q409 Teresa Pearce: It is fair to say, isn't it, that some people now will not invest in a pension? They will invest and save but then they will take the money themselves to decide what to do with that money.

Mr Osborne: Yes, but I do not—

Teresa Pearce: Have you made an estimate of by what percentage pension funds will be reduced going forward because of this measure?

Mr Osborne: I think there is an inherent uncertainty about how many people will want to use other products and take their money out of their pension, but our assumption in the book is that a third of people would do that. There are other industry estimates that are higher and lower, so it is something we will have to assess. I guess it comes down to a fundamental point, which is I think you should trust people to look after their savings and if you do trust people and give them more freedom and flexibility over the use of their savings, they are more likely to want to use these products. One of our hopes is that there will be more accumulation into pensions as well as money coming out of pensions.

Q410 Teresa Pearce: So it is possible that a third of people will not invest in annuity or pension. That is one of the estimates.

Mr Osborne: There is a reasonable costing assumption that the OBR agreed with but, please let me be clear, it is a new area of policy. This is uncertain. We will see what happens.

Q411 Teresa Pearce: Given that in November 2011 you signed a memorandum of understanding between yourself and the National Association of Pension Funds that they will increase their funds investing in infrastructure, what modelling have you done to see what reduction in investment in infrastructure is going to happen because of this measure?

Mr Osborne: Obviously one of the challenges of developing this policy was that, because it was so commercially sensitive—and we were discussing at the beginning of this hearing the fact that it did not leak—we were not able to consult with the industry. I think it would have been extremely difficult to do that in advance in a way that was completely confidential because of the impact on—

Teresa Pearce: But do you see a reduction in—

Mr Osborne: No. This was a question asked in advance, but the encouraging response I have had from my own conversations with leading players in the industry is that they are still interested in investment in infrastructure because of the predictable and stable returns that that can provide. A big part of what we have to do now in the coming months—and the Treasury Select Committee might have views on this—is to look at what we do with freedoms and flexibilities around defined benefit schemes, where there is a very large sum of money involved that is invested in corporate bonds and the like as well as gilts. It is something that we are open to taking views on. It is not something we made a judgment on in the Budget. We have taken as a starting point, and we are very clear about that, that there would not be any changes but we are very much open to discussion. So that is where a huge amount of the institutional money is locked up.

Q412 Teresa Pearce: At a time when we are hoping for everybody to auto-enrol into pensions, have you not in effect sent a message saying

people are better placed to look after their own money than pension funds are? Was that your intention?

Mr Osborne: No, with auto-enrolment we have just—

Teresa Pearce: We want people to opt into that, not saying pension funds are—

Mr Osborne: We have opted people in and of course, as I said in reply to earlier questions, I would like to see overall as an economy, Britain saving more. For individual families it has to be their own matter of judgment. There will be moments when they want to borrow to buy a house, for example. But we want to see more savings. One of the very encouraging things about auto-enrolment is that 3 million more people now have pensions. The projections are that that will increase substantially. I think you make pension saving more attractive when you give people greater freedom. I guess it is just a philosophical difference between us that I think you can say to people—

Q413 Teresa Pearce: It wasn't your intention to send that message?

Mr Osborne: Send the message?

Teresa Pearce: It wasn't your intention to send the message that people are better off looking after their own money than investing in a pension?

Mr Osborne: No, I want to send the message that a pension is an attractive product you can invest in if you would like. You have other options like ISAs, and we have not talked about that today, but if you would like to save in a pension I have made the pension more flexible. I have given you greater freedom over the use of that pension pot later on in life, and that should make pensions more attractive products for people. What I am saying is that the patronising view that existed in the past that when people reached retirement, having saved all their lives, they could not be trusted to manage their own savings is something that I have rejected in this Budget and overturned.

Q414 Teresa Pearce: David Ruffley, my colleague, asked you a question about what modelling you had done of what increases there might be in the buy-to-let market because people may invest in property rather than pensions. It seemed to me that your answer to that was you had not done any modelling. Is that right? Have you done an estimate or not?

