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Treasury Committee

Spending Round 2013

Third Report of Session 2013–14

Volume I

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The Treasury Committee

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Report

1 Introduction

Our inquiry

1. The Committee took evidence from four panels of witnesses during two meetings, as follows:

Tuesday 9 July 2013

- First panel: Carl Emmerson, Deputy Director, Institute for Fiscal Studies, and Gemma Tetlow, Programme Director, Pensions, Savings and Public Finances, Institute for Fiscal Studies;
- Second panel: John Cridland CBE, Director General, CBI, Nicola Smith, Head of Economic and Social Affairs Department, Trades Union Congress, and Professor Douglas McWilliams, Chief Executive and founder, Centre for Economics and Business Research, and Gresham Professor of Commerce;
- Third panel: Rt Hon Danny Alexander MP, Chief Secretary, HM Treasury, and Sharon White, Director General for Public Spending, HM Treasury.

Thursday 11 July 2013

- Rt Hon George Osborne MP, Chancellor of the Exchequer, HM Treasury, and Sharon White, Director General for Public Spending, HM Treasury.

The Committee is very grateful to those who gave oral and written evidence to us. Their willingness to fit in with our necessarily compressed timetable is particularly appreciated.

Spending round 2013

2. In the Spending Review 2010, the Government set out spending limits for Departments until 2014–15.[1] However, the next election will be held on 7 May 2015, part way through the 2015–16 financial year.[2] Spending Round 2013 provides the Government's detailed spending plans for that financial year alone,[3] after Budget 2013 set the overall envelope for Total Managed Expenditure[4] in 2015–16.[5] The Chancellor noted that:

1 HM Treasury, Spending Review 2010, Cm 7942, October 2010

2 Fixed-term Parliaments Act 2011, Section 1

3 HM Treasury, Spending Round 2013, Cm 8639, June 2013

4 For part of their resource and capital budgets, departments are given firm three-year spending limits called Departmental Expenditure Limits (DEL) within which they prioritise resource and plan ahead. Spending that cannot reasonably be subject to firm multi-year limits is included in Annually Managed Expenditure (AME). The main elements of departmental AME budgets are social security and tax credits, while there is also non-departmental AME covering, for example, local government self-financed spending, debt interest and accounting adjustments. DEL and AME together comprise Total Managed Expenditure (TME), an aggregate derived from the National Accounts as public sector current expenditure plus public sector gross investment. Source: ONS, Topic guide to: Public Spending, www.statistics.gov.uk

5 HM Treasury, Budget 2013, HC 1033, March 2013, p 24, para 1.51

> Our trying to set out these spending plans further in advance, so that Departments have time to make the necessary adjustments, is a good innovation in fiscal policy. The certainty we now have for 2015 will, I think, mean better public policy.[6]

The Spending Round process

3. In the lead up to the Spending Round, it was noted in the press that some Ministers were publicly stating their views on the viability of proposed cuts.[7] Just after the Spending Round was announced, there was also speculation that those who had waited the longest to settle appeared to have secured themselves a better deal than those who settled earlier.[8] It was reported that the Spending Round concluded early.[9] When asked why there had been no need to move to the so-called star chambers, the Chief Secretary said that:

> The first thing that I sought to do both in conducting this Spending Review and in 2010 was to try to be as straightforward as possible with Cabinet colleagues about the amount of savings that we were looking for from their Departments, so that you do not end up with this process of game-playing where the Treasury demands twice as much as is wanted and the Department offers up 10% and then you have to haggle. It is about trying to spend the time and effort, and I had a lot of meetings with all Cabinet colleagues about this, discussing not what amount of savings they were looking for, although of course there is room for manoeuvre at the margins, but how they are going about making those savings. I think that is what the public expect us to do—to find the savings in the right way and not just to get to the numbers.
>
> You are right to say that as in 2010, we had a Public Expenditure Committee that was looking at the Spending Round, and that was populated with Ministers from the Departments that settled first, and of course it is the case that if any Cabinet colleague had decided not to settle with the Treasury they would have been brought before that Committee to explain their position and to be scrutinised by their colleagues. I don't think any Department got anywhere near to that position [...][10]
>
> [...] we got collective agreement to an envelope. We gave each Department planning assumptions about the amount of savings that they were expected to find. You will see that the final figures by Department came pretty close in each case to the planning assumptions that we issued, so that is a very straightforward way to conduct the process. Departments had a period of time in which to submit an initial return to the Treasury, about a month after the Budget. My officials and I then spent a lot of time with Departments, working through what they had offered, looking at ways that they could go further where their initial offer did not match up to

6 HC Deb (2013-14) 26 June 2013, col 319

7 'Maria Miller holds out against arts funding cuts', *Financial Times*, 6 June 2013; 'Vince Cable faces showdown over cuts to business budget', *Financial Times*, 21 June 2013

8 'Spending Review: holdouts get best deal', *Financial Times*, 26 June 2013

9 *The Independent,* George Osborne finalises deals with Cabinet ministers on budgets that will cut £11.5bn from spending, 23 June 2013

10 Oral evidence to the Treasury Committee, Spending Round 2013, 9 July 2012, HC 575–i, Q 98

expectations. Through PEX, and also through the quad process, which met five times on the Spending Round, we had processes to ensure there was a degree of collective agreement across the Government about the approach we were taking in each Department.[11]

4. Asked if any Ministers lobbied the Prime Minister, the Chancellor said that:

> As far as I am aware, unless there was a phone call or conversation that I was unaware of, there were no appeals.
>
> Defence was handled as a separate process from some of the other Departments, in that the Prime Minister had set an ambition, which was that there would be no reduction in the front-line capability of our military. Right from the start, he had set that condition. In order to ensure that everyone would be satisfied with that, the Cabinet Secretary led a review of efficiency within the Department—there was a Cabinet Secretary-led review. That avoided what we had seen in previous Governments, particularly on defence—the appeal of the Defence Secretary and the service chiefs to the Prime Minister. That was avoided, because there was an agreed process for assessing what would and what would not impact on front-line military capability.[12]

The Chancellor stated that the success of the Spending Round was in part a consequence of the nature of coalition government:

> […] it is a curious feature of coalition that it requires more formal processes and less informality, so that both sides of the coalition feel they are being fairly dealt with. As a result, there is less scope for going round the formal processes.
>
> I try to set out a long time in advance what we are intending to do, certainly much further in advance than most of my predecessors, in other words to set envelopes clearly in advance and establish dates for these events clearly in advance. It has been the case until recently that one would not know the Budget date until a few weeks beforehand—sometimes three or four weeks beforehand. I set out these dates months in advance. The formality of a coalition allows a process to develop.[13]

5. **It has been put to us that coalition politics has encouraged a more formal process in the Spending Round. Whether true or not, the fact that the Spending Round was concluded without delay or apparent acrimony is noteworthy in view of the scale of the challenge, which is unprecedented.**

11 Oral evidence to the Treasury Committee, Spending Round 2013, 9 July 2012, HC 575–i, Q 100

12 Oral evidence to the Treasury Committee, Spending Round 2013, 11 July 2012, HC 575–ii, Q 212

13 Oral evidence to the Treasury Committee, Spending Round 2013, 11 July 2012, HC 575–ii, Q 213

2 Ring-fencing

Ring-fencing and the shape of the state

6. Spending Round 2013 set out the Government's spending plans for the period between April 2015 and April 2016. The centrepiece of the Spending Round was a reduction in current spending of £11.5 billion in 2015–16 as compared to the 2014–15 baseline. This £11.5 billion reduction in current spending comprised "£10 billion savings from resource spending in 2015–16, on top of the £1.5 billion announced at Budget 2013".[14] Crucially, the Government maintained its policy of ring-fencing particular areas of public expenditure for the year 2015–16, stating that it would continue to "protect spending in real terms on health, schools and overseas development—maintaining the vital public services that everyone relies on at home, and supporting the poorest overseas".[15] The Institute for Government told us that "decisions about spending allocations were constrained by commitments made in advance to maintain pre-announced 'ring-fences' around NHS, schools and international aid budgets". It also noted that "current pensioner benefits have also had an effective political ring-fence since 2010".[16]

7. The Treasury Committee has had concerns since 2010 about the impact of ring-fencing on public spending.[17] We concluded in our Report on Budget 2013 that:

> As the Committee has previously highlighted, the complete protection of ring-fenced departmental budgets will become more difficult for the Government with each successive year of tightening. Ring-fencing carries political attractions for any government, but it threatens to reduce scrutiny of ring-fenced spending, it can lead to waste or worse and it can distort the balance of spending as a whole. The Spending Review, the fruits of which [are] due in late June, will provide an opportunity to the Government to address these risks and provide an explanation of how these risks will be avoided.[18]

8. Whilst ring-fenced areas of public expenditure were protected from real terms cuts, other departments and areas of expenditure saw cuts to their budgets for 2015–16. For example, the Department for Communities and Local Government (DCLG) will face a 10 per cent real cut in both the communities and local government parts of their departmental programme and administration budgets. The Justice Department, HM Treasury and the Cabinet Office will have real 10 per cent cuts. The Department for Work and Pensions (DWP) and the Department for Environment and Rural Affairs (DEFRA) will have a 9.5 and 9.6 real per cent cut respectively. However, owing to the ring-fence protection, the

14 HM Treasury, *Spending Round 2013,* p 17, Para 1.10, June 2013

15 HM Treasury, *Spending Round 2013,* p 5, June 2013

16 Ev w8

17 Sixth Report of Session 2010–12, *Spending Review 2010,* HC 544, para 52

18 Ninth Report of session 2012–13, *Budget 2013*, HC 1063, para 137

Department for International Development saw a 1.1 per cent real increase in its 2015–16 budget whilst the NHS (Health) budget will increase by 0.1 per cent in real terms.[19]

9. Paul Johnson, Director of the Institute for Fiscal Studies, in his overview of the 2013 Spending Round, summarised the Government's strategy with respect to departmental public spending:

> In large part what we will get in 2015–16 is a clear continuation of spending policies laid out in 2010. Health and schools continue to see their budgets protected from cuts. Even so job losses in the NHS are likely to continue. Most other spending programmes get hit hard, with local government, justice and environment among the perennial losers. Each of those will have lost more than a third of their 2010 Budgets by 2015.

Mr Johnson went on to argue that "two facts stand out" on the public spending side:

> First, there are still another £25 billion worth of cuts pencilled in for the two years after 2015–16. That looks tough indeed.[20]
>
> Second, the protection of the NHS and schools and pensions at least through to 2015–16 while all else is being cut is leading to continued change in the shape of the state. These ring fences will have to be looked at again if we continue to cut overall spending.

Mr Johnson's view that departmental spending cuts combined with ring-fencing particular areas of public expenditure was leading to a continued change in the shape of the state was shared by other commentators. For example, Stephanie Flanders, at the time of the 2013 Spending Round, stated that departmental spending cuts were putting the UK "on a road to a very different kind of public sector despite the continued high level of borrowing. In future, the government will spend quite a lot on social security, health, defence and education—and not very much else".[21] This point was echoed by the Institute for Government who told us that "over the decade from the mid–2000s, the UK will effectively have increased the share of our national income spent on pensioner benefits, the NHS and overseas aid through reduced spend on areas such as (non-school) education, law and order and defence". It argued that:

> This shift has occurred through the decision to stick to the cash allocations of the 2007 Spending Review, completed just before the recession, which rapidly expanded spending as a share of GDP in certain areas. This was followed by the explicit and implicit ring-fences in the spending reviews since 2010, which have protected these same areas. Our spending review processes have therefore never considered the large

19 HM Treasury, *Spending Round 2013,* p 10, Table 1, June 2013

20 IFS presentation on the 2015–16 Spending Round, opening remarks by Paul Johnson, Director, IFS

21 *Review that reflects political and economic reality*, Stephanie Flanders, BBC news online, 26 June 2013

> scale shifts in the composition of public spending, limiting the opportunities for proper analysis and debate of these issues.[22]

10. We examined the principle of ring-fencing particular areas of public spending as well as the consequences of continuing to do so until 2015–16 and potentially thereafter. Phillip Booth from the Institute of Economic Affairs made a direct link between ring-fencing and the scale of the cuts being undertaken in non-ring-fenced departments:

> Self-imposed ring-fences around foreign aid and NHS spending together with less formal ring-fences around spending on the elderly, spending on schools and, to a lesser degree, spending on in-work benefits means that all the work in terms of cutting government spending falls on a relatively small number of departments (at a time when debt interest is also rising).[23]

Professor McWilliams, chief executive and founder of Cebr, told us "that the ring-fences should never have been put in place in the first place".[24] John Cridland, Director-General of the CBI, described the reduction in some non-ring-fenced spending departments' budgets as "quite punitive" which he attributed to the decision to ring-fence other areas of departmental spending. Mr Cridland told us that "the consequences of those ring-fences will become more exacerbated the longer the cuts need to continue".[25] In written evidence the CBI welcomed the fact that "in the main, the Chancellor protected key growth priorities in the Spending Round",[26] but Mr Cridland expressed concern about the impact of continued ring-fencing on growth, telling us that this would make "increasingly difficult" the protection of "capital investment and growth-enhancing current expenditure" which were "in the interests of the economy". Mr Cridland acknowledged that ultimately such decisions were "for elected politicians", but thought it likely that "the ring-fences will need to be revisited".[27]

11. Nicola Smith, the Head of economic and social affairs at the TUC, focussed on the fact that the health ring-fence was not as robust as might be thought. She told us that the TUC did "not accept that the ring-fence has been properly implemented insofar as the NHS budget, for example, is experiencing cuts". She explained that "the initial increases in NHS spending did not take account of inflation".[28] The TUC expanded on this theme in written evidence, telling us that:

> The Government's presentation of public service expenditure data has been less than transparent. In the years running up to the crash health expenditure was rising by around 4% a year, with an annual growth rate of over 2.5% needed simply to keep up

22 Ev w8

23 Ev w18

24 Q 79

25 Q 79

26 Ev w9

27 Q 79

28 Q 79

> with rising demand. In this context the impacts of annual increases of only 0.1% in health expenditure are significant.[29]

12. Ms Smith questioned whether the current fiscal framework was "the right fiscal framework", before going on to argue that:

> If a future Government was to, say, take a longer-term approach to addressing the deficit and was to target debt to GDP over rather than [the] structural deficit over a five-year rolling period, that might lead to a less extreme fiscal settlement for our public services. Similarly, if a future Government decided it wanted a different balance between tax and expenditure cuts, we could have a less austere period for public spending.[30]

13. We asked the Chief Secretary to the Treasury about whether ring-fencing was changing the longer-term shape of the state. The Chief Secretary told us that he did "recognise that picture", but acknowledged that the Government's policy "that some departments will see more significant reductions than others" was leading to a "change in the balance" of state activity.[31] He defended the Government's decision to ring-fence particular budgets until, at the least, 2015–16, telling us that "in each case the ring-fences are justified in their own terms":

> If you look at the health system, for example, it is an area that is obviously enormously important to our country, and I suspect to every person in this room, but it is also something where there are significant cost pressures that grow year on year. So there is a very significant efficiency challenge within the NHS even within a budget that is rising in real terms.
>
> In the school system, we have seen very big pressures in terms of rising pupil numbers. That is why we are investing in additional school places in areas of demographic pressure. On international aid, I would say that we have a strong obligation to support those people who, even given the difficulties that we are going through, are a great deal less fortunate than we are. So I would justify them in those terms.[32]

The Chancellor, when asked the same question about longer-term changes in the shape of the state, described it "as an expression of conscious political choice". He robustly defended the ring-fence as:

> an expression of the political desire by the Government to protect NHS spending, to protect schools spending and to hit our international development target. Much is made of the ring-fencing but, ultimately, it is just an expression of political will by

29 Ev w4

30 Q 80

31 Q 169

32 Q 169

> Government and Parliament, in as much as Parliament votes the estimates. These are areas of public spending that we want to relatively protect.[33]

The Chancellor acknowledged that the decision to ring-fence health spending had put additional pressure on non-ring-fenced departments:

> What is interesting, and perhaps not surprising in a democratic country, is that the biggest ring fence of all, one that has far and away the most impact on the decisions that we have had to take in this spending round, which is the health service ring fence—that pretty neatly mirrors what the British public want to see protected, when they are asked. It is an expression of the priorities of the country. I would say that that is the ring fence that requires difficult decisions in other Departments.[34]

The Chancellor went on to defend the ring-fencing of the international development budget. He told us that "too much is made ... about the impact of the aid commitment" and that, unlike the ring–fencing of the health budget, it did not "force the same difficult decisions on other Departments that the NHS ring fence forces".[35] The Department for International Development was 1.14% of Government spending in 2012–13.[36]

Effect on efficiency

14. We examined whether ring-fencing particular budgets reduced the incentives to pursue efficiency savings and to what extent the Government had permitted the erosion of the ring–fencing of particular budgets by, for example, allowing particular costs for certain departments to be met by ring-fenced budget. As regards efficiency savings, the Taxpayers' Alliance told us that the Government's policy of ring-fencing education, health and international aid budgets distorted "spending decisions, leading to waste and misallocation of taxpayers' resources".[37] It argued that:

> Cuts in departmental expenditure limits in other budgets have prompted the civil service to reassess their spending which has led to genuine efficiency improvements. It is a pity that this cost pressure has been weaker for ring-fenced budgets [...].[38]

The Chief Secretary, when asked whether he felt that ring-fencing reduced the incentive to find efficiency savings, told us that he did "not think that is the case", but acknowledged that it was "a risk that we should guard against".[39] The Chancellor denied that ring-fencing was reducing the imperative to find savings. He pointed out that, whilst "the NHS has a real-terms increase" in its budget, it remained "a challenging budget" given "an ageing

33 Q 223

34 Q 224

35 Q 224

36 QDS - Full Year 2012-13 , date: 21/06/2013, http://www.gist.cabinetoffice.gov.uk/qds/2012-13/#pie

37 Ev w16

38 Ev w16

39 Q 171

population and new medical technology”.[40] The Chancellor went on to outline reforms undertaken to make savings in both the NHS and schools programme:

> They [the NHS] have undertaken a major programme of reform, the so-called QIPP savings—£20 billion of savings that they need to find—and all sorts of other savings that we have initiated in things like procurement and through a reduction in administration.
>
> In education, there has been a big reduction in the Department for Education’s administration budget. The cost of building a new school, for example, is 40% less than it was under the building schools for the future programme. There is also an aggressive programme of efficiency in DFID.[41]

A porous ring-fence?

15. The Institute for Government drew attention to the attempt by some departments “to reclassify their spending within protected budgets”.[42] They told us that “it was widely reported that BIS wanted to reclassify academic medical research funding as part of the NHS budget”.[43] They acknowledged that “almost all these attempts to break the ring-fences were unsuccessful”, but said that these attempts to breach the ring-fence “attracted unnecessary attention and energy”.[44] We questioned the Chancellor about attempts to breach the ring-fences in this way. He told us that the Government had “rejected precisely what ... might have been tempting for me to do, which was to tuck things into the ring fence”. He confessed that “there was a proposal early on in the spending round to shift some budgets into the health ring fence—medical training, medical research and Army medicine”.[45] However, he stressed that the Government had “rejected” such proposals and that “Medical research and medical training stay in BIS, and Army medicine stays with the Ministry of Defence”.[46] The one exception, the Chancellor told us, was social care:

> social care reform is not just about money. It is also about involving the NHS with local authorities in the commissioning of care services, which they were not previously involved in, so there is a real reform there. That has been near universally welcomed by everyone in the health and social care world. I have had some very positive feedback from the charities involved. If there had been any suggestion that we were doing this for financial reasons, I would have got a warning from the people who care most about this subject but, actually, it has been very broadly supported. It

40 Q 224
41 Q 226
42 Ev w8
43 Ev w8
44 Ev w8
45 Q 225
46 Q 225

> is precisely this sort of thing where we want government to be working more closely together [...].[47]

16. Our inquiry also touched on the parallel ring-fencing of pensioner benefits. The IEA told us that “whilst welfare spending on those of working age has been trimmed back, spending on older people has, by and large, been increased”.[48] It argued that there was “no strong economic case against abolishing: the winter fuel allowance, free TV licences, free bus passes and the triple lock on pension increases”.[49] The IEA singled out the triple lock which they described as “the biggest issue” and which “not only creates a commitment going forward but creates a growing commitment going forward”. It argued that:

> The abolition of the items listed above—all of which are relatively new so that their abolition should not create great hardship—would save substantial sums of money. If they had been abolished in 2011, the savings would probably have been around £10bn by the end of the Parliament—and that is without, for example, applying the 1% limit to benefit increases to the elderly population. Simply treating the elderly in the same way that the rest of the population has been treated when it comes to benefits could yield even bigger savings.[50]

When we asked the Chancellor about the ring-fencing of pensioner benefits he restated his commitment to the Government’s policy in this area:

> We have made a commitment to the pensioners that we are going to have a triple lock—we are going to give them a generous state pension—and we live by that commitment.[51]

Beyond 2015–16

17. As noted earlier, the Spending Round 2013 provided departmental spending allocations for 2015–16. However, at Budget 2013, an envelope for Total Managed Expenditure was assumed for 2016–17 and 2017–18:

> **Spending in 2016–17 and 2017–18** – In line with previous policy, the Government has set a fiscal assumption that Total Managed Expenditure (TME) in 2016–17 and 2017-18 will continue to fall in real terms at the same rate as over the Spending Review 2010 period. Fiscal consolidation for 2016–17 and 2017–18 is expressed as a reduction in TME. It would, of course, be possible to do more of this further consolidation through tax instead.[52]

47 Q 225

48 Ev w18

49 The triple lock refers to the Government’s guarantee that the state pension will rise at the highest of the increase in the Retail Prices Index, national average earnings growth or 2.5%.