Mr Osborne: We did not draw an impact from the pension measure on house prices because the OBR does this—

Teresa Pearce: No, on the buy-to-let market.

Mr Osborne: The buy-to-let component of it, because the OBR makes this assessment for us. They were in possession of all the details of the policy, so if they had felt it was going to have an impact they would have put it into the—

Q415 Teresa Pearce: I could not find anything about it but that is because it wasn't there. Is that what you are saying?

Mr Osborne: As I say, the OBR looked at the policy and have not changed—well, it is up to you to ask the OBR because they are independent.

Teresa Pearce: I will.

Q416 Mr McFadden: You sent a letter to the Chairman of the FCA the other day. The FCA is your creation, isn't it?

Mr Osborne: Yes, it is. Yes. Sorry, it is Parliament's creation.

Mr McFadden: You drove the legislation through.

Mr Osborne: I think supported by the Labour Party.

Q417 Mr McFadden: You have now written to the Chairman publicly dressing down the organisation after what was a very damaging mistake that they made last week. Are you concerned that by doing it in that way, and so publicly, you might have undermined the authority of the FCA in any other investigations that they are doing? For example, they are conducting an investigation into allegations of foreign exchange manipulation.

Mr Osborne: The short answer to your question is no. I think the FCA is a very important body. I am proud that it is something this Government has created as a powerful consumer champion, but I also have a responsibility. The Government, and indeed Parliament, have a responsibility for the integrity and good conduct of financial markets. When you have something that has such a heavy impact on many British companies and, by the way, on people's pension funds, because they will be invested in some of these companies, then I think it is important that corrective action is taken. I think the senior management of the FCA fully understand that.

You are right to draw people's attention to the foreign exchange manipulation issues. These are potentially very serious, and they are engaged in this work, as is the Bank of England. Again, the Treasury has an overall responsibility for the integrity of Britain's financial markets and I suspect this is something we are going to be hearing more about in the next few years.

Q418 Mr McFadden: We have an endless stream of banks and other such organisations saying that the regulator is too intrusive, asks for too much data and all the rest of it. Banks are very good at lobbying. They lobby Governments and politicians. Don't you think they will take some comfort in seeing the regulator having their wings publicly clipped by you?

Mr Osborne: In the case of this incident, someone at the FCA briefed a single news outlet about a policy that had a very damaging impact on not just share prices but also the reputation for important market-sensitive information being communicated in a fair and open way. People, rightly, around the world wanted to know what the UK was going to do about that. I think it is part of my job description to maintain an eye for Britain's financial markets, the reputation of its regulatory system, and I think this was an egregious error. The good news is that the senior management of the FCA completely agree. There has been no resistance to commissioning an independent report. The non-executive directors want to receive that in a bigger report. So I think we are all aligned. As I said before to this line of questioning in a previous answer, I have confidence in the FCA as a body able to

protect the interests and rights of consumers and the proper regulation of financial markets.

Q419 Mr McFadden: Do you have confidence in its Chairman and Chief Executive?

Mr Osborne: Yes.

Q420 Mr McFadden: I will come to the Budget now and the pension changes that you have just been asked about by Teresa Pearce. In the normal course of conversation, the difference between advice and guidance would not matter. It concerns much the same. But in financial services there is a material difference, as evidence we received this week has shown. Advice is regulated; it carries significantly higher consumer rates than guidance, where the responsibility is very much left to the consumer. In your Budget speech you said that people would be offered free, impartial, face-to-face advice. The Prime Minister used the same term in a Q&A session where he talked about one of the important things in the Budget is the money for face-to-face financial advice. The Budget document that you produced on this talks about guidance, which is materially different than in this context. It was not correct for you to use the word "advice" in the Budget speech, was it?

Mr Osborne: There is a technical distinction between advice and guidance.

Mr McFadden: It is more than technical.

Mr Osborne: Well, there is a technical distinction. The Budget document exists. I do not get up and read this out. You will be very grateful that I do not do that, because this contains all the technical details of the Budget and we publish it at the same moment. The speech also needs to communicate in English so that people watching it can understand what is meant. The issue that you have raised was not something that the consumer groups have had a problem with. They have all understood what exactly was meant. I think the general public have understood what was meant as well, which is the purpose of the Budget speech.

The key challenge now is working with the consumer groups and the industry to get this guidance right, and there is a distinction. Advice is the advice you receive to invest in a particular product for a particular company. Guidance is, "You now have these freedoms. These are your life circumstances. You might want to consider an annuity or you might want to consider this particular product or that particular product" and I think that is well understood. The challenge with the consumer groups, on which they are very helpful, and with the industry is to make sure we get the best guidance package that does help people make these choices. Then if they want particular advice on a particular product they will go and get it.

Q421 Mr McFadden: For the avoidance of doubt, what the Government is promising, and promising to legislate on, is guidance, isn't it? It is not financial advice in the way that that is—

Mr Osborne: It is guidance, yes, and it is not advice in the sense of, "You should invest in this Prudential or Legal & General product". I do not think anyone listening to the Budget would have thought that. Indeed, the reaction from the consumer groups was universally supportive. The consumer groups are part of the process we are now undertaking. We have put £20 million towards the process of developing this guidance, so that it is useful for people as they reach retirement and want to make decisions about how to use their pension.

Q422 Mr McFadden: You have put £20 million towards it. There are 400,000 people a year who come to the maturity of defined contribution schemes. That works out at about £50 per head. Can you just—

Mr Osborne: The £20 million is not the ongoing cost of the guidance system. The £20 million is literally a development fund, to develop over the coming year the guidance package. I did not want to have a row an hour after the Budget about who was going to pay what towards the development of this guidance. I wanted the Government to put a pot of money in so that we can work with the industry and the consumer groups to develop the guidance. Then, of course, going forward the guidance will be a cost borne by the industry and I think that is understood.

Q423 Mr McFadden: We took evidence from a financial advisers' organisation the other day who said that in the current system where most people, precisely because of the way the annuity market has worked, are charged £680 per head for not changing the plan at all and just going ahead and doing what they were going to do anyway. They estimate that cost will increase because this is a complex area. People have to consider their tax implications, the social care implications that you were asked about earlier, and the usual imbalance in information between the seller of financial products and people buying them. How much have you estimated it will cost the consumer? It will not be the industry because its costs will ultimately be passed on to the consumer. How much will it cost per consumer to receive the guidance that you intend to legislate for?

Mr Osborne: First, on the social care implications, I have made it very clear that we are going to have to change the social care tests to take into account the new pension arrangements, so I do not want anyone to be under a misapprehension there. On the cost of the package, I do not think people are getting—this was the point about the FCA's work—particularly good guidance at the moment and the annuities market is not giving particularly good value for money for many people. We need to work on what is a good and useful guidance package for individuals. We do not have today an assessment of the cost because we have not been proscriptive about this. We have said, "Let's work with the industry and the consumer groups on what that is".

Where I have been proscriptive in the Budget speech and the document is that it will be free at the point of use, so that costs will be borne by companies, by the industry, and that are one of many costs of doing business. I think it is more than outweighed by the benefits to the industry of what I am offering, not just the benefits to the pension flexibility, which I think will lead to a lot of product innovation and new flexible products for people and much more choice. That is good for the savings industry but also the changes to ISAs and the savings tax rate and the like as well.

Q424 Mr Newmark: Chancellor, turning to taxation, is the increase in the personal allowance to £10,500 a progressive or regressive policy? I ask that because of the IFS Green Budget model and the effects of increasing the personal allowance to £12,500. They explain that because 17% of workers already pay no income tax, those with the lowest earnings benefit little from a further increase in the personal allowance. Will increasing the personal allowance to £10,500 be ineffective in helping low income earners and who will benefit the most from the personal allowance increase?