50 Ev w18

51 Q 226

52 HM Treasury, Budget 2013, HC 1033, March 2013, p 67, para 2.6

However, Paul Johnson, Director of the Institute of Fiscal Studies, queried whether such fiscal consolidation would come from spending reductions alone:

> At some point we are going to have to have a serious debate about whether all of the rest of the fiscal consolidation is really going to happen through spending cuts alone. We are on course not for sharing the consolidation 80% on spending and 20% on tax as the government originally planned but for an 85:15 split. Returning to an 80:20 split for the consolidation as a whole would mean a £6 billion tax increase in the next parliament. Coincidentally this is pretty close to the average tax increase seen in post election budgets in recent decades.[53]

Mr Emmerson, of the IFS, outlined the implications of achieving the further fiscal consolidation through spending cuts alone, whilst also maintaining the departmental spending ringfences:

> If you want to do the deficit reduction largely on the spending side, as the Government plans going forward, I think it is feasible that you could protect schools and hospitals and cut back spending elsewhere. I think it is more a question of whether you would want to do that. If you were to do all of the continued squeeze on spending, do you really want all of the pain to go on public services that are not health and schools, or do you want to share the pain in some other way? Do you want to lift the ring fence and go for spending on schools or hospitals, or do you want to do more welfare cuts, to be cutting public spending in a different way, or do you want to instead go for greater reliance on tax rises? They are clearly political choices, but I think it might seem unlikely that you would want to put all the pain on not just public spending but spending on public services except for schools and hospitals, which are such a large part of what the public sector does.[54]

This point was also emphasised by the EEF in their written evidence:

> This spending round has been agreed for the last financial year of this parliament only. Further, and potentially steeper, cuts to government spending are inevitable beyond the next general election. The same approach of returning to the same departments in order to deliver additional cuts is not sustainable and would significantly erode the capacity of departments and agencies to deliver policies to support skills and innovation, for example. The next Spending Review must, therefore, be driven by a root and branch assessment of what activities government should be supporting and where it should withdraw.[55]

Nicola Smith, of the TUC, noted that a different mix between tax rises and spending cuts was available:

53 Institute for Fiscal Studies, Opening remarks, Paul Johnson, Director, IFS, 27 June 2013

54 Q14

55 Ev w12

> if a future Government decided it wanted a different balance between tax and expenditure cuts, we could have a less austere period for public spending. I think the current balance, the IFS said, is now 85:15. Under the Darling plan it was 70:30. I understand that in the 1990s under Norman Lamont it was 50:50. There are a range of options available to people as to the relative balance of tax and spending cuts. Even within the current envelope, the TUC has observed that the Chancellor has, for example, decided to cut corporation tax by a very significant amount, which I think amounts to around £8 billion over the course of the Parliament. That is money that a different Government might choose to deploy elsewhere.
>
> I think we can't see austerity into the future as an inevitability. There are choices that Governments can make about how they allocate spending and about the fiscal frameworks they operate in. [56]

18. The Chancellor believed that spending cuts alone could achieve the required consolidation, but noted that these decisions would be made after an election:

> The 80:20 split was a guide that we set out in 2010. I think that it was before this Committee that I said that it was not an exact number, but a guide based on the best international evidence that we have, and that has been reinforced by events around the world since. The further consolidation after the year 2015–16 is built into the tables as a spending reduction—a spending consolidation. I am clear that tax increases are not required to achieve this, and that this can be achieved with spending reductions. It is a coalition Government, however, and the document makes clear that both coalition parties are not, as a collective, signed up to the exact mix of spending and tax. What they signed up to is the path of deficit reduction—the path of borrowing, in effect. Of course, it would always be open to my coalition partners—we are talking about a post-election period—to advocate increases in taxes.[57]

19. **In our Report on the 2013 Budget, we argued that ring-fencing tends to reduce the scrutiny of ring-fenced spending, can lead to waste or worse, and if persisted with will distort the balance of spending as a whole. As the Chancellor argues, ring-fencing is an expression of political preference supported by the ballot box. However, spending in ring-fenced departments may receive less scrutiny than that in departments competing for resources. The Government must remain alert to this danger. The Government should place in the public domain its own assessment of the value for money of ring-fenced departments and its rationale for keeping the ring-fences.**

The future size of the state

20. Spending Round 2013 shows that Total Managed Expenditure as a proportion of GDP is forecast to fall to just above 40% in 2017–18.[58] We discussed with witnesses what their

56 Q 80

57 Q 241

58 HM Treasury, *Spending Round 2013,* June 2013,

preferred level of public sector spending as a proportion of GDP would be. Nicola Smith of the TUC argued that:

> I think the level of public spending the UK in 2008 was around 48%—I can double-check on that statistic—and that was within the range of what was normal within the developed economies with whom we compete. Absolutely, addressing the deficit and the problems our public finances face as a result of the financial crisis, and the consequent drop in taxation revenues and increased social security spend is important, but as you will know from the TUC's recent statements and from our written evidence, we disagree with the approach that the Chancellor is taking to that fiscal consolidation and feel that it is indeed slowing growth and reducing our ability to deal with our public finances.[59]

John Cridland, of the CBI, disagreed. He noted that:

> For medium and longer-run economic growth, we think a figure closer to 40% is healthier for the British economy than the 48% figure. We think evidence suggests that if you get into the mid-40s you begin to choke off the private sector, and that the necessary correction over time is for public sector as a percentage of GDP to come down from the 48% figure.[60]

Ms Smith in response, however, argued that:

> [...] a fall in public spending of that scale would leave the UK with a drop in public spending pretty much the largest of all developed economies, excluding Ireland and Greece, and would leave us very low relative to other countries with the proportion of public spending we would have in our entire economy. The TUC would argue very strongly that we saw strong growth in the years up to the financial crisis. There was not any evidence of public sector spending squeezing out private sector investment over that period. The importance of addressing the public finances and the problems we have with our deficit now need to be seen as distinct from the share of public spending that we need to secure strong growth going forward.[61]

Professor McWilliams was keener for even deeper reductions in public spending than had been suggested by Mr Cridland:

> I think it is important that we compare ourselves not just with other countries in Europe and in the western world more generally, but also with the rapidly emerging economies that are increasingly setting the terms of the game competitively. Hong Kong and Singapore have higher life expectancy, better educational attainment and better infrastructure than us, and neither spends as much as 20% of GDP on public

59 Q 53

60 Q 55

61 Q 56

> expenditure. To make our taxes competitive and to get the deficit down, we will in the long term have to get public spending way below 40% of GDP.[62]

21. Written evidence from the IEA noted that:

> The likelihood is that the government will be locked into a 40 year battle just to keep spending at its desired level of 40% of national income and many of the policy decisions that the government has taken will make things worse.[63]

22. When we questioned the Chancellor on his preferred level of public spending, he did not want to provide a precise target "because, first, GDP can change. As a society and as a Government you have to make a decision about what you think is good value for money for the taxpayer".[64] He went on to note that "It is about what should be collectively provided by the people of this country and the classic balance between spending and taxation". [65] He did, however, warn about the consequences of public spending levels above 40%:

> I would make a broader observation. When spending to GDP rises sharply above 40%, what has happened historically, and what happened again recently, is that the country gets itself into trouble. Even when left-wing Governments try to increase tax, they run into all sorts of problems and popular opposition to that. I do not set myself a precise target.[66]

The Chancellor added that "when I became Chancellor, it was 48%, which is totally unsustainable."[67] When we questioned him on why he would not provide a target figure, he argued that:

> I do not mean it to come across as reticent. The spending plans that I have set out for 2017 get the share of national income taken by the state down to just below 40%—39.5% or thereabouts. I think that is a good path to take and a good point to get to—or else we would not have set it forward.
>
> In some quarters of both the right and the left, there are those who say that you should set a target, whether it is 35%, 40% or 45% of national income. Personally, and it is not that I mean any disrespect, that is not the approach that I think should be taken. I do not think you should precisely target a percentage of national income taken by the state. You should, however, be aware when you are straying into areas that are unsustainable.[68]

62 Q 57

63 Ev w19

64 Q 245

65 Q 246

66 Q 246

67 Q 247

68 Q 249

He concluded that:

> I am clearly signalling that I think it would be good if the state was consuming around 39.5% of GDP, because that is where I am aiming to get to. What we do then is a matter for the Chancellor at the time, which I obviously hope will be myself. That is the question for then. In the way I have set up the fiscal mandate, the debt target and so on, I have not used state spending as a percentage of GDP as a target. I have set a clear signal about what I think is the appropriate size of the state, but I have not made a fetish of it.[69]

23. **The major political parties all favour a reduction in state spending as a proportion of GDP from current levels, as did the previous government. It is the scale and pace of that reduction that is in question, not the direction.**

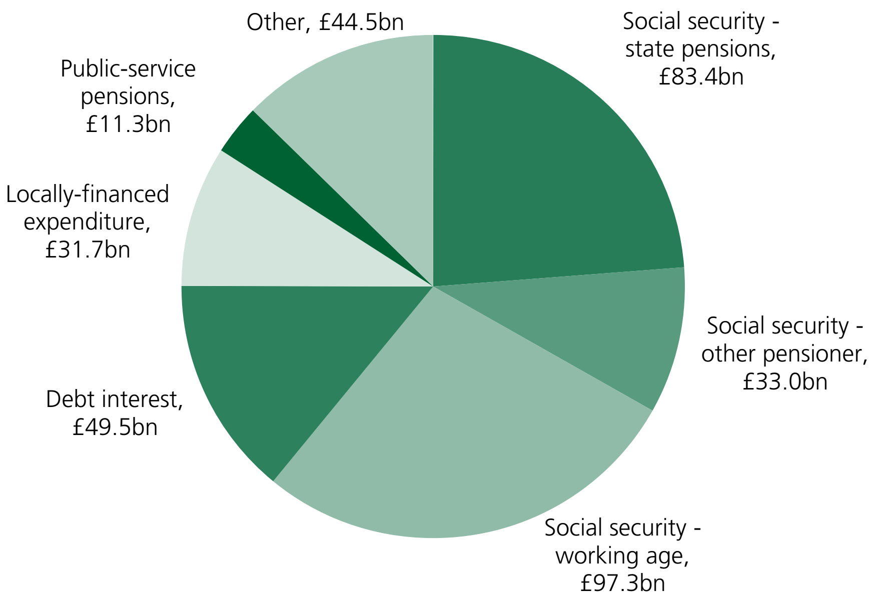
69 Q 250

3 Annual managed expenditure

Introducing annually managed expenditure

24. Annually Managed Expenditure (AME) typically consists of large, demand-led programmes. Under the current public spending framework, AME accounts for around half (some £350 billion[70]) of total public expenditure, the largest component of which is welfare spending (Figure X).

Figure 1: Annually Managed Expenditure in 2013–14



Note: Social security adjusted to include support for council tax benefit and locally-financed expenditure adjusted for Non-Domestic Rates.

Source: Institute for Fiscal Studies, Institute for Fiscal Studies lunchtime briefing on the 2015-16 Spending Round – Controlling Annually Managed Expenditure, 27 June 2013

25. Historically, AME has not been subject to fixed spending controls.[70] During our inquiry into the 2013 Budget, Paul Johnson, Director of the Institute for Fiscal Studies, told us that:

> Annually managed expenditure continues to rise pretty fast such that total spending even between 2010 and 2017 does not change, really, but the composition of it changes very dramatically, with departmental spending falling, and spending on benefits and debt interest, in particular, rising.[71]

70 HM treasury, Budget 2013, HC 1033, 20 March 2013, p 19, para 1.60

71 Oral evidence taken before the Treasury Committee, Budget 2013, Monday 25 March 2013, HC (2012–13) 1063, Q66

Welfare cap

26. In his 2013 Budget statement, the Chancellor announced that the Government intended to introduce additional controls over AME.[72] In his Spending Round 2013 statement, he announced that these additional controls would include “a new welfare cap to control the overall costs of the benefits bill”:

> Under the system we inherited, welfare spending was put into a category called annually managed expenditure, but the problem was that it was not managed at all. The cost of welfare went up by a staggering 50%—even before the crash. Our welfare cap will stop that happening again. The cap will be set each year at the Budget for four years. It [...] will reflect forecast inflation, but it will be set in cash terms. [73]

Concerns have been raised, however, over how effective such a cap will be in practice. Christian Guy, Director of the Centre for Social Justice, has said that although “a radical AME cap has the potential to reduce welfare spending [...] the language is tough but a firm ceiling on this type of demand-led spending is probably unworkable”.[74] In his opening remarks on the Spending Round, Mr Johnson said:

> The first thing to be clear about is that the proposed cap will not tackle those bits of annually managed expenditure which are currently expected to rise. Spending on working age social security is actually due to fall. The big increases are due to be in debt interest and public service pensions. Spending on these is rather harder to cap.[75]

The TUC told us, though, that it rejected the idea of a welfare cap in principle:

> The TUC sees no need for such a rigid and potentially damaging measure. There is no crisis in working age social security expenditure, which fell as a proportion of GDP from the mid-90s until the onset of the recession in 2008 and only rose in real terms over the period as a result of the introduction of tax credits. While there are certainly social security costs which could be better controlled (for example significant rises in housing benefit and disability benefits took place during the early 1990s where higher caseloads and costs respectively drove up the bills) the TUC does not believe that the blunt instrument of a welfare cap is the way to do so.[76]

27. The Spending Round 2013 document sets out that a nominal cap will be introduced set the cap at Budget 2014 and will take effect from 2015–16. The cap will be set over the five-year forecast period, starting in the second fiscal year from the date of the forecast to allow time for policy changes to be developed and take effect if necessary.[77]

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72 HC Deb, 20 March 2013 col 937 [Commons Chamber]

73 HC Deb, 26 Jun 2013, col 314 [Commons Chamber]

74 The Spectator, blog by Christian Guy, Director of the Centre for Social Justice – Wriggle room welfare – 6 AME ‘cap’ observations, 27 June 2013

75 Paul Johnson, Institute for Fiscal Studies lunchtime briefing on the 2015-16 Spending Round – opening remarks, Institute for Fiscal Studies, 27 June 2013

76 Written evidence from the Trades Union Congress, para 27 (Ev w5) [not printed]

77 HM Treasury, Spending round 2013 Cm 8639, June 2013, p 27, para 1.50

28. In its briefing on the Spending Round, the Institute for Fiscal Studies raised the question as to why the Government intends to introduce the cap from 2015–16 rather than 2014–15.78 We put this to the Chief Secretary to the Treasury, who explained that the delay was for operational reasons:

> With a reform of that scale, we need to take time to get the precise operation of it right. The idea is a forward-looking proposal.
>
> We would be too close now to the 2014–15 financial year for this to start. If we introduced it in the autumn statement, let's say, for 2014–15, we would be too close to make it work properly for that year.[79]

Setting the ceiling

29. Mr Guy expressed concern over the practicalities of setting the level of the cap:

> Its feasibility will rely on precise financial forecasts to establish the level of the 'cap'. Yet ministers will need no reminding that projections are unreliable and problems like low pay and rental inflation, which drive AME, are hard to tackle.[74]

The Trades Union Congress also told the Committee that it was sceptical as to the operational viability of setting such a cap:

> By setting a nominal cap over five years the cap will leave a significant inflation risk for all benefit expenditure within its scope. Should forecasts be out by the same magnitude as has been the case in recent years, and should policy then adjust for the cap, the implications for working age benefit entitlements could be severe.
>
> Since the Government took office forecast social security expenditure has risen by £9bn, with around £7bn of this expenditure looking as if it would in the future be within scope of the proposed cap. [...] Had there been a cap in place in 2010, we therefore estimate that the Government would have had to reduce spending by an additional £5bn purely because of cyclical spending pressures which were not taken into account and by a further £2.1bn due to other forecasting errors.[80]

Measures subject to the cap

30. The Spending Round 2013 document sets out that the cap will apply "to over £100 billion of welfare spending", including tax credits expenditure. A number of elements will be excluded, however:

> The basic and additional state pension will be excluded as pension spending is better controlled over a longer time period, for example through an increase in the State

78 Paul Johnson, Institute for Fiscal Studies lunchtime briefing on the 2015-16 Spending Round – opening remarks, Institute for Fiscal Studies, 27 June 2013

79 Qq 181–182

80 Written evidence to the Treasury Committee from the Trades Union Congress, paras 25–26

Pension Age. In addition, the cap will take account of the automatic stabilisers by excluding the most counter-cyclical elements of welfare, such as JSA [Job Seeker's Allowance] and any passported expenditure. All other social security and tax credits expenditure will be included.[81]

We asked the Chief Secretary to the Treasury to provide further clarity over which elements that would be excluded. He told us:

I can't give a list of what all the passported benefits are but, for example, for people who move on to Jobseeker's Allowance and have housing benefit passported as part of that, that housing benefit would also be outside the limit that we are setting.[82]

In its written submission, the CBI told us that while they were "pleased to see a cap introduced [...] the current set of expenditures that will be covered may limit the effectiveness of the targeting".[83] The TUC expressed similar concerns:

The claimed rationale for the cap is 'to protect against structural medium term deterioration in welfare', 'deterioration' here clearly meaning 'spending increase'. This makes little sense. There has been no structural—as opposed to cyclical—change in overall benefit spending or in working age spending since 1997, so a cap is clearly unnecessary to achieve this objective. And the cap will apply to cyclical as well as structural expenditure increases if the only working age benefits excluded from the cap are Jobseeker's Allowance and associated benefits [...].[84]

The TUC also suggested that such a stringent cap could serve to limit the operation of the automatic-stabilisers."[85]

31. The cap will apply to the benefits it covers on an aggregate basis, rather than individual caps being set for each type of benefit. The IFS has suggested however, that this was not the best approach:

there have been times in the past when elements of the social security budget do seem to have run out of control. So a mechanism to ensure this is properly managed might help. But this ought to be done for each element of the budget. There seems little good case for trading off, say, increases in the housing benefit bill against, say, pensioner winter fuel allowances.[86]

We asked the Chief Secretary to the Treasury what the Government's rationale was for choosing an aggregate cap. He told us:

81 HM Treasury, Spending Round 2013, Cm 8639, June 2013, p 27, para 1.47

82 Qq 183–184

83 Written evidence from the CBI, para 11 (Ev w10) [not printed]

84 ToUChstone [TUC] blog. The welfare cap: A political gimmick with very real risks, 28th June 2013, http://touchstoneblog.org.uk/

85 Written evidence from the Trades Union Congress, para 25 (Ev w5) [not printed]

86 Paul Johnson, Institute for Fiscal Studies lunchtime briefing on the 2015-16 Spending Round – opening remarks, Institute for Fiscal Studies, 27 June 2013

> There are always statistical variations up and down for individual benefits. I think it is much more sensible to look at the sort of £100 billion or so of other social security together as one thing. [87]

He denied, however, that the Government had completely ruled out setting individual caps for individual benefits.[88]

32. The Chief Secretary agreed that adopting an aggregate approach might, without any intentional effect, result in an overspend in one benefit squeezing other parts of the welfare budget but said that "it is a judgment for the Ministers of the day to decide what offsetting action they want to take or, if they decide not to, how they will explain that to Parliament."[89]

33. The Spending Round 2013 document states that "over the coming months the Government will consider whether it is appropriate to include other elements of AME in the cap.[90] We asked the Chief Secretary to the Treasury which other elements of AME the Government was considering for inclusion in the cap. He told us that:

> There is a very long list of other AME components. [...] we are looking at a number of measures on that list, and when we have reached a conclusion we will announce what we are going to do. Going back to when we came into office, about half of all public expenditure did not have any control framework associated with it, so there are other elements of AME where we have already introduced control frameworks. In public service pensions, for example, our reforms already have a back-stop cap arrangement in the legislation, so that does not need to be here. We have sought to control the cost growth of the basic state pension through bringing forward increases in the retirement age. I am sure that is a process that will continue in future. There are areas like debt interest which it would not be appropriate to include in a framework like this. Environmental levies already have a control framework associated with them, but there are other smaller elements of AME that we just need to look at and work out if they are appropriate to be included within this framework.[91]

Sanctions

34. The Spending Round 2013 document sets out that "the independent OBR will judge the Government's performance against the cap and the Government will take steps to enshrine this new framework in law".[92] The Chancellor explained further in his statement that:

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87 Q 190

88 Q 192

89 Q 191

90 HM Treasury, *Spending Round 2013*, Cm 8639, June 2013, p 27, para 1.47

91 Qq 185–186

92 HM Treasury, *Spending round 2013*, Cm 8639, June 2013, pp 25–26, para 1.49

> In future, when a Government look to breach the cap because they are failing to control welfare, the Office for Budget Responsibility will issue a public warning. The Government will then be forced to take action to cut welfare costs or publicly to breach the cap and explain it to Parliament.[93]

There will however be "a margin above the cap to ensure policy action is not triggered by small fluctuations in the forecast".[94] The Chief Secretary to the Treasury likened the cap to a fiscal rule:

> It is similar to a fiscal rule, which I think does impose a great deal of discipline on the Treasury and on the Chancellor and the Chief Secretary and the decisions that we make. So I think it is something that will have a real bite.[95]

Commentators have raised concerns, however, about the robustness of the sanction and the likelihood of its resulting in action being taken:

> In the event of a breach, there's wriggle room for the government. It could find savings from elsewhere or justify overspend to parliament. That's not the firm credit card limit suggested by the word 'cap'. [...] Because of this flexibility, a breach could become routine economic business. Missed targets, revised figures and moving goalposts are the norm these days. The stigma is gone.[96]

We put the suggestion that the sanction was a fairly weak deterrent to Departments or Ministers who breach the cap to the Chief Secretary to the Treasury. He responded: "I do not think it is weak—I disagree with that analysis".[97]

35. In term of the policy action that the Government might take in response to a potential breach in the cap, the Chancellor told us that:

> I would much rather control eligibility and rates, rather than try to massage take-up. [...] We are trying to control welfare spending and force choices on Governments in the open space.[98]

36. **The Committee welcomes, in principle, the introduction of measures to provide greater control over Annually Managed Expenditure. Some areas of AME are, however, easier to limit than others and we share concerns that the planned cap may not control those elements that are likely to rise.**

37. **A cap nevertheless has the potential to have a significant impact on the benefits received by those in society who are most in need. It is therefore crucial that policy is**

93 HC Deb, 26 Jun 2013, col 314 [Commons Chamber]

94 HM Treasury, *Spending round 2013* Cm 8639, June 2013, pp 25–26 ,para 1.49

95 Q 189

96 The Spectator, blog by Christian Guy, Director of the Centre for Social Justice – Wriggle room welfare – 6 AME 'cap' observations, 27 June 2013

97 Q 188

98 Q 228

transparent so that the impacts can be understood and debated. We have welcomed the additional transparency from the publication by the Treasury of distributional analysis to accompany the Budget; more detail is required in this area too. We recommend that the Treasury publish clear guidance over which elements of welfare expenditure will and will not be included under the cap, the further areas of AME that it is considering for inclusion, and the size of the margin above the cap before policy action is triggered.