Mr Osborne: There are 25 million, or thereabouts, people who benefit, and those are people earning all the way up to £100,000, but what is striking about the impact of this policy is that it has taken 3 million people out of income tax. If you are, for example, someone on the minimum wage working 31 hours a week, you are not paying any income tax as a proportion of your income.

Q425 Mr Newmark: Are you saying it progressive or regressive then? You are saying it is progressive?

Mr Osborne: I think it is a progressive tax change in our country.

Q426 Mr Newmark: In the Budget, as you said, you forecast over 4.2 million will be lifted out of income taxation by 2015 due to the personal allowance increases. However, differences in thresholds mean that many of these people will still have to pay national insurance contributions. Indeed, something like 1.6 million people will pay employee national insurance contributions but not income taxation in 2015-16. I think this was a point made by the Institute for Fiscal Studies. My question to you is why are you reluctant to align national insurance contributions and income tax thresholds?

Mr Osborne: It is a question of priorities and of making a judgment, and I felt that a further increase in the personal allowance was a better thing to do. I think people have clearly understood that this Government is lifting people out of tax, that it is delivering an income tax cut, and I wanted to continue to help people in that way.

Q427 Mr Newmark: Particularly at the lower end is this alignment something you think the Treasury should be looking at a little bit more or is it a low priority for you?

Mr Osborne: There are many things in this job you would like to do but unfortunately we do not have the money to do them, so you have to make choices and that is what a Budget is.

Q428 Mr Newmark: That brings me neatly to my next question, which has to do with this issue of fiscal drag and the higher rate taxpayers. The higher rate threshold will increase to £42,285 by 2015-16. HMRC has estimated this will result in 400,000 more individuals being brought into the higher rate tax threshold. The Association of Chartered Certified Accountants have pointed out that in 1990 just 6% of UK taxpayers paid at a 40% rate but in 2014 it is 15.8%. Should the Government be doing more to tackle this example of fiscal drag?

Mr Osborne: We have increased the high rate threshold for the first time in this Parliament, and I think the key thing is, are you paying more or less tax? That is ultimately what matters to families. The important thing is that the increase in the personal allowance benefits everyone up to £100,000. After £100,000, the personal allowance is taken away. That was the decision of the previous Government. For me that is the first thing you have to consider. Are people paying more or less income tax? The result of these increases in the personal allowance is that people on the higher rate, as well as people on the basic rate, are paying less income tax.

Q429 Mr Newmark: You have previously said that tax statements setting out how people's tax is spent by the Government would be sent out later this year. There was no mention of this in the Budget. Do you have final versions of what those statements will look like and how many people will receive them?

Mr Osborne: From this October 24 million people will receive a personal tax statement that sets out how much tax they are paying and also gives an idea of where that money goes to. In other words, it divides their taxes up across the different things the Government spends its money on, health, education and defence.

Mr Newmark: In the same way local councils—

Mr Osborne: So there will be a very piece of literature that people receive, as I say, 24 million people. We have the final versions here, and I think when people see them they will see that it is a huge boost for tax transparency, having a better understanding of where their money is spent. Of course, it will empower them to make decisions about the kind of people they want governing them and their priorities.

Q430 Mr Newmark: Effectively, every taxpayer will receive this in the post. Is that the idea?

Mr Osborne: Well, 24 million people will receive it—we have done this in the most cost effective way possible—in other words, people we are already in regular contact with. That is the vast majority of taxpayers. The statements are there and they will go out from this October and I will make sure that there are copies for members of the Committee.

Mr Newmark: Thank you.

Q431 John Thurso: Good morning, Chancellor. Can I return to the Chairman's first question and—just for the record and for those who are not aware of his delicate and subtle use of irony—confirm that he was not suggesting that the Budget last year was leaked by Danny Alexander and that is clearly understood?

Mr Osborne: The Budget last year was leaked by—although they apologised for it—the *Evening Standard*.