38. **We are concerned that the 'comply-or-explain' sanction for breaching the cap on annually managed expenditure could be too weak to ensure adequate control of such public expenditure and that, were this weakness to materialise, the credibility of the cap could be tarnished.**

Supporting people into work

39. In addition to the overall cap on welfare expenditure, the Chancellor outlined a package of reforms to the processes for unemployed benefits claimants to "help people to stay off benefits, and help those who are on benefits to get back into work faster".[99] Under these reforms, claimants will be required to:

- do more right from the start of their claim, such as writing a CV, registering with the Government's 'Universal Jobmatch' service, starting to look for work and having longer initial interviews with Jobcentre advisors;
- attend weekly rather than fortnightly visits to Jobcentres and have a proper in-depth progress review every three months;
- attend English language courses if their poor spoken English is a barrier to work; and
- verify their claim each year if they are subject to conditionality.[100,101]

All unemployed claimants, and those earning less than the Government expects them to, will also now have to wait seven days before becoming eligible for financial support although the extended waiting period will not apply to people claiming contributory Job Seeker's Allowance (JSA) or the Employment and Support Allowance.[101]

Seven day wait

40. The evidence received by the Committee raised particular concerns regarding the introduction of the seven-day waiting period for unemployed claimants. The Chancellor told the House that:

99 HC deb, 26 June 2013, col 315 [Commons Chamber]

100 Conditionality refers to a framework of labour market requirements that claimants must fulfil to remain entitled to the full amount of benefit.

101 HM Treasury, *Spending round 2013* Cm 8639, June 2013, pp 25–26 , para 1.42

> Half all jobseekers need more help with looking for work, so we will require them to go to the jobcentre every week rather than once a fortnight. We will give people more time with jobcentre advisers, and proper progress reviews every three months. We will also introduce a new seven-day wait before people can claim their benefits. Those first few days should be spent looking for work, not looking to sign on. We are doing those things because we know that they help people to stay off benefits, and help those who are on benefits to get back into work faster.[102]

He also confirmed to the Committee that the seven-day wait would apply to the housing benefit element of universal credit:

> The seven-day wait will come into effect next year for jobseeker's allowance and employment and support allowance, and then, from 2015–16, with universal credit, to what is known as the passported benefits, which will include—it will not be called housing benefit any more—support under universal credit for housing.[103]

41. The housing and homelessness charity, Shelter, told the Committee that this inclusion:

> means that people will receive no support for living costs, including rent, for the first week after becoming unemployed [...] this will represent a significant financial loss to claimants [...] [and] will create significant cash flow difficulties and risks forcing households into debt, including reliance on costly pay day lending.[104]

Citizens Advice raised similar concerns:

> Seven days is a long time to wait before being caught by the safety net. This could mean families who have fallen on hard times being unable to eat or heat their homes, relying even more on food banks which are already breaking under the strain of demand, or turning to payday lenders.[...] The uncertainty this creates for people in precarious employment completely undermines the stability Universal Credit is intended to provide.[105]

Shelter also told us that "the impact will be further compounded by the fact that Universal Credit is paid a month in arrears". [106] This view was supported by the TUC:

> Denying unemployed and low waged claimants entitlement to benefits for the first seven days of their benefit claims will have damaging implications. Simply extending the current three day JSA waiting period to seven days would no doubt be financially challenging for claimants. But as the change being proposed appears to apply to the entire Universal Credit award (which will be comprised of all entitlements including those currently classified as housing benefit and tax credits) the consequences will be even more significant. Given the default payment system for UC will be for it to be

102 HC Deb (2013-14) 26 June 2013 , col 315

103 Q 260

104 Written evidence from Shelter, para 12–14 (Ev w7) [not printed]

105 Citizens Advice, Citizens Advice responds to the Spending Review, 26 June 2013, http://www.citizensadvice.org.uk/

106 Written evidence from Shelter, para 13 (Ev w7) [not printed]

> paid four weeks in arrears, and for conditionality to be applied to those who are 'earning less than the Government expects them to', the TUC believes this policy risks denying unemployed and low waged claimants access to finance for five weeks beyond the point at which their initial claim is lodged.[107]

Nicola Smith, Head of the economics and social affairs department at the TUC, added:

> [...][The seven-day wait] will leave people at a very vulnerable time, when they are facing unemployment, with extremely straitened public finances. We can see no rationale for introducing this measure, and I think it would be useful to explore further with the Government what the perceived rationale for the measure is and what the actual implications will be for families.[108]

Evidence to support reform

42. The Chancellor told us that the 'supporting work' reforms package "is a set of changes based on the best international evidence of what works to help people get into work" and that the measures had all been "subject to an equality impact assessment". [109] The Chief Secretary also told us that:

> All the money that we are saving through that measure is being reinvested in measures that we know, on the basis of DWP assessment and research, make a significant difference to the prospects of Jobcentre Plus being able to help people back into work quickly. [...] I think that the things that we are investing the money in really will make a difference in that respect, and that surely must be the right thing for all of us if we want to get people off benefit quickly and into work.[110]

43. In his statement, the Chancellor said that "this new contract with people on benefits will save more than £350 million a year, and all that money will enable us to afford extra support to help people to get into work".[111] In his evidence to the Committee he emphasised that "this is not money being snaffled by the Treasury or being used to reduce the deficit; this is money going into support for unemployed people".[112] In the policy costings document, published alongside the *Spending Round 2013*, however, the Office for Budget Responsibility identifies the costing of the 'supporting work' measures as subject to particular uncertainty:

> Behavioural responses of benefit recipients to changes in DWP operations and conditionality requirements: the costings of the 'supporting work' measures are highly sensitive to the assumptions about benefit recipients' behavioural responses to the changes, where in some cases were based on limited evidence from DWP

107 Written evidence from the Trades Union Congress, para 28 (Ev w5) [not printed]

108 Q 91

109 Qq 264, 268

110 Q 146

111 HC deb, 26 June 2013, col 315 [Commons Chamber]

112 Q 262

previous programmes, with the assumption that behavioural responses will be similar under the Universal Credit as with the existing social security system.

Interactions with Universal Credit: the ‘supporting work’ measures in the Spending Round are costed on a basis consistent with the Budget 2013 Universal Credit forecast. Any changes to the Universal Credit forecast will have a knock-on impact on the estimates of the social security measures presented in this document, especially the measure to introduce waiting days in Universal Credit.[113]

44. **Concerns have been raised over the rationale for the seven-day wait and other ‘supporting work’ measures announced in the Spending Round. In addition, the Office for Budget Responsibility has highlighted that the costings for these measures are subject to particular uncertainty. In the interests of transparency, we recommend that the Treasury publish its assessment of the behavioural impact of the policy, its analysis of the costs and savings it will generate, and the international evidence of what works to get people into work upon which it has relied in developing this policy.**

113 HM Government, Spending Round 2013: policy costings, 26 June 2013, p16, para A.6

4 Help to Buy

Help to Buy: mortgage guarantee scheme

45. At the 2013 Budget the Government introduced a new 'Help to Buy' scheme which it said would "increase the supply of low-deposit mortgages for creditworthy households, increase the supply of new housing and contribute to economic growth".[114] Help to Buy comprised two schemes:

- Help to Buy: equity loan, where the Government provides an equity loan worth up to 20 per cent of the value of a new build home, repayable once the home is sold; and
- Help to Buy: mortgage guarantee, designed to assist households—whether first time buyers or not—who are creditworthy, but lack a sufficient deposit either to enter the housing market or to move within it.[115]

46. The Government outlined the broad details of how the mortgage guarantee element of Help to Buy would work in a paper *Help to Buy: mortgage guarantee scheme outline* which was published alongside the 2013 Budget. The scheme offered a government guarantee to lenders who offer mortgages to people with a deposit of between 5 per cent and 20 per cent of the purchase price of the property.[116] More specifically, the Government stated that it would provide lenders with the option to purchase a guarantee on the top-slice of the mortgage which would result in the Government compensating the mortgage lender for a portion of the net losses suffered in the event of repossession.[117] The guarantee would apply down to 80 per cent of the purchase value of the guaranteed property.[118] There was to be no income cap constraints and Government support would be available on homes with a value up to £600,000.[119] The Government was, however, unable to clarify at that stage whether the scheme would be open to households wishing to purchase a second property. The Government stated at the time of the 2013 Budget that the mortgage guarantee scheme was intended to be temporary, scheduled to run for three years from January 2014.[120]

47. The Treasury Committee took evidence on the Help to Buy: mortgage guarantee proposals as part of our inquiry on the 2013 Budget. In our subsequent Report we described the guarantee scheme as "a sizeable intervention in the UK market" which "makes the Government an active player in the mortgage market". Furthermore, our Report stressed that "the appropriateness of the taxpayer amassing contingent liabilities in this way needs careful scrutiny". We raised a number of specific concerns about the Government's proposals, namely around the impact of the scheme on house prices; the

114 HM Treasury, Budget 2013, p 38, para 1.100

115 HM Treasury, Budget 2013, pp 38-39, para 1.104

116 HM Treasury, Budget 2013, p 39, para 1.103

117 HM Treasury, *Help to Buy: mortgage guarantee scheme outline,* March 2013, p 9, para 3.2

118 HM Treasury, *Help to Buy: mortgage guarantee scheme outline,* March 2013, p 9, para 3.4

119 HM Treasury, *Help to Buy: mortgage guarantee scheme outline,* March 2013, p 11, para 3.8

120 HM Treasury, *Help to Buy: mortgage guarantee scheme outline,* March 2013, p 11, para 3.12

appropriateness of the taxpayer amassing contingent liabilities in this way; potential losses to the Exchequer; and the risk that a temporary three year scheme could end up becoming permanent.[121]

48. The Committee highlighted the risk that "existing constraints on the supply of new housing ... will mean that the primary effect of easier credit, at least in the short-to-medium-term may be to raise house prices". We said we found "the Chancellor's assertion that increased demand for home ownership and rising prices, resulting from the mortgage guarantee scheme, will trigger a corresponding supply response, unconvincing, at least for the short term". We acknowledged that a corresponding supply response "would be likely in a well-functioning market, but pointed out that the UK "housing market contains severe supply constraints".[122]

49. We also expressed concern that the taxpayer would provide compensation to mortgage lenders for a portion of any net losses suffered in the event of repossession. The Government told us that expected losses under the scheme would be covered by the commercial fee charged to participating lenders. However, we pointed out that "no details of the proposed level of the fee nor how it will be structured in practice are yet available", which the Committee said meant it was "therefore unable to assess the likelihood that the Chancellor will be correct when he says expected losses under the mortgage guarantee scheme will be covered by the commercial fee". We went on to note that "recent history tells us that the housing market is volatile and the level of repossessions difficult to calculate" making it "extremely difficult to price the fee in such a way that sharply curtails Exchequer risk".[123]

50. Another area of concern which we highlighted in our Report on the 2013 Budget was the risk that the Help to Buy mortgage guarantee scheme, whilst intended to be a temporary scheme of three year's duration, could end up becoming a permanent scheme. The Government had justified its "temporary" intervention in the mortgage market on the basis that the current scarcity of high loan-to-value lending was primarily a cyclical issue rather than a symptom of a longer-term structural change in the mortgage market. However, the Committee expressed concern that "the Government has provided little evidence to support this assertion" and drew attention to the possibility "that, should the current scarcity of high loan-to-value mortgages reflect structural rather than cyclical factors, the pressure for Government to extend the scheme in three years time will be immense". The Committee cautioned that "the unintended and unwelcome outcome could be that a scheme designed to deal with a supposedly temporary problem in the UK housing market becomes a permanent feature of the UK housing market".[124]

51. We focussed on these areas of concern in our evidence on the Spending Round with the Chancellor of the Exchequer. The Chancellor defended the introduction of the

121 Treasury Committee, Ninth Report of Session 2012–13, *Budget 2013*, paras 157, 159, 175

122 Treasury Committee, Ninth Report of Session 2012–13, *Budget 2013*, paras 170-171

123 Treasury Committee, Ninth Report of Session 2012–13, *Budget 2013*, para 158

124 Treasury Committee, Ninth Report of Session 2012–13, *Budget 2013*, para 175

mortgage guarantee scheme as a necessary supplement to the funding for lending scheme which he said had “helped with the pricing of mortgages”, but had “not helped with the availability of high loan-to-value mortgages for first-time buyers”:

> The purpose of this [mortgage guarantee scheme] is to repair an impaired mortgage market, which is clearly not functioning properly. If you look at the comparison over the years, the number of first-time buyers is half what its average has been. The average deposit that the first-time buyer needs has gone up from 36% of income to 79% of income. That is not functioning. It is a block on aspiration. It is also a block on home building [...].[125]

> I do not think the fears that the Committee has expressed are justified. This is a three–year scheme, which is targeting a specific problem that has arisen because of a financial crisis, and we are stepping in to repair that bit of the financial transmission mechanism. One thing we have learnt over the past five or six years is that more effort has been required than anyone anticipated to repair broken financial transmission mechanisms, whether that is the funding for lending scheme or the work that we have undertaken with the banks or indeed, now help to buy.[126]

52. We asked the Chancellor what estimate the Treasury had made of the impact of the guarantee scheme on house prices as well as the likely supply response from the introduction of the scheme. On the first point, the Chancellor told us that the price estimate was “provided by the OBR”, but that the OBR had not changed their house-price inflation forecast as a result of the proposed introduction of the guarantee scheme. The Chancellor said that the OBR estimated that “house-price inflation is going to rise broadly in line with long–term average rate-of-earnings growth”, before telling us that “like all things, you want moderation in house prices. As the OBR says, you want house prices to rise broadly in line with long-term average rate-of-earnings growth. You do not want house-price bubbles, nor do you want housing crashes”. The Chancellor, when asked whether he was concerned about a potential housing bubble, told us that:

> the best thing that I can do is to quote the director-general of the CBI, John Cridland, and I certainly agree with him. He said “clearly there are dangers in the long term of asset price bubbles, but we are a very long way from that”. I do not think the situation at the moment looks like an asset price bubble.[127]

We questioned the Chancellor on what action, if any, the Government would take with respect to the guarantee scheme if house prices rose faster than earnings and whether the scheme, in such an eventuality, might be shortened. He told us that:

> It is sensible to have a three year scheme. I do not want to create uncertainty with institutions that are being asked to deliver this that it might suddenly end early. [128]

125 Q 297

126 Q 299

127 Q 304

128 Q 321

53. The Chancellor went on to defend the Government against the charge that the scheme would merely increase house prices:

> The ITEM Club has also taken the view that "the risk of higher prices does not appear to us to be a major concern". Interestingly, the response from the home builders—the crucial word is "builders"—is that they think that impaired mortgage finance has been the principal constriction on the supply of new building, and they think that, as a result, that will help enormously with the construction of new homes. Also, planning applications, because of the planning reforms that we have introduced, are up 10% in the last year. [129]

The Chancellor subsequently reiterated this point, telling us that there was "plenty of evidence from the home builders that one of the biggest impairments to supply has been mortgage finance".[130] He said that the Government had "not put forward an estimate for the number of new homes that will be built", but that "as we develop the details of the [mortgage guarantee] scheme—it is not operational until the end of this year—I am happy to look at those estimates".[131]

54. We also discussed safeguards to ensure that the scheme could not simply be extended by the government of the day after three years. The Chancellor told us that the guarantee scheme would "come to an end after three years".[132] He stressed that the guarantee scheme was "a time-limited scheme" and that it was "not something that we want to see as a permanent feature of our financial landscape".[133] The Chancellor explained that there was "a sort of double lock in that the FPC [Financial policy Committee] will also be invited to give a comment if the Government of the day proposes to extend the scheme. There will be a clear red card in the system".[134] He explained the rationale behind the "double lock":

> The reason the lock is there is because people have been concerned that, if the scheme becomes a permanent feature of the mortgage market, and the Government is therefore a long-term player in the mortgage market, it could contribute years hence to ... asset-price inflation ... the scheme is absolutely intended to end after three years. This is only something I have put in to reassure those who feared that it would become a permanent feature of our financial system.[135]

We questioned the Chancellor further about the "double lock" and, in particular, whether the FPC would indeed—as had been intimated at the time of the 2013 Budget—have a veto over any proposed continuation of the guarantee scheme after three years. He told us that he "would set out in greater detail later this year" how the "double lock" would work in practice, but that:

129 Q 292

130 Q 298

131 Q 297

132 Q 305

133 Q 310

134 Q 301

135 Q 313

> The way I envisage it working is that a Chancellor would say, "I am considering extending this scheme", and would write to the FPC about that and get the FPC's views on whether or not that was sensible ...
>
> In the hypothetical situation in which a Chancellor said, "I'm going to extend the scheme", that is when the FPC's warning lights, if they wanted to activate them, would come into effect.[136]

The Chancellor defended the proposed 'double lock', telling us that he had given the FPC "a pretty powerful weapon" which gave them the ability "to alert everyone to the fact that this is not something that they think is sensible". When asked about whether the Government could simply override a FPC objection to the extension of the scheme, he told us that an extension would "politically ... be extremely difficult to do if the FPC was recommending against it",[137] before reminding us that:

> Parliament is sovereign in our country, but Parliament and Governments have a strong aversion to doing things that our independent Financial Policy Committee says are not a good thing.[138]

55. **The Treasury Committee expressed serious reservations about the Help to Buy: mortgage guarantee scheme at the time of the 2013 Budget. We highlighted the risk that, without a corresponding supply response, the scheme could serve merely to drive up house prices. We also expressed concern about the appropriateness of the taxpayer acquiring contingent liabilities in this way and questioned the Government's assertion that the commercial fee to be charged to participating lenders could be priced accurately so as to ensure the taxpayer did not suffer losses. We also warned that the political pressure to extend the guarantee scheme—designed to run for three years—could be immense, particularly if the current shortage of high loan-to-value mortgages turned out to be to be structural and not the cyclical problem which the Government said that it was seeking to address.**

56. **The Government's response to our Report on the 2013 Budget has done little to allay our concerns that the primary effect of the guarantee scheme, at least in the short to medium-term, could be to raise house prices rather than stimulate new supply. Furthermore, we continue to believe that the government of the day will face strong incentives to extend the scheme, with the attendant risk that the mortgage guarantee scheme becomes a permanent feature of the UK mortgage market. Following Committee scrutiny it transpires that the so-called "double lock"—whereby we initially understood that the FPC would have a veto over the continuation of the scheme after three years—is not a lock at all. Our understanding is that the government of the day, if it chose to extend the scheme, could do so despite any objections raised by the FPC. The Government should provide more precise information on the operation of the so-called**

136 Q 311

137 Q 318

138 Q 320

“double lock” and, in particular, re-examine the case for giving the FPC an explicit veto over the continuation of the scheme.

57. In a recent speech, Dr Mark Carney, Governor of the Bank of England, emphasised that the Bank now had the tools to take action around risks from the housing market:

> […] the Bank of England is acutely aware of the risk of unsustainable credit and house price growth and will be monitoring it closely.
>
> The important thing to recognise is that we now have tools other than interest rates that can be used to contain risks in the property and financial sectors. These so-called macroprudential tools were not available to us before the crisis and we are now fully prepared to deploy them if that were needed. The Bank of England is now in a position, for example, to supervise lending to specific sectors more intensively, to make recommendations to banks and building societies to restrict the terms on which new credit is provided, or even to raise capital requirements on mortgage or other types of lending.[139]

58. **As the Governor of the Bank of England recently noted, the FPC has both powers of recommendation, and powers of direction, to counter risks from the housing market. We note that the FPC can issue recommendations to the Treasury, and we would expect it to do so if it believed that the mortgage guarantee scheme should finish early.**

139 Bank of England, Crossing the threshold to recovery, Speech given by Mark Carney, Governor of the Bank of England, at a business lunch hosted by the CBI East Midlands, Derbyshire and Nottinghamshire Chamber of Commerce and the Institute of Directors at the East Midlands Conference Centre, 28 August 2013, pp 9-10

5 Infrastructure

The Economic Case for High Speed 2

59. "High Speed 2" (HS2) is a high speed rail project planned for construction in the UK. The project comprises two stages. Stage one is a high speed line between Birmingham and London. Stage two extends the stage one line to both Leeds and Manchester in a "Y" network. In the 2013 Spending Round, the Government reiterated its commitment to the project as part of its long term UK infrastructure plan.[140] An economic case for HS2 is produced and maintained by HS2 ltd and the Department for Transport. First completed in March 2010, the study initially estimated a long term cost to benefit ratio of 2.4 to 1, without wider economic impacts. As HS2's plans matured, the economic case was revised and the cost to benefit ratio has fallen. At the last update performed in August 2012, the full HS2 "Y" network was estimated to generate a cost-benefit ratio of 1.9 to 1 without wider economic impacts. Including wider economic impacts, the cost-benefit ratio rises to 2.5 to 1.[141] HS2's full "Y" network's projected costs have risen since the latest assessment, increasing by around 17% from £36.4bn to £42.6bn.[142] The entire project is now expected to cost £50.1bn, including £7.5bn set aside for rolling stock. [143]

60. Whilst broadly supportive of rail infrastructure investment, John Cridland, of the CBI, described the increased cost of HS2 as "a matter of concern"[144] and called for a reassessment of the project's value for money:

> I find it hard to envisage in 30 years' time that the UK, as a major economy and industrial nation, will not have excellent rail infrastructure. I am quite convinced that there is a strong case for more rail capacity, both for intercity transport and for commuter and rail freight transport on the west coast main line. For High Speed 2 to go ahead, it has to wash its face. I am quite convinced that the value for money test needs properly applying.[145]

61. The National Audit Office has also questioned several aspects of this economic appraisal in a recent report.[146] Amongst other concerns, it questioned three key areas: the calculation of transport benefits to business users, forecasts of ridership on the new line and a lack of evidence on regional rebalancing.

62. On the calculation of transport benefits, the NAO noted that to "calculate benefits for business travellers, the largest estimated benefit, the Department is using data which are

140 "Investing in Britain's Future," HM Treasury, 27 June 2013, p.25, para 3.16

141 "High Speed 2: A review of early programme preparation," National Audit Office, 16 May 2013, p 7

142 "Updated Economic Case for HS2," HS2 ltd, August 2012, p 4, Table 2

143 "Investing in Britain's future," HM Treasury,27 June 2013, p 25, para 3.16

144 Q 72

145 Q 72

146 "High Speed 2: A review of early programme preparation," National Audit Office, 16 May 2013, pp 6-8

over ten years old."[147] It recommended that the methodology for calculating business travel benefits should be updated, saying:

> The Department's methodology uses a simplifying assumption that time spent travelling is unproductive and business travellers will use all the time saved from faster journeys to work. While this approach is used in appraisals in other countries, it has been challenged by opponents of the High Speed 2 programme on the basis that it is unrealistic for rail travel.[148]

The NAO also highlighted a problem in the demand forecasts HS2. It said that:

> HS2 Limited has not yet analysed the effect of premium pricing on forecast passenger demand, revenues and the benefit–cost ratio. To forecast passenger demand, HS2 Limited uses the same average fares for high-speed and conventional rail in its models, although premium fares are charged on High Speed 1.[147]

Professor McWilliams, Chief Executive of CEBR, raised a similar point regarding passenger numbers, and its effect on the economic case for HS2. He said:

> research we did two years ago showed that demand [for HS2] was way overstated and if you put realistic demand numbers in [...] the costs way outweighed the benefits and [...] there would be a very large funding gap.[149]

63. HS2 ltd have acknowledged "sensitivity" in their analysis to "the approach taken to modelling fares growth and its interaction with passenger demand." In August 2012, they said "HS2 Ltd and DfT will consider whether these approaches can be improved upon for future decisions. Where there is uncertainty around demand forecasting parameters we will reflect this is in our analysis."[150]

64. The NAO also believed there to be insufficient evidence to support the need for increased rail capacity and how HS2 will achieve regional rebalancing. Its report into HS2 said:

> In presenting its case for investment, the Department has poorly articulated the strategic need for a transformation in rail capacity and how High Speed 2 will help rebalance economic growth. The [DfT] and HS2 Limited have started a lot of work recently to strengthen the evidence and analysis on which the case is based.[151]

The role of HS2 in regional rebalancing was also raised by Professor McWilliams, who said "it is a very expensive way of promoting regional growth", [152] and that "skills and

147 "High Speed 2: A review of early programme preparation," National Audit Office, 16 May 2013, p 8

148 "High Speed 2: A review of early programme preparation," National Audit Office, 16 May 2013, p 28

149 Q 68

150 "Updated Economic Case for HS2," August 2012, HS2 ltd, p 5, paras 6.1 – 6.2

151 "High Speed 2: A review of early programme preparation," National Audit Office, 16 May 2013, p 11

152 Q 68

technology look a lot better as candidates than a high speed rail project, although urban transport in these regional economies is also important."[153]

65. When challenged on the economic case for HS2, the Chief Secretary to the Treasury and the Chancellor questioned the role of cost benefit analyses in infrastructure decisions, criticising their inability to capture all of the benefits of HS2. The Chief Secretary to the Treasury said:

> [...]
>
> the specific analysis of transport projects does not, in general, take into account the much wider economic benefits of these sorts of projects. [...] If we simply followed the economic model in the way you are suggesting, this country might not have built the M1 in the 1960s, for example, or completed the M25 in the 1980s. These are transformational projects that go beyond just the travel time benefits of a particular rail service.[154]
>
> [...]
>
> We have made a very strong commitment to it on the basis not just of the short-term economic analysis but of our view about the longer-term economic transformational potential that this project has in the context of what is still a very divided economy, especially across England. [155]
>
> [...]
>
> We know from countries around the world that improved connectivity of this sort makes a big difference to balance of your economy over a number of decades. We also know that capacity constraints on some lines are really starting to bite now, so this investment not only creates a very important infrastructure improvement in its own right but also releases capacity for existing services.[156]

The Chancellor of the Exchequer argued that:

> [...]If you look at economic returns on transport projects, they will basically tell you to spend everything in the south-east of England and around the M25. We reject that because, as a country, we do not want to see the only investment going into the south-east of England. We also want to improve the economic performance of the rest of the country, so a huge amount of investment is going around the country more broadly.[157]

153 Q 70

154 Q 134

155 Q 134

156 Q 132

157 Q 248

66. Since we took evidence on the Spending Round, the former Chancellor of the Exchequer and Secretary of State for Transport in the previous Government, Rt Hon Alistair Darling MP, has warned that building HS2 might cause a “nightmare” on the rest of the rail network if there was not enough money to maintain the rest of the network.[158] Subsequently the Institute of Directors has also criticised the value for money of the scheme, suggesting that the money would be better spent on the existing rail network and other infrastructure projects.[159] The Chancellor of the Exchequer has restated his commitment to HS2:

> We have set the budget for £42bn for the construction costs. That includes, by the way, a big contingency. As we demonstrated with the Olympic Games, we can deliver these big projects actually sometimes under budget.
>
> I think we have got a good budget, which has got a very big contingency in it, we’ve set a budget.
>
> I’m passionate about this project because time and again, we have this debate in our country about how we're going to bring the gap between north and south together, about how we’re going to make sure that our growth is not just based on the City of London.
>
> High Speed 2 is about changing the economic geography of this country, making sure the North and the Midlands benefit from the recovery as well.[160]

On 11 September 2013, HS2 Ltd published a report produced by KPMG entitled *HS2 Regional Economic Impacts*.[161]

67. **On 11 September 2013, HS2 Ltd published additional material on HS2. We will wish to examine whether the material published by HS2 Ltd, and any further material published by the Government, meets the following requirements:**

- **The National Audit Office has highlighted a number of problems with the existing cost-benefit study that, combined with the increased cost of the project, could have a large impact on its value for money. The Treasury should not allow HS2 to proceed until it is sure the cost-benefit analysis for HS2 has been updated to address fully the concerns raised by the National Audit Office.**

- **The Treasury has based the need for HS2 upon the existence of benefits that are not captured by the existing economic appraisal. The Treasury should publicly quantify these benefits.**

158 *HS2 costs could mean rail nightmare, says Darling,* BBC News website, 23 August 2013, http://www.bbc.co.uk/news/uk-politics-23808993

159 *Institute of Directors calls on the Government to abandon HS2*, 27 August 2013, http://www.iod.com/influencing/press-office/press-releases/institute-of-directors-calls-on-the-government-to-abandon-hs2

160 *George Osborne ‘passionate’ about HS2 rail link*, BBC News website, 1 September 2013, http://www.bbc.co.uk/news/uk-politics-23919949

161 High Speed 2 (HS2) Limited, *HS2 Regional Economic Impact*s, Ref HS2/074, September 2013

- **Prior to any decision by the Treasury to proceed with HS2, it should publish its own comprehensive economic case supporting its decision.**

Once these requirements have been met, the Government should formally reassess the project before deciding whether to proceed. In the event that it does proceed, Parliament can then consider the hybrid Bill in the light of that reassessment.

Infrastructure spending plan

68. At the time of the Spending Round 2013, the Treasury announced a long term infrastructure plan for the UK. The Treasury document *Investing in Britain's future* detailed spending plans in a number of areas including roads, railways, energy and science. John Cridland spoke favourably regarding elements of the infrastructure plans:

> [...] The package announced by the Chief Secretary the day after the Spending Review was a source of some encouragement to business, both in energy and in transport, and I think complemented the announcements in the Spending Review on forward capital.[162]

69. However, there has been some scepticism amongst commentators regarding the Government's ability to deliver on its announcements. Adam Marshall, director of policy at the British Chambers of Commerce, said:

> Infrastructure projects are too often promised and too rarely delivered in this country, and that cycle must be broken. If these announcements are to translate into short-term confidence, medium-term construction jobs and long-term competitiveness, the Whitehall machine must be judged by the number of diggers on the ground, not strategies and press notices.[163]

Some of this scepticism may have been caused by re-announcements made by the Treasury in its infrastructure plan. For example, the Department for Transport had already confirmed the construction of HS2 as early as January 2012, [164] and had announced the allocation of £470m for the Mersey Gateway Bridge in October 2011[165]—both of which were also contained in the Government's *Investing in Britain's Future*. [166] Nick Prior, Head of Infrastructure at Deloitte said "there is little here that we hadn't heard already and there may be scepticism in the sector about turning this rhetoric into reality."[167]

70. **The Committee welcomes the creation of long term plans for infrastructure investment. It is now crucial that the projects are delivered in a timely and effective manner. To aid transparency and public accountability, the Treasury should provide**

162 Q 91

163 "Quick delivery of infrastructure projects is crucial for jobs and confidence," British Chambers of Commerce

164 "Britain to have new national high-speed rail network", Department for Transport press release, 10 January 2012

165 "New bridge over the Mersey," Department for Transport press release, 3 October 2011

166 "Investing in Britain's Future," HM Treasury, 27 June 2013, pp 6,9, paras 1.8, 1.16

167 "Spending Review: Deloitte comments on infrastructure measures," Deloitte press release, 27 June 2013

infrastructure plan updates on an annual basis at every Budget. The updates should set out progress on each infrastructure measure announced in *Investing in Britain's Future*.

6 Release of Budget information

71. Prior to the Chancellor's Budget statement to the House, the London *Evening Standard* released an image on Twitter of its front page for that day. This included potentially market-sensitive information on the public finances, economic growth and duty changes. The image was subsequently removed and the *Evening Standard*'s editor apologised to the Speaker and the Chairman of Ways and Means.

72. In our Budget 2013 sessions, the Chancellor of the Exchequer acknowledged that "the practice that has gone on can't continue because of what happened."[168] Following the disclosure, the Chancellor requested that Sir Nicholas Macpherson, Permanent Secretary to the Treasury, conduct a review of the practice of pre-releasing information to journalists.[169] In his report, published on the day of our hearing with the Chancellor, Sir Nicholas concluded that:

> Recent practice in relation to pre-release of Budget information on Budget day appears to have been the product of a process of evolution. This has led, without any single strategic decision, to an increase in the amount of information being provided.
>
> Each of the individual decisions that led to this appears to have been made for good reason. Nonetheless the fact that the change occurred in a piecemeal fashion meant that the overall risk was not assessed. Moreover, while the pre-release was under strict embargo terms, these were uncodified and meant that the Treasury did not have a clear line of sight to, or control over, the risk management within media organisations. With the benefit of hindsight, this was unsatisfactory.[170]

73. The review states that because practice evolved piecemeal, once a behaviour had begun there was no ability to reverse it. Sir Nicholas describes in his report a "ratchet effect", whereby it was difficult to make a case for reversing a practice of pre-releasing certain information if this had not had an adverse impact.

74. When we considered this matter in our Report on Budget 2013, we recommended that "there should be no Treasury pre-releasing of Budget information, even in secure conditions."[171] Sir Nicholas, however, drew a distinction in his report between core and non-core information, recommending that:

> the Treasury introduces a ban on the pre-release of the core of the Budget (and Autumn Statement), that is: the economic and fiscal projections, the fiscal judgement and individual taxes, reliefs and allowances.[172]

168 Oral evidence to the Treasury Committee, Budget 2013, 26 March 2013, HC 1063–iii, Q 452

169 HM Treasury, *Review into the pre-release of Budget information*, July 2013

170 HM Treasury, *Review into the pre-release of Budget information*, July 2013, p 13

171 Treasury Committee, Ninth Report of Session 2012–13, *Budget 2013*, HC 1063, p 92

172 HM Treasury, *Review into the pre-release of Budget information*, July 2013, p 13

In evidence to the Committee, the Chancellor said that:

> the central recommendation, which I accept in full, is that the Treasury introduces a ban on the pre-release of the core of the Budget and the autumn statement—that is, the economic and fiscal projections, the fiscal judgement, individual tax rates, reliefs and allowances. I am confident, as I think is Sir Nicholas, that this will prevent a repeat of what happened and the disservice that that did to Parliament.[173]

Asked what the justification was for the pre-release of non-core information, the Chancellor said that:

> I think it is perfectly reasonable, in the modern age, to try to explain the context in which a Budget happens. We no longer have the closed economy of the 1950s, when the Budget was the be-all and end-all. The Budget is one of a number of economic statements that we make during the year. It has been perfectly reasonable for myself, for Alistair Darling and for others to try to explain the context in which the Budget is happening, just as Government Ministers constantly seek to explain the context in which Government policy is made.[174]

75. **Sir Nicholas offered no justification in his report for confining the ban on the pre-release of Budget information to "core" information, and the Committee is not convinced that a clear distinction between core and non-core information can always be drawn. The scope that exists for politically motivated judgements about whether data is core or non-core could be subject to abuse. There would also be scope for other information to be released principally for reasons of obtaining good coverage rather than in order to explain the "context" of the Budget. In addition, allowing the Government to pre-brief on certain topics, without the "core" data, leaves room for the Government to manage the message of Budgets and Autumn Statements to an unacceptable degree.**

76. **There is no public interest in pre-releasing Budget and Autumn Statement information, whether Ministers classify it as "core" information or not. The Treasury should not pre-release the Budget or Autumn Statement.**

77. Sir Nicholas also stated that:

> the review focused largely on the activities of permanent civil servants rather than special advisers, since the evidence showed that the practice of pre-release was generally the preserve of permanent officials.[175]

78. The fact that special advisers were not included within the scope of the investigation merely increases the chance that pre-briefing and leaks may migrate to special advisers. **For**

173 Uncorrected oral evidence to the Treasury Committee, Spending Round 2013, 11 July 2012, HC 575–ii, Q 206

174 Uncorrected oral evidence to the Treasury Committee, Spending Round 2013, 11 July 2012, HC 575–ii, Q 208

175 HM Treasury, *Review into the pre-release of Budget information*, July 2013, p 3

the avoidance of doubt, the Committee recommends that the prohibition on pre-briefing also include special advisers and Ministers.

Conclusions and recommendations

Introduction

1. It has been put to us that coalition politics has encouraged a more formal process in the Spending Round. Whether true or not, the fact that the Spending Round was concluded without delay or apparent acrimony is noteworthy in view of the scale of the challenge, which is unprecedented. (Paragraph 5)

Ring-fencing

2. In our Report on the 2013 Budget, we argued that ring-fencing tends to reduce the scrutiny of ring-fenced spending, can lead to waste or worse, and if persisted with will distort the balance of spending as a whole. As the Chancellor argues, ring-fencing is an expression of political preference supported by the ballot box. However, spending in ring-fenced departments may receive less scrutiny than that in departments competing for resources. The Government must remain alert to this danger. The Government should place in the public domain its own assessment of the value for money of ring-fenced departments and its rationale for keeping the ring-fences. (Paragraph 19)

3. The major political parties all favour a reduction in state spending as a proportion of GDP from current levels, as did the previous government. It is the scale and pace of that reduction that is in question, not the direction. (Paragraph 23)

Annual managed expenditure

4. The Committee welcomes, in principle, the introduction of measures to provide greater control over Annually Managed Expenditure. Some areas of AME are, however, easier to limit than others and we share concerns that the planned cap may not control those elements that are likely to rise. (Paragraph 36)

5. A cap nevertheless has the potential to have a significant impact on the benefits received by those in society who are most in need. It is therefore crucial that policy is transparent so that the impacts can be understood and debated. We have welcomed the additional transparency from the publication by the Treasury of distributional analysis to accompany the Budget; more detail is required in this area too. We recommend that the Treasury publish clear guidance over which elements of welfare expenditure will and will not be included under the cap, the further areas of AME that it is considering for inclusion, and the size of the margin above the cap before policy action is triggered. (Paragraph 37)

6. We are concerned that the 'comply-or-explain' sanction for breaching the cap on annually managed expenditure could be too weak to ensure adequate control of such public expenditure and that, were this weakness to materialise, the credibility of the cap could be tarnished. (Paragraph 38)

7. Concerns have been raised over the rationale for the seven-day wait and other ‘supporting work’ measures announced in the Spending Round. In addition, the Office for Budget Responsibility has highlighted that the costings for these measures are subject to particular uncertainty. In the interests of transparency, we recommend that the Treasury publish its assessment of the behavioural impact of the policy, its analysis of the costs and savings it will generate, and the international evidence of what works to get people into work upon which it has relied in developing this policy. (Paragraph 44)

Help to Buy

8. The Treasury Committee expressed serious reservations about the Help to Buy: mortgage guarantee scheme at the time of the 2013 Budget. We highlighted the risk that, without a corresponding supply response, the scheme could serve merely to drive up house prices. We also expressed concern about the appropriateness of the taxpayer acquiring contingent liabilities in this way and questioned the Government’s assertion that the commercial fee to be charged to participating lenders could be priced accurately so as to ensure the taxpayer did not suffer losses. We also warned that the political pressure to extend the guarantee scheme—designed to run for three years—could be immense, particularly if the current shortage of high loan-to-value mortgages turned out to be to be structural and not the cyclical problem which the Government said that it was seeking to address. (Paragraph 55)

9. The Government’s response to our Report on the 2013 Budget has done little to allay our concerns that the primary effect of the guarantee scheme, at least in the short to medium-term, could be to raise house prices rather than stimulate new supply. Furthermore, we continue to believe that the government of the day will face strong incentives to extend the scheme, with the attendant risk that the mortgage guarantee scheme becomes a permanent feature of the UK mortgage market. Following Committee scrutiny it transpires that the so-called “double lock”—whereby we initially understood that the FPC would have a veto over the continuation of the scheme after three years—is not a lock at all. Our understanding is that the government of the day, if it chose to extend the scheme, could do so despite any objections raised by the FPC. The Government should provide more precise information on the operation of the so-called “double lock” and, in particular, re-examine the case for giving the FPC an explicit veto over the continuation of the scheme. (Paragraph 56)

10. As the Governor of the Bank of England recently noted, the FPC has both powers of recommendation, and powers of direction, to counter risks from the housing market. We note that the FPC can issue recommendations to the Treasury, and we would expect it to do so if it believed that the mortgage guarantee scheme should finish early. (Paragraph 58)

Infrastructure

11. On 11 September 2013, HS2 Ltd published additional material on HS2. We will wish to examine whether the material published by HS2 Ltd, and any further material published by the Government, meets the following requirements:

- The National Audit Office has highlighted a number of problems with the existing cost-benefit study that, combined with the increased cost of the project, could have a large impact on its value for money. The Treasury should not allow HS2 to proceed until it is sure the cost-benefit analysis for HS2 has been updated to address fully the concerns raised by the National Audit Office.