Q432 John Thurso: Thank you. Can I come to the question of fuel duty? We have an effective reduction of something in the order of 20p, which has done a huge amount for affordability in households in the far north—my part of the world—for which we are indeed grateful. The Government has also recognised that very remote areas still have a problem of paying quite a considerable premium and have introduced the fuel discount scheme in the islands, and are looking to also roll that out in the more distant parts of the mainland. There are three criteria that need to be met: distance from supplier, cost at the time of the registrant's point and population density. On the first two of those there is not a tremendous argument. On the last of those the Treasury has chosen to use postcodes, which are specifically not designed for that purpose and which specifically state, in ministerial advice in other ministries, that they are purely routes for delivery of Royal Mail and cannot be used for measures of geography or density. I have written twice to the Treasury to ask for an explanation of this and I am still awaiting a reply. What is your explanation and when might I get a response?

Mr Osborne: First of all, you will get a response in the next week. I can assure you of that.

John Thurso: Thank you.

Mr Osborne: Second, we are aware of this issue. We have used postcodes because they have been the available dataset, but the point you make about the way postcodes are constructed is a very fair one and obviously no previous Government has tried to cut fuel duty for remote rural areas.

John Thurso: Absolutely. I do commend the Government for at least trying.

Mr Osborne: By the way, we would like to go further but the European Union restricts us and we have to fight a hard argument in Brussels for including as many areas in Scotland, England, Wales and Northern Ireland as possible. So we are looking at whether there is a better assessment of areas. I can say that the Chief Secretary for the Treasury—who coincidentally is the Member for Inverness—also takes a keen interest.

Chair: Coincidentally?

Q433 John Thurso: I am very grateful, Chancellor, for your statement that you are looking at alternatives. A village like Bettyhill,

which is 50 miles from the opposite end of the postcode it finds itself in and therefore loses out, by any definition is remote and rural. Clearly that is not acceptable, so I am very grateful for that.

Can I turn to a matter that was in the Budget, which is paragraph 1.208 of the Red Book? Can I ask do you accept the long-held constitutional principle that the judiciary and the Executive should be separated in their functions?

Mr Osborne: Yes.

John Thurso: Why then does paragraph 1.208 propose giving HMRC the powers to dive into people's bank accounts without any judicial oversight? The Chartered Institute of Taxation state, "We have strong concerns. This power is unprecedented in the UK. We are concerned that the proposed power could undermine confidence in the relationship between taxpayers and HMRC". Another piece of evidence we had states, "This is a power grab. At the moment, if HMRC want to seize your property or cash, they have to take you to court, win and then get a court order. Now, after a couple of warning letters and a phone call, they apparently do it at the flick of a switch. There is no safeguard built into this system". This surely is one of those mad ideas that should have been strangled at birth.

Mr Osborne: Obviously I do not agree with you about that. I think it is important to understand what is going on. The vast majority of people in this country pay their taxes on time, and people who do not pay their taxes are a burden on everyone else and the taxes, all other things being equal, have to be higher as a result on people who do pay. So I think we are perfectly entitled to try to collect the taxes that are due. In this case, these are people who have been contacted on average nine times by the Revenue. They have exhausted all their appeals. That is, of course, the judicial safeguard that you identify, and there are judicial tribunals and the like. They have exhausted all those. They owe the money, and the point where we would now go into a bank account is the point we would send the bailiffs round.

So, instead of the physical seizure of property, which you could argue has an even bigger potential impact on people—and by the way it is expensive to the rest of us—we are now proposing that at that moment, when you have had all of these opportunities, you have been contacted nine times, and by the way we also then give you 14 days' notice before we go into the bank account, this is the moment when we would otherwise send the bailiff around. We are saying, "Let's take a frankly more modern approach and take the money out of a bank account". It has to be a bank account that has £5,000 in it, and it is something that is done in such illiberal places as Sweden, Denmark, Ireland, Finland and New Zealand.

John Thurso: Most of which have written constitutions.

Mr Osborne: Well, we have laws of the land, but the—

Q434 John Thurso: Which you keep changing. There is a fundamental point here that nobody else can do it. It is not done anywhere else. It is a massive step change in the constitutional arrangements, and to slip it through in two paragraphs in the Red Book, without any thought about the implications, is a huge change. The next thing is other people start saying, "Oh well, we will just have a dive into your bank account".