- The Treasury has based the need for HS2 upon the existence of benefits that are not captured by the existing economic appraisal. The Treasury should publicly quantify these benefits.

- Prior to any decision by the Treasury to proceed with HS2, it should publish its own comprehensive economic case supporting its decision.

Once these requirements have been met, the Government should formally reassess the project before deciding whether to proceed. In the event that it does proceed, Parliament can then consider the hybrid Bill in the light of that reassessment. (Paragraph 67)

12. The Committee welcomes the creation of long term plans for infrastructure investment. It is now crucial that the projects are delivered in a timely and effective manner. To aid transparency and public accountability, the Treasury should provide infrastructure plan updates on an annual basis at every Budget. The updates should set out progress on each infrastructure measure announced in Investing in Britain's Future. (Paragraph 70)

Release of Budget information

13. Sir Nicholas offered no justification in his report for confining the ban on the pre-release of Budget information to "core" information, and the Committee is not convinced that a clear distinction between core and non-core information can always be drawn. The scope that exists for politically motivated judgements about whether data is core or non-core could be subject to abuse. There would also be scope for other information to be released principally for reasons of obtaining good coverage rather than in order to explain the "context" of the Budget. In addition, allowing the Government to pre-brief on certain topics, without the "core" data, leaves room for the Government to manage the message of Budgets and Autumn Statements to an unacceptable degree. (Paragraph 75)

14. There is no public interest in pre-releasing Budget and Autumn Statement information, whether Ministers classify it as "core" information or not. The Treasury should not pre-release the Budget or Autumn Statement. (Paragraph 76)

15. For the avoidance of doubt, the Committee recommends that the prohibition on pre-briefing also include special advisers and Ministers. (Paragraph 78)

Formal Minutes

Wednesday 11 September 2013

Members present:

Mr Andrew Tyrie, in the Chair

Mark Garnier
Stewart Hosie
Andrea Leadsom
Mr Andrew Love
Mr George Mudie
Mr Brooks Newmark
Jesse Norman
Teresa Pearce
David Ruffley

Draft Report (*Spending Round 2013*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 78 read and agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Thursday 12 September at 9.45 am

Witnesses

List of additional written evidence

(published in Volume II on the Committee's website www.parliament.uk/treascom)

List of Reports from the Committee during the current Parliament

Session 2010–12

First Report	June 2010 Budget	HC 350
Second Report	Appointment of Dr Martin Weale to the Monetary Policy Committee of the Bank of England	HC 475
Third Report	Appointment of Robert Chote as Chair of the Office for Budget Responsibility	HC 476
Fourth Report	Office for Budget Responsibility	HC 385
Fifth Report	Appointments to the Budget Responsibility Committee	HC 545
Sixth Report	Spending Review 2010	HC 544
Seventh Report	Financial Regulation: a preliminary consideration of the Government's proposals	HC 430
Eighth Report	Principles of tax policy	HC 753
Ninth Report	Competition and Choice in Retail Banking	HC 612
Tenth Report	Budget 2011	HC 897
Eleventh Report	Finance (No.3) Bill	HC 497
Twelfth Report	Appointment of Dr Ben Broadbent to the monetary Policy Committee of the Bank of England	HC 1051
Thirteenth Report	Appointment of Dr Donald Kohn to the interim Financial Policy Committee	HC 1052
Fourteenth Report	Appointments of Michael Cohrs and Alastair Clark to the interim Financial Policy Committee	HC 1125
Fifteenth Report	Retail Distribution Review	HC 857
Sixteenth Report	Administration and effectiveness of HM Revenue and Customs	HC 731
Seventeenth Report	Private Finance Initiative	HC 1146
Eighteenth Report	The future of cheques	HC 1147
Nineteenth Report	Independent Commission on Banking	HC 1069
Twentieth Report	Retail Distribution Review: Government and FSA Responses	HC 1533
Twenty-first Report	Accountability of the Bank of England	HC 874
Twenty-second Report	Appointment of Robert Jenkins to the interim Financial Policy Committee	HC 1575
Twenty-third Report	The future of cheques: Government and Payments Council Responses	HC 1645
Twenty-fourth Report	Appointments to the Office of Tax Simplification	HC 1637
Twenty-fifth Report	Private Finance Initiative: Government, OBR and NAO Responses	HC 1725
Twenty-sixth Report	Financial Conduct Authority	HC 1574
Twenty-seventh Report	Accountability of the Bank of England: Response from the Court of the Bank	HC 1769
Twenty-eighth Report	Financial Conduct Authority: Report on the Governments Response	HC 1857
Twenty-ninth Report	Closing the tax gap: HMRC's record at ensuring tax compliance	HC 1371
Thirtieth Report	Budget 2012	HC 1910

Session 2012–13

First Report	Financial Services Bill	HC 161
Second Report	Fixing LIBOR: some preliminary findings	HC 481
Third Report	Access to cash machines for basic bank account holders	HC 544
Fourth Report	Appointment of Mr Ian McCafferty to the Monetary Policy Committee	HC 590
Fifth Report	The FSA's report into the failure of RBS	HC 640
Sixth Report	Appointment of John Griffith-Jones as Chair-designate of the Financial Conduct Authority	HC 721
Seventh Report	Autumn Statement 2012	HC 818
Eighth Report	Appointment of Dr Mark Carney as Governor of the Bank of England	HC 944
Ninth Report	Budget 2013	HC 1063

Session 2013–14

First Report	Appointments of Dame Clara Furse, Richard Sharp, and Martin Taylor to the Financial Policy Committee	HC 224
Second Report	Appointments of Dr Donald Kohn and Andrew Haldane to the Financial Policy Committee	HC 259
Third Report	Spending Round 2013	HC 575

Oral evidence

Taken before the Treasury Committee

on Tuesday 9 July 2013

Members present:

Mr Andrew Tyrie (Chair)

Mark Garnier
Stewart Hosie
Andrea Leadsom
Mr Andy Love
Mr Pat McFadden
John Mann
Mr George Mudie
Jesse Norman
Teresa Pearce
Mr David Ruffley
John Thurso

Examination of Witnesses

Witnesses: **Carl Emmerson**, Deputy Director, Institute for Fiscal Studies, and **Gemma Tetlow**, Programme Director, Pensions, Savings and Public Finances, Institute for Fiscal Studies, gave evidence.

Q1 Chair: Thank you very much, both of you, for coming in this morning and kicking off our examination of public expenditure control in the wake of the announcement of the review. Can I begin by asking you, Mr Emmerson, how long is this austerity going to last?
Carl Emmerson: The Chancellor's plan, based on the OBR's forecasts, is that he will get the deficit down to the level we are comfortable with in 2017–18, so that plan is that austerity will continue until March 2018. That is a central estimate, so there is a 50% chance that it will be over before then and a 50% chance it will take longer than that, based on the OBR's projections.

Q2 Chair: Does the IFS think that is the end of the matter?
Carl Emmerson: Beyond that, there are a number of challenges to the public finances. We know that we have an ageing population, which is putting pressures on the budgets of the NHS and social care and pensions. We know that we have pressures on North Sea oil revenues. As production in the North Sea declines, those revenues will gradually fade away. We know that revenues from fuel duties and vehicle excise duty will decline as people increasingly drive cleaner and cleaner vehicles. There are a whole load of challenges that face the public finances, quite possibly of a similar scale to what we have been dealing with over the last few years, but we have a much longer time horizon over which we can adjust. We will have to make decisions over taxation and spending to deal with the ageing population and to deal with the revenues that are likely to fade away.

Q3 Chair: Having been through a phase of great optimism about the sustainability of revenue, revenue has now collapsed and we are in a phase of saying, "We won't be able to fund very much because the tax won't come in".
Carl Emmerson: The current crisis for the economy has turned out smaller than we expected, revenues have disappeared with that collapse in the economy, and that is the problem we are dealing with at the moment. Even if the financial crisis and recession had not happened, we would still have had the longer-term challenges of an ageing population and what happens to fuel duty revenues, vehicle excise duty revenues and so on.

Q4 Chair: Also the overhang of a structural deficit that you have analysed on many occasions.
Carl Emmerson: And the deficit that we will get back to appropriate levels around 2017–18. Of course, the stock of public sector debt will still be much higher than it was pre-crisis, so Governments in the future will need to think about what level of debt they are comfortable with and how quickly they want to get debt back to that level. Clearly, one thing we have learned in recent years is that one advantage of having low debt is that you can increase it a lot if you need to when a crisis comes along, so we will need—

Q5 Chair: The IFS did publish an estimate of what they thought the underlying deficit was prior to the crash, but I can't remember what the figure was. Can you remind me?
Carl Emmerson: Before the crash happened, we thought that there was a problem in the public finances of the magnitude of about 1% of GDP, about £15 billion. That was a forecast based on, "If the Treasury is right about the path of the economy, what do we think will happen to tax revenues?" We were projecting that there was a problem, but clearly nowhere near as large as the problem that we are now dealing with.

Q6 Chair: Sorry, that was my fault for not being precise in the question. Retrospectively you re-examined the judgment that you were making in 2007–08, and I am asking you what that retrospective judgment was.
Carl Emmerson: With the benefit of hindsight, we know that the crisis and associated recession have done damage to the public finances.

Q7 Chair: No, I am asking you what the size of the structural deficit was prior to the crash, with the

benefit of the information you know now, not what size it is after the crisis.
Carl Emmerson: The problem is, if you look just at data up to 2007–08, it is less clear that there was a huge problem in the public finances. Clearly, as soon as you look at data beyond that you see there was a huge problem worth about 9% of national income, and therefore if we had a time machine and we could go back to the early 2000s, we would want to have higher taxes or lower spending sooner in order to ease the problem that we subsequently had. But if you don't look at data beyond 2007–08, it is much harder to make the judgment, although the public finances were in a very, very bad state.

Q8 Chair: You did publish a figure for this, and I can't remember what it is.
Gemma Tetlow: Since the crisis, the Office for Budget Responsibility has published a new estimate of where it thinks the trend level of GDP was before the crisis. On that basis, we estimated that the structural borrowing in the UK was 1% of GDP higher than the Treasury figures prior to the crisis suggested.

Q9 Chair: Giving a figure of—
Gemma Tetlow: I am afraid I can't remember off the top of my head.

Q10 Chair: Could you let the Committee know afterwards?
Gemma Tetlow: Yes.
Chair: Neither your memory nor my memory is good enough. I have slightly more excuse, but both of us can be excused.

Q11 Mr Mudie: Paul Johnson projected that the share of the difference between taxation and cuts would be 85:15. At what point does he suggest you reach that point, 85:15? Are we at it now?
Gemma Tetlow: The plans that are currently set out suggest that by the end of the current planned fiscal tightening, which, as Carl mentioned, is 2017–18, the composition of the measures at that point will be 85% coming from spending cuts and 15% from tax increases. The 80:20 is where we will be at from the measures that are implemented up to 2014–15.

Q12 Mr Mudie: If we got to that, is there some £6 billion increase projected to get those figures right?
Gemma Tetlow: If you wanted to do the same size of fiscal tightening by 2017–18, but do it 80:20 instead of 85:15, that would mean doing £6 billion more on tax increases and £6 billion less on spending cuts.

Q13 Mr Mudie: It seems from the figures that, apart from the first flush of enthusiasm for cuts when the Government came in, the deficit has remained roughly the same, and there seems little likelihood, unless growth contributes, that they will move away from that. That means that they are pushing everything until after the election. Do you think that the ring fence can survive under those situations after the election?
Carl Emmerson: Whether you want to protect areas like health and schools from spending cuts—they are clearly big parts of what Government does—will depend in large part on how much you think austerity should come from cuts to public services versus welfare cuts or tax cuts.

Q14 Mr Mudie: Carl, I understand the sensitivity of these areas, but if you are going to deal with the deficit, I think in some of your figures your organisation projected—I think it was you, Chairman—that we would go up to, what is it, 15% cuts in the areas that are non-sensitive, that are not ring-fenced? There are fierce cuts, and there comes a point where you can't cut any more, so if all this is being pushed after the election, is it feasible that you can deal with the budget deficit without going into the ring-fenced areas?
Carl Emmerson: If you want to do the deficit reduction largely on the spending side, as the Government plans going forward, I think it is feasible that you could protect schools and hospitals and cut back spending elsewhere. I think it is more a question of whether you would want to do that. If you were to do all of the continued squeeze on spending, do you really want all of the pain to go on public services that are not health and schools, or do you want to share the pain in some other way? Do you want to lift the ring fence and go for spending on schools or hospitals, or do you want to do more welfare cuts, to be cutting public spending in a different way, or do you want to instead go for greater reliance on tax rises? They are clearly political choices, but I think it might seem unlikely that you would want to put all the pain on not just public spending but spending on public services except for schools and hospitals, which are such a large part of what the public sector does.

Q15 Stewart Hosie: In terms of the impact of the CSR, if I have understood this correctly from the Government's own distributional analysis, the bottom quintile has gone from losing £830 a year in 2015 at the time of the Budget to £930 a year since the CSR. Is that correct?
Carl Emmerson: The Budget document sets out how the consolidation up to 2014–15 is shared by income quintiles, and the Spending Review document does it up to 2015–16. We are moving forwards one more year, and in that year we have one more year of welfare cuts, the welfare uprating Bill and cuts to public services. I do not think it would be surprising if a lot of that were to be felt by those towards the lower end of the income distribution.
However, I do not think you can compare the numbers in the Spending Review completely with the ones in the Budget, because the Treasury has changed the methodology. I think it would be much more helpful if the Treasury had said, "Here are the figures up to 2014–15 based on our latest best methodology, and here are the figures up to 2015–16", and you could, therefore, directly compare them. They did not do that, and I think it is good that they are trying to do this analysis, but it is something that they could do a much better job of documenting what is going on.

Q16 Stewart Hosie: That might be something we will want to raise with the Chief Secretary later, but

in general terms, from what the Government has provided and the assessment you have done, the poorest quintile, in the following year, is likely to be another £100 worse off as a consequence of the CSR cuts.
Carl Emmerson: At IFS we have only modelled the impact of tax changes and welfare changes. We have not looked at changes to public services, so that is not something we have tried to do. The Treasury has tried to look at public services, but it is important to remember that they have only included 60% of spending on public services in their analysis, and they have almost certainly only included a minority of the actual cuts, because they have included all the spending on health and schools, but that is not being cut. It is a very hard thing to do, but the numbers they have are not the impact of the whole Spending Round, because there is so much they have not been able to model. Again, that is something they have not really set out in their document. They do not make clear what percentage of the cuts they have included in their analysis.

Q17 Stewart Hosie: That is important, because it is the loss of benefits in kind that the lowest quintile households get that forms a large part of the impact. What would your overall assessment be, taking into consideration not just the cash cuts, benefit cuts and tax credit changes but the cuts in terms of benefit in kind? Would it be an accurate assessment to say that as a consequence of the CSR, the lowest quintile is now bearing the largest share of the burden?
Carl Emmerson: I would want to look at the consolidation as a whole. It seems to be an important bit of context. This Government has chosen to do tax rises upfront. They are naturally something that affects those further up the income distribution, and then over time the welfare cuts kick in a bit more. I think it is a bit unfair just to look at the change in 2015–16, given that the up-front stuff they did was much more likely to be paid for by the rich. I would say, according to the Treasury's analysis, the richest fifth has been hardest hit, but the next hardest hit is the poorest fifth.

Q18 Stewart Hosie: I think in general terms that is right, but is that the case as a consequence of the CSR decisions only?
Carl Emmerson: I think it would be rather odd to look at the CSR on its own in isolation from the whole consolidation package. It would seem that the Chancellor, whoever is in government, would want to take into account the impact of all of the decisions they are taking to get the deficit down.

Q19 Mr McFadden: The Government has failed to secure any meaningful growth in the last few years through this strategy, and the Spending Review was in two parts. We had the cuts announced on the Wednesday by the Chancellor, and then the statement on infrastructure by the Chief Secretary. I would like to ask you about that. The Government has made a great deal of lots of spending on roads, bridges, rail and so on, but the table on page 11 of the report issued alongside the spending plan shows departmental capital budgets flat in cash terms between 2014 and 2015 at £50.4 billion, which is a real-terms cut. What is actually happening with infrastructure spending?
Gemma Tetlow: The figures that were published alongside the CSR for capital spending all the way up to 2017–18 were essentially exactly the same set of figures as had been published in the Budget for capital spending.

Q20 Mr McFadden: So there is nothing new in this statement.
Gemma Tetlow: In terms of the total level of public sector gross investment, the figures for 2014–15 to 2017–18 were exactly the same in the Spending Review. We did obviously get more detail from the Chief Secretary about some of the priorities within capital spending. I think, qualitatively, the plan for public sector gross investment is essentially for it to be roughly flat across the years up to 2017.

Q21 Mr McFadden: Define "flat".
Gemma Tetlow: It is set to grow very slightly in cash terms. That will be a small cut in real terms.

Q22 Mr McFadden: In real terms, after all this, we have a cut in capital spending.
Gemma Tetlow: I would describe it probably as broadly flat, but it is declining slightly in real terms.

Q23 Mr McFadden: Would you like to add anything to this, Mr Emmerson?
Carl Emmerson: It is not being cut as hard as day-to-day spending, which is in contrast to the last Spending Review where investment spending was cut much more sharply than day-to-day spending. So you could say there is a change in the priority of this Government, because previously it chose to cut capital spending much harder than day-to-day spending. Those capital cuts were following the plan that Mr Darling set out in his March 2010 budget, whereas in this Spending Round they have chosen to cut capital spending in real terms, as Gemma said, by less than the cuts to day-to-day spending.

Q24 Mr McFadden: You raised Mr Darling's last budget. The Government has claimed as justification for its position that it is spending more on capital than under the plans inherited from Mr Darling, but that is not true, is it? The OBR has published figures saying that they are a cut in relation to those as well.
Carl Emmerson: I would say that in broad terms they delivered the cuts that were set out in that March 2010 budget. They have topped up the spending plans a little in 2013–14 and 2014–15, but the big picture there is that we are spending a lot less on investment than we were in 2010–11 and, as Gemma says, in broad terms it is roughly flat going forwards.

Q25 Andrea Leadsom: Ms Tetlow, do you think that £50 billion spent on High Speed 2 represents good value for infrastructure spending?
Gemma Tetlow: I am afraid High Speed 2 is not my particular area of expertise, so I can't comment on that.

Q26 Andrea Leadsom: Let me ask you in a different way then. Do you think that the actual projects that infrastructure capital is spent on matter, or is it simply important to spend money on infrastructure?
Gemma Tetlow: Certainly in the longer term we want to make sure that we are spending investment spending in the places where it is going to have most long-term value. Obviously, the short-term boost to the economy may matter simply in what you can get started most quickly, but in terms of the long-term value to the economy then, yes, it certainly matters what you spend the money on.

Q27 Andrea Leadsom: Mr Emmerson, do you have any views on whether, if you had £50 billion to spend on infrastructure, HS2 is where it should be spent?
Carl Emmerson: I am afraid IFS has not done any work on where we would best spend £50 billion of capital spending, and indeed, as Gemma said, we have not done any work looking at the cost-benefit analysis of High Speed 2.

Q28 Andrea Leadsom: All right. Would you ever intend to spend time looking at the relative merits of one piece of infrastructure spending over another, or do you not see that as your brief at all?
Carl Emmerson: I don't think it is our relative strength.
Andrea Leadsom: Okay. Thank you.

Q29 Chair: You have looked at capital spending in aggregate, though.
Carl Emmerson: Yes, we have.

Q30 Chair: Presumably, when you get up into the tens of billions, it might be a good idea to have a look at the return expected from them.
Carl Emmerson: Yes. Of course, it is easier for economists to think about the financial return and harder for us to think about the social return, which we would also care about, and that may be much more difficult to measure.

Q31 Chair: But isn't that what the IFS exists to do?
Carl Emmerson: The other thing that is difficult here is, of course, that often when we are looking at the merits of some tax change or some benefit change, we can look at similar things in the past and work out how people responded to those changes in the past, whereas with High Speed 2 it is very hard to think of a comparator to say, "We did a project like this in a similar way and it worked, and these were the pros and these were the cons". We don't have that kind of experiment to look at.
Chair: We have not discussed this as a whole Committee, but I do know roughly where people stand on this. I think that there would be at least a number of colleagues around this table who would find it extremely helpful if the IFS were to consider doing such work for the very largest projects. It is, after all, very much your field of expertise and the expertise of a number of your micro-economists, as well as the macro-economists.

Q32 Mark Garnier: Mr Emmerson, in the past you have done some work on schools funding, which it is a focus of mine, and on the calculation that harmonised different local authorities' allocation methods, and the *FT* quoted you as coming up with the fact that six schools out of 10 will lose funding whereas just one school in 10 will gain funding. Do you think there may be a similar problem with the Government proposals to try to reduce the difference in the schools funding formula post-2015?
Carl Emmerson: I think it is a natural consequence of the Government's decision. It is something that needs to be thought about, but whether it is a problem is less clear. School spending at the moment is allocated in a way that is not optimal or desirable. School money is allocated to local authorities based not just on their current circumstances but a lot of history, and I think it would be a good move to move to a system where two schools with similar circumstances and similar sets of pupils receive the same amount of money. The current system is very unequal and moving to that system will be painful. It will involve some schools getting big increases in their budgets and some getting big cuts, and we will want to manage that carefully, but I think ultimately, in the medium term, we can end up in a better place.

Q33 Mark Garnier: To give an example, I have a secondary school in my constituency with about 1,100 pupils. Were you to pick up this particular school, Baxter College, and move it to Tower Hamlets, they would get £3 million more to run the school on a per annum basis than they do now. Are you suggesting that what should happen is that, effectively, Tower Hamlets loses £1.5 million and Baxter College gains it in Kidderminster, or would you see a regression to mean closer to the higher level as a way to approach this problem?
Carl Emmerson: I think that it is quite hard to describe the pattern of what kinds of schools would lose and win under this, because the current system of allocating funding looks so strange. I can't sit here and say, "These types of schools would definitely gain and these types of schools would definitely lose". Clearly, we do not want big changes in budgets overnight. We want to manage that process. It could be managed over a number of years. It would be easier to do in a world where school spending was gradually rising, so you could have bigger increases in some schools and smaller increases in others. Ultimately, where we want to get to, I think, is that schools with similar intakes should get similar levels of funding.

Q34 Mark Garnier: We clearly have a bit of a nonsense where, according to the f40 group, the bottom end is £4,328 per pupil and the top end is £8,051 per pupil. I have cited an example between Worcestershire, where we are 148th out of 156 shire counties in the ranking, and Tower Hamlets, which is first. I use those extremes to illustrate a point.
My question is slightly more subtle, if you like. That is an obvious inequity, but clearly in Tower Hamlets they have key problems. However, do you think it is worse that we have a situation of Worcestershire bang next door to Birmingham where you have, literally on

the other side of the road, an £800 increase per pupil funding? Do you think that is more of a social problem than these big differences across wide parts of the country—the cliff edge between districts?
Carl Emmerson: The big differences will depend on a judgment about what kinds of characteristics should involve a school getting more money. There is not going to be a right or wrong answer to what things need more money in a school. People will disagree about that. I think that we know that because local authorities have been allocated money based on a lot of history, and because local authorities themselves come up with their own formulas, it does mean that across borders you are going to get differences, and that does seem rather odd, and we would probably be able to allocate public spending in a better way.

Q35 Mark Garnier: With this difference between £4,328 at the bottom end and £8,051 at the top end—as I said, I can see a justification for a difference, depending on certain issues like London weighting—in your opinion what is a fair difference between the best-funded and the worst-funded per pupil across the country? That is nearly a 100% difference. What do you think would be a fair percentage difference?
Carl Emmerson: I am afraid I do not have a view on whether that gap is too big or too small.

Q36 Mark Garnier: You agree it is too big, though?
Carl Emmerson: I don't have a view on whether it is too big or too small.

Q37 Chair: If it was 200%, how about that? Do you have a view?
Carl Emmerson: What I have a view on here is that two schools with the same intake should get the same funding, and the current system does not deliver that and therefore the system we are moving to is an improvement. What we then need is a discussion about what kind of characteristics we should take into account, and people may disagree on what things should count and should not count in the school funding formula.

Q38 Mark Garnier: If we unpick a key part of that reply, you have just said you think that there should be no difference at all.
Carl Emmerson: Among schools that have the same intake in terms of their pupils, but different pupils may—

Q39 Mark Garnier: The same numeric intake or same—
Carl Emmerson: No. It might be the same number of children but also the same types of backgrounds that those children come from. Then there is the question about how much you think you should spend on children from different backgrounds, which is what I think people might disagree with.

Q40 Mark Garnier: Are you likely to do any work on this?
Carl Emmerson: We are doing lots of work on this, and we have already done some analysis of what a funding formula might look like and pointed out that one in six schools could see their budget change by 10% or more, up or down, and we are planning to do more work as we respond to the Government's consultation on the formula when that comes out in due course.

Q41 Mark Garnier: But overall you welcome this measure?
Carl Emmerson: Yes.
Mark Garnier: Thank you.

Q42 Jesse Norman: Mr Emmerson, you have said that the current system of school funding is highly unequal. Can you talk about exactly why that has arisen, what the elements are that have made it so unequal?
Carl Emmerson: What has happened is that we give money to local authorities based on the types of pupils they have, but then we introduce lag, so we don't want the funding to change too much over time. We have been doing this for a long while, and then it has led to a situation now where it is very hard to explain why one local authority is getting X pounds and another one is getting Y pounds. Moving to a system where the spending that a local authority gets more carefully reflects their current circumstances would be an improvement.

Q43 Jesse Norman: Should the broad principle be—of course, there are lots of subsidiary principles—that the richer the area, the less funding they have?
Carl Emmerson: Per pupil, you would think that would be sensible, yes.
Jesse Norman: In the very broadest terms.
Carl Emmerson: Yes.

Q44 Jesse Norman: So, it would be highly anomalous to have a situation in that arrangement where you had low levels of local income and low levels of funding for schools?
Carl Emmerson: Yes.

Q45 Jesse Norman: Picking somewhere just at random, a place that had below-average income and yet was third-bottom rated for schools funding would be highly anomalous, according to those criteria?
Carl Emmerson: It would. Of course, income might not be the only measure. You might think about not just average incomes but whether these children have parents whose first language is not English. They may have high-income parents, but you might think those children still have a lot of educational needs, so it would not be as simple as just income.

Q46 Jesse Norman: No, I understand that. You will have detected that I am referring to Herefordshire, my own county, which was the third worst-funded area in the country until last year—only just off the bottom—and yet has lower than average income. Can I ask you about the principle of allocation? You have been talking in terms of what I think is generally correlated to deprivation. Is deprivation the right measure? I will give you a way of answering the question—might the effect of deprivation be to focus you on the bottom

10%, the very least well off, and miss the two deciles above that?

Carl Emmerson: You would want to think about a range of measures, I guess. You would think about things that were correlated with deprivation and poverty. You would also want to think about differences right across the distribution. I do not think we would want a world where you have the same amount of funding per pupil for most pupils and then just an increase for the very poorest. It would be more continuous than that.

Q47 Jesse Norman: No. In other words, more weight ideally would be given to the deciles above the very bottom one.

Do you think that the pupil premium has the effect of concentrating attention only on those who receive free school meals and, therefore, ignoring the deciles of the relatively poor or less well off who, nevertheless, either are not taking free school meals or are just ineligible for them?

Carl Emmerson: Clearly, the pupil premium is going to help those schools that have a lot of free school meal children. Some schools that are just slightly below average income might still have a lot of those children, so it is fine. There may be other schools where they are just below average income but they have relatively few children in that situation, in which case you might want to allocate money in a different way. But I think these are judgments about what kinds of characteristics really should count, and what I am saying is good about the Government's proposals is that they want a consistent approach.

Q48 Jesse Norman: Just to be clear, would a system that was smoother in treating the people who are just above the free school meals level in those two deciles we talked about, and that bore a more equitable relationship between income and funding, be a lot fairer than the one we have at the moment?

Carl Emmerson: The current system is not one where we only give extra money for people who are on free school meals. There are other criteria that get you extra cash as well, so the hypothetical system you described would not seem optimal, but I do not think that is where we are.

Q49 Jesse Norman: No, but we are quite close to it, though. We have those other elements that are slightly shadier, but the broad picture is that the pupil premium goes to the least well off and the two or three deciles above that do not receive anything like the same level of support.

Carl Emmerson: The pupil premium does, but the other elements of school support might help those other areas as well.

Q50 John Thurso: Can I turn to you, please, Gemma Tetlow? What assessment have you made of the impact on growth of this Spending Round?

Gemma Tetlow: We have not made an assessment of the impact on growth. As you probably know, the IFS does not produce macro forecasts and, therefore, we have not looked at this in detail.

Q51 John Thurso: The OBR is not undertaking any work in that field until the autumn. Have you anything you can guide me with as to the impact of what has been done on growth generally, whether it is likely to be enhancing or detracting?

Gemma Tetlow: In terms of the Spending Review announcements, all that they have done is to tell us how the given envelope of money will be allocated, rather than changing the total level of Government spending. To that extent, I suspect their impact on growth is quite negligible. In particular, the split between capital and current spending is exactly as we thought it was going to be in the March Budget, for example.

Chair: Thank you very much for coming to give evidence this morning. We have managed to be brief, which is not always our style. There are one or two things that we are hoping to receive from you afterwards. We will move straight on to the next session. Thank you very much.

Examination of Witnesses

Witnesses: **John Cridland CBE**, Director General, CBI, **Nicola Smith**, Head of Economic and Social Affairs Department, Trades Union Congress, and **Professor Douglas McWilliams**, Chief Executive and founder, Centre for Economics and Business Research, and Gresham Professor of Commerce, gave evidence.

Q52 Chair: Good morning. Thank you very much for coming to give evidence on the Spending Review. Can I begin with you, Nicola Smith, and ask you whether you think that controlling public spending—that is, reducing spending's share as a proportion of GDP—is an essential part of the rebalancing of the economy in order to create the space for the private sector to take up the slack and grow?

Nicola Smith: No, I don't agree that in general the UK had a problem before the crisis with a disproportionate share of public spending relative to GDP overall.

Q53 Chair: Do you think 50% is okay? That is your view?

Nicola Smith: I think the level of public spending the UK in 2008 was around 48%—I can double-check on that statistic—and that was within the range of what was normal within the developed economies with whom we compete. Absolutely, addressing the deficit and the problems our public finances face as a result of the financial crisis, and the consequent drop in taxation revenues and increased social security spend is important, but as you will know from the TUC's recent statements and from our written evidence, we disagree with the approach that the Chancellor is taking to that fiscal consolidation and feel that it is indeed slowing growth and reducing our ability to deal with our public finances.

Q54 Chair: Do you agree with that reply, John Cridland?
John Cridland: No. I think the business community is supportive of the Government's strategy. Since the election we have talked to small and large corporates in the UK and the view is that the overriding responsibility of Government is to get the public finances in good order, and that is a necessary corrective for the health of the private sector in the country.
In relation to the Spending Review, we felt the Government should continue with plan A but, given the disappointments with economic growth and the consequences for tax receipts, it was necessary to have continued spending reductions in 2015–16, but also the Government must set out a longer-term view of its investment intentions, because that was the best way—

Q55 Chair: We might come on to that in a moment. Before we get on to how the money is spent, I am talking about this overall envelope, the balance in the tripod between spending, tax and borrowing. I just want clarity about whether you agree, broadly speaking, that 48% is okay or whether you think it should be some other figure. I am not asking you for a precise target, but roughly where do you think it should be in order to maximise medium and longer-run economic growth?
John Cridland: For medium and longer-run economic growth, we think a figure closer to 40% is healthier for the British economy than the 48% figure. We think evidence suggests that if you get into the mid-40s you begin to choke off the private sector, and that the necessary correction over time is for public sector as a percentage of GDP to come down from the 48% figure.
Chair: Perhaps you could send that evidence in and let us have a look at it.
John Cridland: Indeed.

Q56 Chair: I will allow Nicola Smith a quick rejoinder, but I want to bring in the professor before moving questions on.
Nicola Smith: Thank you, Chair. Just to note that a fall in public spending of that scale would leave the UK with a drop in public spending pretty much the largest of all developed economies, excluding Ireland and Greece, and would leave us very low relative to other countries with the proportion of public spending we would have in our entire economy. The TUC would argue very strongly that we saw strong growth in the years up to the financial crisis. There was not any evidence of public sector spending squeezing out private sector investment over that period. The importance of addressing the public finances and the problems we have with our deficit now need to be seen as distinct from the share of public spending that we need to secure strong growth going forward.

Q57 Chair: Professor McWilliams, what is your view on all this? You are a former chief economic adviser to the CBI, aren't you?
Professor McWilliams: Yes, that was the job I did in my misspent youth. I take a slightly different view from either John or Nicola. I think it is important that we compare ourselves not just with other countries in Europe and in the western world more generally, but also with the rapidly emerging economies that are increasingly setting the terms of the game competitively. Hong Kong and Singapore have higher life expectancy, better educational attainment and better infrastructure than us, and neither spends as much as 20% of GDP on public expenditure. To make our taxes competitive and to get the deficit down, we will in the long term have to get public spending way below 40% of GDP.

Q58 Chair: Way below 40%?
Professor McWilliams: Way below 40%, and we may have to go as far as 30%.

Q59 Mr Mudie: In May you did a press release that was quite chilling. It was quite chilling inasmuch as you projected all the problems after the next election and you were saying that after the next election, if there was any easing on dealing with the deficit, there could be a financial crisis because the markets would move in a bad way. You are projecting a £76 billion deficit for 2017–18, and this year the Chancellor was projecting a £60 billion deficit. He promised us it in his 2010 budget. It is twice that now, and he has been projecting it last year and this year—there is a three-year run. Why have the markets been so benign with a Chancellor who seems to have abandoned any hope of doing anything with the deficit?
Professor McWilliams: The markets have been benign. There are two different markets that are relevant in this. First of all there is the gilts market. The gilts market is fairly relaxed because of the scale of quantitative easing, which means that in practice the Government can finance its current deficit without a problem of trying to sell gilts in a market that is fairly adverse. The forex market has not been especially benign. The foreign exchange market has already brought the pound down, which is one of the factors contributing to inflation being above target, but it has not yet fallen in what you might call a catastrophic fashion.
I think the circumstances could change, though, for two different reasons. The first is that if it becomes more clear that effectively the deficit is not going to move very much for a couple of years, the past progress will be discounted in a way it has not been so far. The second thing is that as QE slows down in the US, I think the markets will cast a beadier eye on those countries where they are still needing to fund a deficit and use accommodative monetary policy to deal with their fiscal deficits.

Q60 Mr Mudie: Is there any sign, or would you care to predict, that in the next two years before the election the foreign exchange markets will be prepared to continue putting up with a failure to deal with the deficit?

Professor McWilliams: As you know, forex markets are a law unto themselves and—

Mr Mudie: I thought you were a very good forecaster.

Professor McWilliams: We have had a good track record, but even we cannot—

Mr Mudie: I was going to nominate you for the OBR.

Professor McWilliams: I certainly think we could improve their forecasting track record, but I still don't think that any forecaster who is realistic about his or her abilities will claim to have much certainty about how markets will behave. But there is a risk of a financial crisis before the election.

I think it will depend, first of all, on what happens internationally and then, secondly, on what happens in the UK. I think the markets would be prepared to accept that, for political reasons, the process of reduction will slow, as it very often does in countries in the run-up to an election, provided that they are reasonably convinced that the process will accelerate again after the election. But if they are afraid that the process will not accelerate again after the election, I think that they will view the UK with less equanimity.

Q61 Mr Mudie: It is a pretty tolerant market, then, if they take political practice into consideration, because out of a five-year term he has probably had a good 18 months in terms of dealing with the deficit, and we are now saying quite happily that the markets will accept three years of a five-year term as acceptable behaviour on the deficit because of political reasons. It is a very tolerant view, isn't it?

Professor McWilliams: It is a tolerant view, but I have pointed out that we have seen quite a fall in the pound already. It just has not moved to catastrophic levels. Catastrophic levels would be levels that created inflation that was intolerable, and that would prevent monetary accommodation. We have seen a fall in the pound, so in a sense the markets have not fully accepted it, but they have just about been prepared to leave us in the situation that is manageable, so far.

Q62 Mr Mudie: You mention in that press release "the increasing signs that the country is well beyond the limits of its economic taxable capacity". Can you explain that in a little more detail?

Professor McWilliams: Yes, I certainly can. First of all, on the top rate of tax, it is now 45p in the pound; it was 55p in the pound. Of course, that excludes the national insurance contributions, which are on top of it. The IFS did a study that showed that the ideal top rate of tax was, I think, 36%. Our own study shows that the Treasury is likely, over time—it does not happen immediately—to lose money through having such a high top rate of tax. We did a similar study on fuel duties a few years ago, which showed that we were probably at a point where we were actually losing money by having such high fuel duties because of the impact on purchases abroad and on discouragement for spending. I have seen similar work on some of the other taxes, on alcohol.

When we looked at the impact of VAT at 15%, I think our study, which was one of relatively few studies, showed that the reduction in VAT that Alistair Darling put in was much less of a cost to the revenue because of the stimulus it gave to spending. There were a series of different studies looking at different taxes, which seemed all to have a similar conclusion that taxes at their current levels are starting to damage economic activity.

Q63 John Mann: Can you tell us a bit about the research that you have been doing on jobs? How many of the new private sector jobs are under 20 hours?

Nicola Smith: I don't have specific evidence on how many new private sector jobs are under 20 hours. I believe TUC analysis shows that just over 50% of new jobs are full-time employee positions. We know that underemployment in the labour market—that is the number of workers who report to the Labour Force Survey that they would like to work more hours than they are being provided with—is over 3 million and remains at record highs. We know from IFS analysis, I understand, that private sector job creation is not correlated exactly with where jobs are being lost in particular regions of the country. The TUC's analysis is that the jobs being created are generally of a poorer quality than many of the jobs that were being lost. Indeed, work that we will publish next week will show that 80% of jobs that have been created are in the low-paid sectors, for example.

Q64 John Mann: That was not quite the question, because I was not just asking about jobs being created. I am also talking about existing jobs being altered. I am interested in—either from the TUC or CBI—any research there is on the number of jobs that are now under 20 hours, including the new jobs created.

John Cridland: The CBI has not done research on this, but my understanding of the labour force figures is that they show, as you suggest, Mr Mann, an increase in the numbers—I don't have the figures in front of me—of jobs of shorter duration, as there has been an increase in the number of zero-hours contracts and fixed-term contract work. We understand that in a difficult economic time that is one of the responses employers are forced to make. I think it peaks and then comes down as the economy picks up, but it looks like those figures will get to a normative position that is higher than they were before the recession.

Q65 John Mann: It is not the employers who are necessarily, in terms of their profit lines or shareholder response to problems, the ones that are making the most changes, is it? It is in fact a lot of large employers. Is it not just zero-hour contracts but in fact minimalist contracts now? We are seeing, for example, a company like Tesco putting existing employees on to guaranteed hours of as low as three, four or five hours a week.

Nicola Smith: I certainly know from evidence provided to us from USDAW that it is now the norm in the retail sector for workers to have shorter-hours contracts and to be often required to work larger shifts on top of those minimal hours that they are guaranteed, but with no guarantee of those shifts being provided. I would echo John's point. Our analysis is that we currently see a labour market characterised by deficient demand, and that that has all sorts of consequences both for the types of jobs that are being created, which are more likely to be shorter hours and to be lower paid, with less job security for employees, and for the number of hours that employees who remain in work are able to be offered by their employers. Until such a point as we see a strong recovery start to take place, it is hard to see how that situation can change significantly.

Q66 John Mann: With a strong recovery—

Chair: This is the last question.

John Mann: The question of jobs is an important issue, Mr Chairman. You, Mr Cridland, of course, if there is a strong recovery, are very keen to see the maximum flexibility—

John Cridland: Yes.

John Mann:—and to have cheap labour from across Europe and an expanded Europe coming in and keeping those fixed hours and wage rates down. Where is the spend going to come from that is going to sustain recovery from this huge amount of under-employment, which for the first time has become a huge and permanent feature of the UK labour market?

John Cridland: The labour market has reacted since 2008 in some unusual and quite complex ways, and I think many of us are still getting a better understanding of what has been happening. I accept the point you make, but I think overall, a flexible labour market has worked to the advantage of the British economy over this period because unusually, compared with previous periods of economic difficulty, employers have tended to seek to retain skilled labour rather than let it go. I know that for British workers that has led to a reduction in earnings growth. Many have lost their jobs but many have had more chance of sustaining in work, and I think in that way the British labour market since 2008 has acted in a more European fashion and a less American fashion. Clearly, it is important for British business that we have a flexible labour market where employees feel they are getting a fair return for their labour, at a time when I believe the overall economy is just beginning to pick up. Many CBI members are concerned about skill shortages, and skill shortages require us to be able to make sure that more of our fellow citizens are able to access the jobs available, get skills enhancement and get the income growth that will come with that.

Q67 Andrea Leadsom: Good morning. Professor McWilliams, the Treasury has suggested that High Speed 2 will help rebalance the economy regionally. Do you think that that is right?

Professor McWilliams: The main work on this has been done by a man called Daniel Graham, who is I think acknowledged to be the major expert in the world on the subject, and his conclusion is that it will have some effect but is a very expensive way of achieving that effect. If you connect two ends, you cannot always tell which of the two ends is the one that is going to benefit most, and I think his calculations are that about 20% of the benefit is regional and about 80% of the benefit goes to London and the south-east.

Q68 Andrea Leadsom: Do you think HS2 is a good way to promote regional growth or do you think that there are better priorities?