Mr Osborne: DWP is not quite the Magna Carta moment that I think you are trying to suggest because the DWP—

John Thurso: The DWP can arrest a bank account after a court has given them permission.

Mr Osborne: The DWP already have this power with child maintenance payments. As I say, this is about an individual who has exhausted all their appeals, who owes tax to the nation, who is deliberately refusing to pay their tax and, by the way, the incomes of these people are very substantial on average. These are people who have exhausted all the appeals, been given many warnings and are finally told they have 14 days to pay up and we would send, at considerable cost, the bailiffs round to seize their physical assets. We are introducing a new power used across Europe and across the Western world to say that instead of sending the bailiff round, we will take the money direct from a bank account with money in it.

Q435 John Thurso: Would you give my company the right to dive into somebody's bank account?

Mr Osborne: Over half of the people affected will have more than £20,000 in the account that we are dipping into.

Q436 John Thurso: The paragraph makes clear it also covers people on tax credits. Given the number of people that I have dealt with who have been wrongly asked for £7,000 or £8,000 back on their tax credit, which at the end of it has been written off because of the mistakes within HMRC, the idea that some rampant officials in a call centre can go charging into these people's bank accounts is of extreme constitutional concern and highly illiberal.

Mr Osborne: I just do not accept that. I think it is highly illiberal to live in a country where you consistently allow a small group of people not to pay what is owed and the rest of the country has to, as the result, shoulder the burden. These are people who have been repeatedly contacted. I will send you the letters they have received, the final notice warnings, the opportunities to appeal that have all been exhausted at this point. This is not about making a judgment of whether they owe the money or not. The assessment has been made under judicial oversight. The money is required. It is owed. It is about debt collection, and I am not sure how massively more illiberal the option of the physical arrival of the bailiff at the door is than taking money from the bank account. As I say, a whole range of European countries do this and ultimately we have to explain to people who pay their taxes why we are carrying people who do not pay their taxes.

John Thurso: We must beg to differ, Chancellor.

Q437 Chair: Wherever the balance of powers lie, HMRC tend to drop by to see Chancellors for the odd extra one and this has been going on for a very long time, sometimes with justification. The point that John made has been expressed to me by a large number of people, including several other members of this Committee, and is a source of considerable

concern. Would you accept that the risk in this area, which is related to the point about a written constitution but a particular risk for a Chancellor, is that while he or she may open up with a proposal, which is very carefully ring-fenced with safeguards, over time those safeguards too come to be eroded and there is no easy way of protecting them? You are about to be passed a note, so it might have some interesting information in it. Perhaps this might be looked at again.

Mr Osborne: As I say, as Parliament we have already at this moment in the process granted to HMRC the power of someone they have employed to physically enter someone's property and seize their television, say, or their car. So I do not think this is somehow a fundamental new principle. I think that point was crossed many years ago.

Q438 John Thurso: Can I say that might be something that we would look at because the powers that are held by HMRC are grandfathered from the old Customs and Excise, and there is some doubt as to exactly how those powers might apply on areas where they are not—

Chair: That is a very good point.

John Thurso: Before you get reams of notes from behind you and everywhere, let us leave it there because we have other things to do and we will have this debate.

Q439 Chair: I must give the Chancellor the opportunity to reply, but it is true that the merger of two very different cultures, one built up over many generations, HMRC, the Revenue as it then was, to get the money in, with very careful balances of rights, the other basically a cutlass-originating culture to chase down smugglers, which ended up with VAT as well, is still perhaps taking a bit of time to bed down.

Mr Osborne: This is an issue of debt collection. As I say, we have a whole set of processes about whether the money is owed or not or whether there has been an error. This is when all of that has been exhausted, when there have been multiple attempts to get the money, when the bailiff literally turns up at the door. We are saying take a frankly more modern approach, which is used by all these other European countries, and indeed Australia, New Zealand and the like, and the end result is that taxes can be lower on the rest of everyone.