Professor McWilliams: It is a very expensive way of promoting regional growth, and it is a project where the study we did two years ago showed that demand was way overstated and if you put realistic demand numbers in, first of all, the costs way outweighed the benefits and, secondly, there would be a very large funding gap. I see that the latest Spending Review has started to support our conclusions on the funding gap.

Q69 Andrea Leadsom: John Tomaney, the Professor of Urban and Regional Planning at UCL, said to the Transport Select Committee that he thought regional policy was more important than transport for regional rebalancing. He was suggesting that what matters more is investment in skills, knowledge and technology in preference to a piece of transport infrastructure. Would you agree with that assessment?

Professor McWilliams: I have not done a specific study to back it up, but it sounds like the right type of approach.

Q70 Andrea Leadsom: I am not really asking you on this specific project, but in general terms, for regional economic development, would you agree with his thesis that skills, knowledge and technology are more important than a piece of transport infrastructure, relatively speaking?

Professor McWilliams: Very much so, and one tends not to think of the London economy as a region, but recently it has had some similar characteristics to a depressed region. London suffered a massive loss of financial sector jobs and that has been absorbed very easily by the growth of the technology sector, the so-called flat white economy, as we have called it and as other people have started to pick up, because it has so many industries coming together that you cannot define it by SIC codes but more by the type of coffee they drink. It has created, on our numbers, 60,000 jobs, and it could well be many more than that, in London in a couple of years.

If you apply that to the regions, it is clear that skills and technology look a lot better as candidates than a high-speed rail project, although urban transport in these regional economies is also important.

Q71 Andrea Leadsom: That sort of transport being buses and local train links and so on, as opposed to intercity.

Professor McWilliams: That is absolutely right.

Q72 Andrea Leadsom: Yes. Thank you. Mr Cridland, you have asked at what point HS2 ceases to be value for money. Do you have an answer to that question yourself?

John Cridland: I don't, because I think it is a question that has only very recently come into sharp contrast. I think the increased costs of HS2 are a matter of concern. The view of business is that infrastructure investment is critical to regional economic growth, alongside the other investments that you mentioned, and there is a considerable appetite for infrastructure investment. We have always balanced out, in our own representations to Government, smaller local projects—repair and maintenance—with appropriate big projects, but they have to be value for money and they have to wash their face. I find it hard to envisage in 30 years' time that the UK, as a major economy and industrial nation, will not have excellent rail infrastructure. I am quite convinced that there is a strong case for more rail capacity, both for intercity transport and for commuter and rail freight transport on the west coast main line. For High Speed 2 to go ahead, it has to wash its face. I am quite convinced that the value for money test needs properly applying.

Q73 Andrea Leadsom: If you had £50 billion to spend on infrastructure, would HS2 be your priority, or what would your priorities be for the economic development of this country?

John Cridland: To date, the CBI has supported the investment in HS2 on the previous costings. We had to face the choices as to whether that money could be spent on other infrastructure or other public priorities, and we felt it was an appropriate scheme following on from other major infrastructure developments—most particularly, thinking of London and the south-east, Crossrail. I am acutely conscious that it took 20 years to get Crossrail decided upon. It would have been very easy at difficult moments for public spending in those times to have lost our nerve on Crossrail, and I think we are already beginning to see that Crossrail is essential to London. The extra capacity is vital, but what has, in a sense, raised the questions we are now asking in the last two weeks is the extra cost, and we need to model what the implications of that extra cost will be on other infrastructure projects. I am afraid I can't answer that question, because it is a new issue for the CBI to face.

Q74 Andrea Leadsom: Essentially, you are saying that the merits of the project need to be reviewed in light of the increased contingency that has been applied to it.

John Cridland: I am.

Andrea Leadsom: Thank you.

Q75 Chair: I am surprised that you said it has only very recently come into focus. HS2 value for money has been a controversy running for years.

John Cridland: Yes, but what has most recently come into focus is that on the same day as the Government had to announce £11.5 billion of spending reductions in one financial year, the Department for Transport had to increase the upper end of High Speed 2's budget by £10 billion.

Q76 Chair: Are the beneficiaries of the contracts from HS2 members of the CBI, and are they very active in expressing their view?

John Cridland: I am sure there will be some beneficiaries. As on—

Chair: Are you a shop steward on this this morning?

John Cridland: I hope not, Mr Chairman. As on any infrastructure project there will be beneficiaries, but let me be clear. On any CBI infrastructure policy proposals, I speak for corporate users—the small businesses who want more connectivity with the south of England, the supermarkets, the engineering companies that want to get their product to market—and we speak for the users of infrastructure, not for the providers.

Q77 John Thurso: Can I ask each of you about the question of growth? I will perhaps start, if I may, with Nicola Smith. Can you say what impact, if any—positive, negative, neutral—the Spending Round has had on our prospects for growth? The same question for everybody, please.

Nicola Smith: We can't see that the Spending Round has had any particular impacts for our short-term growth prospects insofar as the money that was announced for infrastructure was, as you heard from the IFS in your previous session, not new money, and indeed is not due to come online until 2015–16. Insofar as the Spending Review saw the Chancellor stick to his current fiscal framework, which we believe is damaging the UK's growth prospects, there has not been a significant change in what the consequences of that will be.

Our view is that the consequences so far have been that borrowing is up over £200 billion more than the Chancellor forecast it would be at the time he took office, tax revenues are down some £245 billion, and there is scope for an immediate stimulus. Recent research we published from the National Institute of Economic and Social Research showed, for example, that a £30 billion stimulus now, equivalent to about 2% of GDP, could boost output, reduce unemployment in the short run and lead to a lower debt to GDP ratio over the medium term. The output gap remains, scope for stronger growth remains, and unfortunately the Spending Review did not take the opportunity to change course and deliver better outcomes.

John Thurso: Thank you. Mr Cridland, same question.

John Cridland: I think the Spending Review avoided policy mistakes that could have damaged growth. I think, with an £11.5 billion spending target for savings and with the constraints caused by protected Departments and ring-fencing, it is not inconceivable that some growth-enhancing measures and programmes, particularly in the BIS budget around science and skills, could have been hit, or that more unfortunate decisions could have been taken on public sector capital. The very fact that the Chancellor was able to walk that tightrope and avoid cutting growth-enhancing programmes was I think the right judgment call on policy.

Of course, the Spending Review was also a longer-term forecast on what the economy might look like. I think some of the decisions there about the pipeline of major infrastructure projects, and about the rebalancing within spending towards measures that would have a tangible effect on growth—I think of the emphasis on repair and maintenance expenditure, both by local government and by the Highways Agency; I think of the increased funding for the Technology Strategy Board within the BIS budget; I think of the forward plan beyond 2015 of support for affordable housing investment—were all signals to the private sector that will have impact now, because they give a degree of policy certainty that was previously lacking.

Professor McWilliams: We think that the spending numbers that are contained in this will be quite hard to manage with the financial markets, so we are not convinced that the cuts are sufficient to prevent another quite tough Spending Round after the next election. On the other hand, we do believe that infrastructural spending, both from the point of view of the user benefits and from the direct stimulus through demand, does have a beneficial effect on the economy.

We are looking for improved ways of bringing private sector money in to develop infrastructure, because we think that is the solution to a conundrum where essentially public spending is likely to have to be cut rather more aggressively than it is planned to be for the next three years. At the same time, our work for the civil engineering contractors suggested that the country has an infrastructure deficit of about £100 billion-worth of spending.

Q78 John Thurso: Is there a failure in Government of all shades and within the Treasury to grasp the concept of the difference between investment—if we move cash from one side of the balance sheet to an asset that is productive on the other side of the balance sheet—and current spending, where you simply spend to achieve something currently? Do you believe that they have not really got their heads around the concept of turning cash into an asset that produces value?

Professor McWilliams: Obviously, as far as monetary policy is concerned, whether the money is spent on capital or current, it has the same monetary effect. So I do understand the Treasury's concern with the overall envelope of spending from that point of view, but we have invested in infrastructure much less than most other comparable countries. Even countries with very low levels of public spending as a share of GDP seem to manage to invest more in infrastructure than we do, and we seem to be not very clever at findings ways out of what is a real problem, which is how you get infrastructure spending at a time of public sector austerity.

Q79 John Thurso: I have one other related subject, and perhaps I can start with you, Professor McWilliams. We have had a major shift in how we spend money publicly, which began quite a long time ago. A document we had from the Institute for Government makes it very clear that, as they have put it, "We have increased the share of our national income spent on pensioner benefits, the NHS and overseas aid through reduced spend on areas such as education, law and order, and defence". This brings into focus the question of the ring fence. How long is it sensible to have a ring fence in certain areas if one is looking to bring down, as you argued earlier, the totality of Government spending? Is it not an absolute given that the ring fences have to go?

Professor McWilliams: I believe so, but I believe that the ring fences should never have been put in place in the first place so, in a sense, my view has not changed. I think the circumstances have made the choices very much tougher than they might have appeared if you believed the OBR forecasts back in 2010.

John Thurso: Can I ask the same question of both of you? Mr Cridland.

John Cridland: Thank you. I think, as we move into the next Parliament, it will be increasingly difficult for the Chancellor of the day to protect the sort of capital investment and growth-enhancing current expenditure programmes that the CBI needs to see protected in the interests of the economy while the ring fences and protected spending continue as they are. The challenge that the Chancellor faced in June of this year, with quite punitive levels of reduction in some spending Departments because of the consequences of those ring fences, will become more exacerbated the longer the cuts need to continue. At the end of the day, those are political decisions for elected politicians, but I think it is likely that the ring fences will need to be revisited.

Nicola Smith: A few points from me. Firstly, the TUC would not accept that the ring fence has been properly implemented insofar as the NHS budget, for example, is experiencing cuts. There are a number of ways that can be evidenced. The initial increases in NHS spending did not take account of inflation. There is an additional national insurance charge that NHS employers will be facing of about £1 billion, as a result of the end of contracting-out—

Q80 John Thurso: But if we stick with the headline numbers just for a moment, if you look at the Departments I named, broadly, in real terms, they are static or going up, and the other Departments I named are going down. Could I ask you to concentrate on that principle?

Nicola Smith: I suppose the question is whether the current fiscal framework is the right fiscal framework, and whether that is one that a future Government might operate in. If a future Government was to, say, take a longer-term approach to addressing the deficit and was to target debt to GDP rather than structural deficit over a five-year rolling period, that might lead to a less extreme fiscal settlement for our public services. Similarly, if a future Government decided it wanted a different balance between tax and expenditure cuts, we could have a less austere period for public spending. I think the current balance, the IFS said, is now 85:15. Under the Darling plan it was 70:30. I understand that in the 1990s under Norman Lamont it was 50:50. There are a range of options available to people as to the relative balance of tax and spending cuts. Even within the current envelope, the TUC has observed that the Chancellor has, for example, decided to cut corporation tax by a very significant amount, which I think amounts to around £8 billion over the course of the Parliament. That is money that a different Government might choose to deploy elsewhere.

I think we can't see austerity into the future as an inevitability. There are choices that Governments can make about how they allocate spending and about the fiscal frameworks they operate in.

Q81 Jesse Norman: John Cridland, the CBI has clearly recognised the importance of education to the long-term prosperity of the country. Do you have any views on the current school funding settlement and its fairness or unfairness?

John Cridland: If you look at our investment in education per capita, we are not underfunding the education system as a whole in contrast to some of our major international benchmark competitor countries. I think that is because previous Governments significantly increased the investment in education. However, there are some significant imbalances in education funding, particularly as we see a marked shift in the structure of schools. I do think that many of the challenges of the British education system, it seems to business, derive from primary school. There is a question to be asked about the balance of per capita funding between primary education and secondary education. In secondary schools we are dealing with problems of underperformance that have started earlier in the education system, with relatively poor return on the investments in secondary school.

I also think there are issues about the further education system. I think the further education system received some protections in the most recent Spending Review, but at a time of significant unemployment we need to be focused on the stock of skills as well as the flow of skills.

Q82 Jesse Norman: Just focusing on the issue of schools funding, because that is the area in which the funding formula is going to be tweaked, the imbalances that you have described suggest that you would not disagree with the IFS in describing the situation as highly unequal at present.

John Cridland: I would agree with that.

Q83 Jesse Norman: Would you also agree with their judgment that, broadly speaking, income should correlate negatively with funding? That is, the higher the income of an area, the lower level of state funding it should receive? Very, very broadly.

John Cridland: Broadly, yes.

Q84 Jesse Norman: So it would be an anomaly to have a part of the world that had low funding and low income.

John Cridland: Yes.

Q85 Jesse Norman: Good, thank you. Would you also share the view that it is not just a matter of performance, because often you get high-performing schools in low-funded areas? It is also a matter of equity to the children themselves, who may be having a less rich school experience although they are performing quite well in academic terms.

John Cridland: I do agree with that, but I would balance that by saying all the research I have seen suggests that the key factor in the performance of a school is the leadership and capability of the teaching force. Therefore, one can see, as you have suggested, schools that have many disadvantages that are very highly performing. I would put the investment, where I accept the points you are putting to me, alongside the capability of leadership, Government and the teaching force.

Q86 Jesse Norman: Do you think the escalating costs of public transport are making a further shift in the balance against schools where there is a lot of transport required—just the difficulty of getting a child to school?

John Cridland: Yes. Forgive me, I have no specific research on that, but it is certainly my view that it is advantageous for education, as well as for communities, if people are as close as possible to their school, such that long commuting distances for schoolchildren are a disadvantageous outcome.

Q87 Jesse Norman: If you have high transport costs, private or public, that would on balance tend to advantage city schools where people live close to the school, versus rural schools.

John Cridland: Yes.

Q88 Jesse Norman: Do you have any comments on that, Professor McWilliams?

Professor McWilliams: The research we have done suggests that it is not just costs but time that is relevant. A young person spends quite a long time at school anyway, and if you add as much as 90 minutes either way you are significantly increasing the proportion of the day that they are spending away from home, and that does make it a lot more difficult.

Q89 Jesse Norman: That would bear on both the quality of the school education they receive and the equity underlying it?

Professor McWilliams: It would probably have an impact on performance as well, because if the children are tired when they come to school they are less likely to perform well.

Q90 Jesse Norman: A high-performing school that nevertheless has an awful lot of those costs associated with it would really be doing extremely well.

Professor McWilliams: If a school performs well in those circumstances, it is a very impressive result.

Jesse Norman: That is very kind. Thank you very much indeed.

Q91 Chair: We are running to time, in fact just slightly ahead of time, and I am going to end by asking each of you to say, in 60 seconds, if there is something that you have come to this hearing wanting to say and have not yet had an opportunity to say. It may be a nil return. I will start on my right and move to the left. Nicola Smith.

Nicola Smith: I think I have made my broad points about the Chancellor's economic policy, but one point I would like very much to highlight is the TUC's concern about the Chancellor's move to a seven-day waiting period for unemployed claimants and the negative consequences that this may have for household finances. The TUC understands that the actual policy will be that universal credit will be paid four weeks in arrears as per the current plans, but that instead of receiving a universal credit payment equivalent to four weeks, the claimants will receive a universal credit payment only equivalent to three weeks. That will include housing benefit and other elements to support the costs of children as well, and will leave people at a very vulnerable time, when they are facing unemployment, with extremely straitened finances. We can see no rationale for introducing this measure, and I think it would be useful to explore further with the Government what the perceived rationale for the measure is and what the actual implications will be for families.

Chair: We may well be doing that very shortly this morning. John Cridland.

John Cridland: Thank you, Mr Chairman. In addition to the appropriate judgments that we felt the Chancellor made on the day of the public spending announcements, British business took some encouragement from the announcement of the parallel package on the following day on infrastructure investment. We had felt that infrastructure investment was in danger of being stalled in its delivery and we were looking for more encouragement around energy investment, which you asked me some questions on when I last appeared before you, particularly the use of UK guarantees, the prospects for shale gas and appropriate strike prices for renewables. We were also looking for the pipeline of major transport infrastructure projects—some of my industrial Olympics—to be given more clarity and determination. The package announced by the Chief Secretary the day after the Spending Review was a source of some encouragement to business, both in energy and in transport, and I think complemented the announcements in the Spending Review on forward capital.

Chair: Professor McWilliams.

Professor McWilliams: We want planned public spending on cautious assumptions about growth that take account of the cataclysmic change in the shape of the world economy as the east becomes much more competitive. We also face a challenge to our terms of trade through raised costs of energy, raw materials and other important factors of production. Secondly, we should put the brightest minds in the Treasury on to the project of ensuring that the infrastructure that we need gets built, and finding a way of bringing in private finance to fund that.

Q92 Chair: I am not able to tell on the basis of that whether you are supporting the energy policy or opposing it, or arguing that the infrastructure policy is basically right or wrong.

Professor McWilliams: I think the ambition is right, but what we have seen so far has been a failure in delivery, and we need to get the delivery. I am not convinced from what has been said so far that there is proof that we will have delivery, and I think that finding a way to ensure delivery is the key to this.

Chair: Thank you, all three of you, for coming in this morning. We will resume at 11.25am, five minutes earlier than planned, to begin our cross-examination of the Chief Secretary. Thank you very much indeed for coming in.

Examination of Witnesses

Witnesses: **Rt Hon Danny Alexander MP**, Chief Secretary, HM Treasury, and **Sharon White**, Director General for Public Spending, HM Treasury, gave evidence.

Q93 Chair: We are just a few minutes earlier than planned and, as I have alerted various people to, we may run slightly longer than intended, since a lot of colleagues want to come in.

You have succeeded, Chief Secretary, in keeping to the envelope that you set yourself. How did you do that?

Danny Alexander: Thank you, Mr Chairman. I should just introduce Sharon White, who is the Director General of Public Spending at the Treasury.

I think there is a combination of factors, as in all these things. There is a very strong political commitment around the Cabinet table to dealing with the deficit, and that is a collectively agreed position, before the Spending Round and subsequently. All of my Cabinet colleagues had a shared interest in ensuring that we delivered the savings that we did set out to deliver in the Budget.

Q94 Chair: To translate that, is that basically because it is a make-or-break issue for the Coalition?

Danny Alexander: Sorting out the economic problems of this country was the set of issues that caused the Coalition to be formed—dealing with the budget deficit, making those decisions and continuing to make them.

Q95 Chair: Isn't it mainly the deficit that is at the heart of the Coalition agreement?

Danny Alexander: I would say dealing with the deficit is, because in itself it is necessary to restore the financial credibility of this country, and because it is necessary to restore economic growth in this country that we regain some control over our public finances. So commitment to that would be the first point. That is obviously backed up by a market discipline, by a strong sense that by being willing to take tough decisions we have kept interest rates low in this country, and that is obviously good for the economy.

I would make another point, which is about efficiency. In this Spending Round, I think I was the first Chief Secretary in history to have at my disposal a pool of commercial expertise located in the Efficiency and Reform Group in the Cabinet Office, which was able, through this process, to really get under the skin in each Department about contract renegotiation, IT management and a lot of the building blocks of efficiency that I think the public really expects us to look at. That expertise helped to analyse in detail what was going on in Departments and to release the £5 billion of the £11.5 billion through efficiency savings that we said we would do in the Budget.

Of course, added to that is a sense that this was a Spending Round for one year, for 2015–16. From the point of view of Departments and Permanent

Secretaries, this is part of a long-term process. There is obviously a need for further fiscal consolidation in the two years beyond that. I think that again helps to be a motivation for Departments to play their part in this process, as well as the answer for the Treasury in dealing with these things.

Q96 Chair: Going back to market discipline, there is always some market discipline on spending decisions, but are you saying that it is much stronger now than it was before and therefore, by implication, that whoever is trying to take these decisions is going to end up hamstrung, in a sense, if they want to spend more money?
Danny Alexander: I do probably think that. Given the scale of our deficit, the problems in our public finances and the need to continue to deal with that and to eventually get our debt falling as a share of our economy, market participants of all sorts watch those things very carefully, and the sense that you have a Coalition Government that is continuing to deal with those difficult choices in a fair, balanced and measured way is something that helps to maintain confidence in the UK economy.

Q97 Chair: You were talking about techniques of the Efficiency and Reform Group, which all sounds nice and techie but the truth is, isn't it, that you were pretty ruthless? You picked off a few colleagues, got some settlements, and then showed the instruments of torture to the rest of them.
Danny Alexander: I am not sure about instruments of torture. I think that is over-dramatising it.