Chair: A couple of colleagues have quick questions they want to come in on with respect to the Co-op and the letter that I sent to you on this, to which you have now sent a reply.

Q440 John Mann: This is an extraordinary paragraph, Chancellor, in your letter to the Chairman, in which you state that the Treasury interpretation of law should supersede that of the regulator. That is not what happens with other regulators, for example Ofcom. The independent regulators take their own advice on interpreting law and are not superseded by a Government Department. In that context, I would be keen to know when either you or your Ministers or officials discussed the

Co-op's application for a waiver, in relation to the Verde transaction, with officials at the FSA before that waiver was granted on 7 June 2012 and, in doing so, what did you say to the FSA?

Mr Osborne: First of all, on the specific point you make about the role of the Treasury and the implementation of EU law, this is part of an Act of Parliament that I think you voted for. It has always been understood that the Government is responsible for our obligations under the European Communities Act. That has been the case for a long time and was reaffirmed in the most recent legislation that created the Financial Conduct Authority and the PRA, although in this case it was a previous law, I assume passed by the last Government for the creation of the FSA. It is a longstanding understood arrangement.

Second, more broadly on the Co-op, let us be clear. First of all, the sale did not happen. This is not like the sale of Britannia to the Co-op, which did indeed happen. It is not like the sale of ABN AMRO to the Co-op, the sale to RBS, or not like the sale of HBOS to Lloyds. This sale did not happen. In other words, the system worked. The regulator identified a problem with the sale, which was the capital position of the Co-op Bank, and there was absolutely universal agreement that, therefore, the sale could not proceed. I think it is an example of the system spotting the problem rather than what has happened previously. That is the first point I would make. The second is that the Co-op made an application to Lloyds for these branches, which by the way we are required to sell due to the last Government's state aid agreement with the European Union. Lloyds approached us saying that the Co-op had offered to buy these branches. Every single person who has given evidence to this Committee, Wynn Bischoff and António Horta-Osório, Peter Marks at the Co-op, Andrew Bailey, and the letter that you have received from Mervyn King and even the Reverend Flowers, has said there was no undue pressure.

Then you come to the issue of the interpretation of the law and whether or not the Banking Consolidation Directive required the designation for Co-op as a financial holding company. Again, this is something that Mr Bailey has talked to you about so it is not new news. This was discussed in his evidence. Here in this case there was a disagreement between lawyers about the legal interpretation of this European Union directive. The lawyers disagreed and ultimately the issue was not resolved. It did not need to be resolved because the Co-op came forward with an arrangement that the regulator was happy with. Even with that, the regulator then uncovered the worsening capital position in the Co-op and made it clear that the sale should not go ahead, which as I say we readily agreed.

I think you have here an example of the system working, unlike the situation we had with the Britannia where the Co-op did buy the Britannia and clearly that was where—as again the evidence you have received makes very clear—the problems that ultimately caused a real issue for the Co-op began.

Q441 John Mann: Implementation and interpretation are not the same thing. I come back to the question that you have not answered. Did you, or your Ministers or officials, discuss the Co-op's application for a waiver with officials of the FCA before it was granted on 7 June 2012 and, if so, what did you say?

Mr Osborne: We were aware throughout this sale, because we were required to by the agreement of the previous Government with the European Union, that we had to divest these branches. We were aware of the discussions that the regulator was having with the Co-op and the like. We were kept informed of those. Obviously there was a discussion about the legal interpretation of the European Union directive. But I come back to the

point that the system worked. The Co-op did not buy the Lloyds branches. I have sat here in this job and had to deal with the mess of the takeover that RBS made of ABN AMRO, of the Lloyd's HBOS takeover and the Britannia takeover by the Co-op. That is what I have had to spend a disproportionate amount of my time as Chancellor dealing with. In this case, the system worked. The Co-op did not buy the branches and we then put in place—led by the Bank of England and the regulator—a rescue package for the Co-op that did not involve taxpayers' money, all of which is a far cry from the situation under the previous Government where billions of pounds of taxpayers' money was spent and very large financial institutions were brought to their knees by unsuitable takeovers. I think there is a very marked contrast in what has happened here with the Co-op.

John Mann: Your non-answer is noted.

Q442 Mr McFadden: Chancellor, you referred a moment ago to the evidence that the Committee had received on this issue of political pressure. When I asked the Reverend Flowers, when he was giving his evidence on this, whether the Government's contacts with the Co-op meant that they wanted to see a deal done or whether they wanted to see a deal done by the Co-op, he was clear it was a deal done by the Co-op. Lord Levene, who chaired the alternative bid from NBNK, has also said consistently to us that he thought there was political pressure in favour of the Co-op doing the deal. In fact he has written to us, even after the former Governor of the Bank of England had, to say that he stands by that position. So we have had conflicting advice from witnesses on whether or not there was political pressure. But the question I want to ask you is how does the admission in the letter that the Government, as you say, took a more active interest in this question of the waiver to stop the whole Co-op group being defined as a financial holding company, the Government intervention on that, sit with your assertion in the rest of this letter that all you were doing was keeping a watching brief and nothing more?

Mr Osborne: We have a requirement given to us by Parliament to see the correct application of European Union law in this country. There was a legal disagreement between the lawyers. Ultimately it was not resolved, and the Co-op, in discussion with the regulator, came up with an arrangement that the regulator would have been happy with. Ultimately, that did not come to pass because the regulator uncovered the worsening capital position in the Co-op. Of course, we had an interest in the sale of the Lloyds branches. We had an interest in the sale of the Lloyds branches because the previous Government forced us to take an interest. The deal struck with the European Union was that we had to, under a state aid agreement, divest Lloyds of these branches or ensure that Lloyds did divest the branches. We had an interest in promoting competition in the banking system, which this Committee took a keen interest in and the Vickers Commission recommended. So we were keen to see the Lloyds branches sold. Lloyds came to us and said, "The Co-op is the preferred bidder". We were content with that.

But I have been reading the evidence given to this Committee by the chairman of Lloyds when asked by Mr Tyrie, "There was no political pressure?" "No." When Mr Mann asked the chief executive of Lloyds, "Did the Government express their preference for the

mutual deal?” “No.” You then have the evidence from Mr Bailey who made it absolutely clear; Mr Mann again. I cannot help drawing the conclusion that Mr Mann wants to divert attention from where some of the responsibilities lie for what went wrong at the Co-op, “Did anyone—”

John Mann: No, I want to find—

Chair: Order, order.

Mr Osborne: You asked Mr Bailey, “Did anyone lean on you at any stage in relation to this?” “No.” In other words, every single person who has come before this Committee and been asked this question has given you this answer. Even the Reverend Flowers gave you this answer. In his evidence he said, “I would not say pressure”. I understand what is happening, which is that the Labour Party—closely linked to the Co-op movement—is trying to divert attention away from the responsibility of the management and oversight of that organisation for what went wrong. But the evidence you have received from the people involved, from the independent regulator, from the banks concerned, including the chief executive and chairman of the Co-op, I think has been very clear and, certainly, is absolutely consistent with the account that I have given you.

Chair: One aspect of the work that the Committee may want to come back to you on before it concludes its work is, of course, the miners review. Beyond that, of course, there are a heap of reviews that are already in progress and there is a great deal to look at, so I do not think this is the last word that we will be having on this subject, and probably not the last word we will be having with you.

We have a number of further questions on the Budget but it is getting on for two hours since we began. I think perhaps the best thing to do would be if I write to you with some of those further questions, not least, for example, on how it is exactly that the export credit scheme is going to work without risk to the Exchequer, and also the work that the Treasury has been doing on economic and financial sanctions that may yet come as a result of Russia’s activities in the Crimea.

But for the time being thank you very much, Chancellor, for coming to see us this morning. We have picked up a good deal and we will be producing a report in due course.