Q98 Chair: Have you ever been involved in a star chamber?
Danny Alexander: No, I haven't.
Chair: Weren't you threatening one?
Danny Alexander: Let me answer the question in my own way, if you don't mind. The first thing that I sought to do both in conducting this Spending Review and in 2010 was to try to be as straightforward as possible with Cabinet colleagues about the amount of savings that we were looking for from their Departments, so that you do not end up with this process of game-playing where the Treasury demands twice as much as is wanted and the Department offers up 10% and then you have to haggle. It is about trying to spend the time and effort, and I had a lot of meetings with all Cabinet colleagues about this, discussing not what amount of savings they were looking for, although of course there is room for manoeuvre at the margins, but how they are going about making those savings. I think that is what the public expect us to do—to find the savings in the right way and not just to get to the numbers.
You are right to say that as in 2010, we had a Public Expenditure Committee that was looking at the Spending Round, and that was populated with Ministers from the Departments that settled first, and of course it is the case that if any Cabinet colleague had decided not to settle with the Treasury they would have been brought before that Committee to explain their position and to be scrutinised by their colleagues. I don't think any Department got anywhere near to that position, because everyone wanted to—

Q99 Chair: They were all such nice chaps, were they not, and they came quietly? Is that a fairer description?
Danny Alexander: I would not want to mischaracterise it. Of course there were robust discussions, there were very thorough exchanges about what was the right way to find savings, and one or two people sought to try to attract some media attention to that process. I would say that did not put me up or down, but—

Q100 Chair: Just to be clear, what you did was you got collective buy-in to an envelope, and then you operated divide and rule, didn't you?
Danny Alexander: No, I would not put it like that. I would say we got collective agreement to an envelope. We gave each Department planning assumptions about the amount of savings that they were expected to find. You will see that the final figures by Department came pretty close in each case to the planning assumptions that we issued, so that is a very straightforward way to conduct the process. Departments had a period of time in which to submit an initial return to the Treasury, about a month after the Budget. My officials and I then spent a lot of time with Departments, working through what they had offered, looking at ways that they could go further where their initial offer did not match up to expectations. Through PEX, and also through the quad process, which met five times on the Spending Round, we had processes to ensure there was a degree of collective agreement across the Government about the approach we were taking in each Department.

Q101 Chair: There is one other question that I would like to ask at the start. It is one thing to agree figures, it is quite another to deliver them. So far the Government seems to have been able to deliver its numbers. How far has that been because inflation has been acting as a cracking good cutter on cash numbers, since inflation has been above trend, and how much has it been down to the use of other tools? For example, are you using zero-based budgeting?
Danny Alexander: I would say it is down to the process that we entered into in 2010 when we started out. In 2010 we set budgets that were set in cash terms for each Department for the four years of the current Spending Review period. I have taken steps to tighten spending control in a number of ways. I published a document a year or so ago called *Improving Spending Control*, which is about improving forecasting and giving the Treasury more access at an earlier stage to the information about what is going on in Departments. It is to do with managing the reserve very tightly, not using it as a slush fund but making sure that it is only available where it is absolutely needed, and therefore having a rigorous but straightforward process of spending control.
That is why we have not ended up with Departments breaching their budgets, and I would say it is a testament to the commitment of Secretaries of State, and also to their civil servants, that in many cases

Departments are ahead of the savings that we expected them to be at at this stage. At the start of this year we had already made 65% of the savings that we had set out in the 2010 Spending Review, when the original forecast had been about 50%. So in many cases Departments themselves have sought to get ahead of the game on this, to make sure that they deliver to the plans we set out.

Q102 Chair: Because their Ministers do not want you around to see them with this committee that you have created?
Danny Alexander: I am sure all of my colleagues would be delighted to see me at any time.

Q103 Chair: Okay. It was said, wasn't it, by Joel Barnett that the Chief Secretary was rather like the Jackal in *The Day of the Jackal*? He could never work again once he had done this job, because he had made so many enemies.
Danny Alexander: Thank you for the career forecast, Mr Chairman.
Chair: You might just wonder what has really been going on behind the scenes, but you look quite jolly on it at the moment, Danny.
Danny Alexander: Well, I am the third longest-serving Chief Secretary now—there was a period when they seemed to last about nine months. I think Lord Barnett was the second longest-serving, and we have longevity in the role in common at least.
Mr Ruffley: John Major became Prime Minister. A bit of history.
Danny Alexander: I think if you are going to be strictly accurate about the career progression of my predecessors you might also point out that Jonathan Aitken was once Chief Secretary, so there is a range of options afterwards.

Q104 Mr Mudie: You agreed with the Chairman when the suggestion was put that dealing with the deficit was the main objective. You have failed, wouldn't you say?
Danny Alexander: No, I wouldn't say that. I would say a number of things about that. I would say, first, that since we came in the deficit is down by a third. I would say that if you look at the underlying measures, broadly speaking we have been tightening the structural deficit that we are targeting in our fiscal mandate—it is an underlying measure of the deficit, taking away the cyclical factors as short-term economic effects have an impact on the public finances—at roughly 1% every year. That has continued through this Parliament and is forecast to continue. I think that is the right way to approach it. It is a measured and sensible pace at which to take it, and we are continuing on the spending side to be, as was observed earlier, on track to deliver the spending numbers that we set out.

Q105 Mr Mudie: The numbers you set out are slightly different, Chief Secretary, aren't they? We have had a witness here, Professor McWilliams, whose projection for the deficit in the year 2017–18 is £76.6 billion. You were going to have it cleared by a year earlier than you assumed; in fact your deficit is something like £118 billion this year. In your first plans given to the Chamber at the first Budget it was not going to be £118 billion, it was going to be £60 billion. Do you call that a success?
Danny Alexander: You are right that the deficit this year is higher than it was when we first forecast. I think we have been very clear. The OBR—which is responsible for these forecasts now, so it has been taken out of my hands and the Chancellor's hands and made independent—has been very clear too that the impact of the eurozone crisis has had a major effect on the UK economy. A period of high inflation, particularly in 2010–11, had a significant effect too, and of course there is the legacy of the financial crisis. We had figures two weeks ago showing that the depth of the financial crisis was even greater than originally forecast—I think it was 7.2% of GDP. The legacy of that through the financial system is greater on our economy, and inevitably that has had an effect on our economy and on our public finances.
The point I am making to you is that if you look at the structural deficit and look at the primary balance, cyclically adjusted, you will see that has been more than halved from its peak in 2009–10, and we are continuing to make progress at that steady pace. I think that is the right way to approach things. I do not think we should be chasing those numbers. I think we should be sticking, as we are, to the spending plans that we set out when we started.

Q106 Mr Mudie: In terms of the deficit, you are standing still for three years of this Parliament. I don't see how that is tying in with your original plans, or even tying in with dealing with the deficit. To be standing still on the deficit at that amount seems to me to be failure.
Danny Alexander: I would say that the deficit is coming down as a share of GDP. Of course it is more slowly than we originally forecast, and that is one of the reasons why we have just conducted a Spending Review for 2015–16 because, rather than chasing those numbers, which I do not think you would have argued we should have done, instead we chose to extend the period of deficit reductions and to do so in a way that has enabled us to make the right short-term decisions but also to maintain confidence in the UK's ability to manage its public finances. I think that is the right balance.

Q107 Mr Mudie: Chief Secretary, those are words but what I am putting forward, and you are accepting, are the actual figures. Let's take debt. You inherited debt at 76.3% of GDP. No, you were going to peak at 76.3% of GDP in 2015. That was from an inherited position of 57%. The Labour Government had handed over at 57%. You were going to peak at 76%, and you saw that as a success. The estimated debt for 2017–18, on the figures we have heard this morning, is 92.3% in 2017–18. That is not a success either, is it, on the figures?
Danny Alexander: Of course the consequence of larger than expected deficits is that your debt rises. We set our fiscal mandate—

Q108 Mr Mudie: That is the importance of the deficit going down, and the fact that you have it steady at £118 billion a year, that is £118 billion going on the debt each year, and so that is why you arrive at 92.3%. You are chasing Japan.
Danny Alexander: If I can just answer the question, we are bringing the deficit down year by year. We are taking difficult decisions on public expenditure.

Q109 Mr Mudie: You are not taking the deficit down year by year. You have held it steady for three years.
Danny Alexander: I would be delighted to answer the question, if I could get a word in edgeways.

Q110 Mr Mudie: I have just given you the facts, you accepted them, and now you turn them around and say you are bringing the deficit down. You are not bringing the deficit down. That is the sad fact.
Danny Alexander: Firstly, the deficit when we came into office, inherited from the previous Government, was over £150 billion. As a share of GDP it has fallen by one-third, since we came in. It will continue to fall as a share of GDP. If you take the underlying measure of the structural deficit, which is I think the right measure to target—it is what we chose to target in our fiscal mandate—we are consolidating at roughly 1% a year. I think that is a sensible pace to consolidate at.
Of course we have had representations, such as the ones you are making, that we should cut the deficit more quickly, that we should make more cuts now. We have rejected those representations in favour of sticking with the pace of consolidation that we set out when we started. We have had representations that say we should borrow a lot more now. We have rejected those too, on the basis that we think that that would significantly undermine the confidence that our plan has established in the UK economy. Instead, through our spending control processes and through this Spending Round, we have sought to make sure that we are using public expenditure in the best way we can to support economic growth. I think that is the right balance for the country as we make a transition from a huge deficit, mismanaged public finances and a large structural deficit under the previous Government even before the financial crisis hit, to ensure that our public finances become more sustainable.

Q111 Mr Mudie: Professor McWilliams went through these figures in his report and he projects the real worry of a financial crisis after the election, because all the debts, all the hard decisions, have been put off until after the election. He points out that a financial crisis could be extremely serious for the country, as you can imagine. Against that background, don’t you think that we have wasted three years when we should have been dealing with this deficit?
Secondly, you are coming here really on the back of the infrastructure announcement. It is much exaggerated, but it projects a lot of schemes starting after the election. With these figures, how can we take these promises of expenditure after the election seriously, because of the financial problems that we do not have the courage to deal with this Parliament but somehow we will do in the next Parliament?
Danny Alexander: I don’t accept that analysis. I would say that we have made, in a serious-minded way, some very tough decisions, to reduce departmental budgets, to freeze and then restrict pay growth in the public sector, and some difficult decisions on welfare expenditure too. We have increased taxes, particularly on the wealthiest in society, and taken more action to tackle tax avoidance, all of which were necessary to improve our public finances. I don’t want to repeat what I said before, but I think that the approach we have taken is the right one.
Of course there are further decisions to be taken after the election. There are two more years on the current plans of fiscal consolidation. That means, effectively, that we have done five years’ worth and there are two more years to be done. I hope in time that all political parties will recognise that those decisions have to be made, while of course having a debate in the election about what is the precise nature of the choices you would make to meet those things. I do not think we are there yet. If your warning is that our economy will be damaged if one party comes into office without a clear plan to deal with the problems in our public finances, then I would accept that.
Chair: I would ask colleagues to be brief in their questions, if they can, and also the Chief Secretary to be as brief as he possibly can manage with his replies, otherwise we might find ourselves missing out on lunch.

Q112 Stewart Hosie: Chief Secretary, the overall impact of public spending, tax credit and benefit changes, including benefits in kind, in 2014–15 as a percentage of the 2010–11 figure was £830 for the bottom quintile families, 3.4% of income. After the Spending Review the figures for 2015–16 were £930, 3.9% of income. Why did you configure fiscal consolidation in the Spending Review in a way that was going to make the poorest quintile even poorer?
Danny Alexander: First, I would say that we have published very transparently the distributional analysis that you are quoting. We are the first Government and first Treasury ever to have done so, which, exactly as you say, has looked at the impact of all of the consolidation decisions, not just spending but taxation and welfare decisions as well, as a share of income and benefits in kind. There have been some methodological changes made to improve the analysis, in consultation with organisations like the IFS, for example, which mean that the two sets of figures, as I think the IFS may have said when they were here earlier, are not directly comparable.
The other point that I would make is that, while clear and transparent, this analysis does not capture the improvements to the quality of public services, so the services that people receive as a result of some of the reforms we have put through. For example, a freeze in teachers’ wages would feature in this analysis as a loss of benefit for people who consume education as opposed to something that affects the workforce. This is a new area in terms of distributional analysis of public spending. There are further improvements that could be made, and our team in the Treasury is talking to the IFS and other organisations about how we can

strengthen the analysis, but overall I would say that our consolidation has affected the top quintile the most. You are right to say that it has a significant impact on the bottom quintile. Public expenditure is consumed much more heavily in the bottom quintile, but the wealthiest fifth of the population continue to pay the most, as they have in every year of our fiscal consolidation, and I think that is right.

Q113 Stewart Hosie: I have a suspicion with that argument. The problem is that your own distributional analysis, thinking about the Spending Review only, shows that the impact on the top quintile goes from 4.1% of income to 4% of income; quintiles 4, 3 and 2 also go down. It is only the bottom quintile where the impact as a share of income goes up, and that is a fact. Do you accept that?
Danny Alexander: I think the proper way to look at this is as the impact of the fiscal consolidation as a whole. Of course, this Parliament is not over and so we have further Budgets to make tax policy decisions and so on. If you look at the top quintile, for example, that quintile is a net contributor rather than a net recipient, in terms of public expenditure and taxation, and therefore it is tax policy decisions rather than spending decisions that have the major effect.
I did ask my officials to do some analysis—you might be interested in this—of which areas of public spending are skewed towards the top quintile of the population. The answer is very few. Arts and culture expenditure, roads, railways and universities are the only areas of public spending that in a distributional sense are skewed towards the top quintile of the population. Therefore, I sought to focus in the Spending Round on making a large proportion of our savings through efficiencies in the back office, joining up services and so on—things that do not affect the frontline outcome, although of course some of which still show up in this analysis, subject to further improvement. Reforms such as the troubled families scheme and the integration of health and social care, which get better outcomes for a limited amount of public money, are particularly focused, as social care expenditure is, very directly on the bottom quintile of the population.

Q114 Stewart Hosie: I am sure everyone will welcome more efficiency and better quality of service in these targeted areas, but that does not change the fact that in austere times the impact of the Spending Review has hit the bottom quintile hardest. You said earlier that what you had tried to get was transparency but, as Carl Emmerson from the IFS told us, because of the methodological changes we can’t do a like-for-like comparison on the 2014–15 figures. We move straight from 2014–15 on the old methodology to 2015–16 on the new. Has the Treasury itself done a 2014–15 analysis based on the new methodology?
Danny Alexander: We have applied the new methodology to the 2015–16 analysis that we have published.

Q115 Stewart Hosie: Yes, but have you done it for 2014–15?
Danny Alexander: We have not done it on a backward-looking basis. We have applied the improvements to the methodology, which we have spent a lot of time discussing with the IFS—they may have mentioned that—to these new figures. So, for example, the previous methodology was based on an assumption about the take-up of benefits, which assumed that benefits were taken up by 100% of the population. This is looking at a more accurate analysis of benefit take-up. Likewise, for some of the more detailed analysis of particular elements of public expenditure and where they fall, the analysis has been updated by Departments.

Q116 Stewart Hosie: In that case, will you be prepared to publish an analysis of 2014–15 on the new methodology? If it is things like benefit take-up being reduced, then it means the rise in the impact on income in the lowest quintile would be even more significant than a rise from 3.4% to 3.9%. Would you be prepared to publish a 2014–15 analysis on the new methodology?
Danny Alexander: I will certainly take it away and look at it, but I am not inclined to put a lot of Treasury officials’ limited time into a backward-looking analysis when the Treasury, like all Departments, is shrinking in numbers. I think we are down to 1,000 civil servants by the end of the next financial year. But I will certainly take the idea and look at it and come back to you about it.

Q117 Stewart Hosie: Without it we would not be able to accurately measure on a single methodology what the impact on any quintile was of the decisions taken up to the Budget and then the decisions taken at the Spending Review. Without that information we are looking at a set of figures that go from March to the Spending Review into 2015–16, and that is really not particularly helpful.
Danny Alexander: I think that the information we published is better in quality and detail than any Government has published before. I would say that it is inevitable, when you have a new form of analysis that no Government, including the Scottish Government, has done before, that you are going to want to improve the methodology. I would hope that this Committee would welcome those methodological improvements rather than seek to rake over the past.
Stewart Hosie: In that case, let us just have some consistency so that we can do a proper analysis, and our job is to scrutinise not to rake over the past.

Q118 Chair: I would be very grateful if the Chief Secretary could reflect on the request that has been made.
Danny Alexander: I will certainly reflect on it and come back to the Committee.
Chair: Having said that, it is worth pointing out that it was this Committee that pressed for many years for a distributional analysis, and the Treasury said no for a decade or more—15 years or so. You have now started producing some very interesting distributional analysis, and this Committee is very grateful for the fact that you have responded to the request we made in 2010.

Danny Alexander: You were right to request it. To me, personally, it is vitally important that we continue to make sure that the burden of our consolidation falls most heavily on those most able to bear it. That is why we published the analysis. It is not perfect but it is improving analysis, and we will continue to make improvements to ensure that it is as robust and open as possible.

Chair: It is time to bring in a fellow Liberal Democrat Scot, John Thurso.

Q119 John Thurso: Firstly, can I ask you what assessment you have made of the quality of financial management in the Government, across the Government and in individual Departments?

Danny Alexander: A very good question, and I would say that the quality of financial management has improved during my time in office. When I came in there were some Departments where financial management was deemed to be incredibly weak. The National Audit Office had passed recommendations on various Departments. I think in those areas particularly we are seeing a strengthening.

One of the things that we also announced as part of the Spending Round was a review of financial management within Government, because it is an area that I think does need to be strengthened further. There have been a number of very useful independent reports on that subject in the last few months. One of the areas that I have been pushing on is to improve the quality of management information within Government. One of the issues in a Spending Round, and for people trying to understand the public finances, is being able to compare apples with apples, so that they can look at different Departments and be able to understand the figures on a comparable basis. That is an area where we have made some progress, but we need to do more.

Q120 John Thurso: The Institute for Government, in their submission to us, said that the Government needs to invest in a more strategic approach to financial management and that they welcomed the review that you had announced. When do you expect that review to report, and what will you be looking for from it?

Danny Alexander: I expect the review to report by the end of this calendar year. We have asked Richard Douglas, who is the head of the Government Finance Profession, to carry out this work, with Lord Sainsbury as an external adviser. He is someone who has taken a close interest in these matters. I am not going to try to prejudge the report, because I want it to look in a searching way, to take on all the external advice that we have had, including from the Institute for Government, and look at ways in which both the ability of the centre to get the information it needs to understand what is going on and also the financial management capabilities of Departments could be improved. Perhaps there could be more of a system of owned autonomy, so that when a Department proves that it is able to really manage its finances very tightly, as I think some have, we can relinquish some of our tight controls, but in other areas we can focus greater Treasury scrutiny on Departments that are not performing. That is the sort of regime that I think would be useful, but I am not going to prejudge it.

Q121 John Thurso: But you would broadly agree with their view that the strategic financial leadership roles at the centre of Whitehall are relatively underdeveloped?

Danny Alexander: Not wholly. Given that I am the holder of one of those offices, I suppose I would have to say that. I think it is true that as the Treasury gets smaller, in common with all Departments, we need to make sure that within that smaller Treasury we have the professional skills alongside the political and strategic skills that are necessary to carry out that role properly.

Q122 John Thurso: Let me come on to my second question. What assessment did you make of the impact of the Spending Review on prospects for growth?

Danny Alexander: We spent a lot of time. You will remember that when we launched the Spending Round we had four themes of activity: efficiency, reform, growth and fairness. We have discussed the fairness issue in relation to the distributional analysis, and we might come back to it in other contexts. We talked a lot to external organisations, such as the CBI and other business organisations, about which areas of spending they would seek to prioritise. The long-term focus on infrastructure was a key ask of that particular industry. We had topped up our capital budgets in the Budget and are also now setting out long-term plans for capital expenditure, so I think we are getting the balance right there. Also, there are things like apprenticeships, school spending, which is vitally important for the long-term quality of our workforce, and innovation expenditure. One of the things that we did in the Spending Round around Lord Heseltine's excellent report—setting up the Single Local Growth Fund—was a direct response to an argument about an improvement to the way in which public spending is used to support local economic growth, which I think we responded to very sensibly.

It was a central part of our process and our discussions, particularly—this is the point that the Chairman made earlier that I did not respond to—in relation to capital expenditure, where as well as putting in place longer-term plans we did a zero-based review to look at all of the bids across Government and allocate that funding on a Government-wide basis, with a particular focus on the expenditure that would make the most difference in economic terms.

Q123 John Thurso: The OBR has not taken into account any of these policy changes and will only do so in the autumn. You would presumably be disappointed if the OBR did not adjust its growth forecast up and specifically state which of these policies had been part of increasing growth?

Danny Alexander: Having decided to establish the OBR as an independent forecasting organisation, I think for me to try to start forecasting the forecasters would not be an—

John Thurso: I am asking for your potential reaction.

Danny Alexander: You are asking for a measure of my mood, as opposed to a forecast. The OBR has tended not to factor these kinds of things into their economic forecast, because of the methodology that they apply. I think the test that I apply more is to listen to the reaction of industry organisations. The CBI has welcomed the decisions that we made; other business organisations likewise. The Home Builders Federation and the National Housing Federation, which represents housing associations, have very much welcomed the decisions that we made on housing policy, because in all cases we have made long-term commitments that enable those industries to plan ahead with confidence. That is an important part of securing growth in our economy.

Q124 John Thurso: The EEF, which represents the engineering and manufacturing sector, said in their submission that, "In future it must be more clearly anchored to a more coherent economic strategy. So far this Government's plan for growth in response to Lord Heseltine's *No Stone Unturned* report has failed to provide the underpinning to this strategy." That is presumably something you would not accept.
Danny Alexander: I would not accept that. I have spent time discussing these things with the EEF and they have produced some extremely good ideas that we have taken forward, for example on improved capital allowances for first-year investment for businesses, which we took forward last year. I would look to the reaction of the organisation of Local Enterprise Partnerships, which very warmly welcomed what we have done on the Single Local Growth Fund. When you take together the Single Local Growth Fund and the other resources that LEPs are able to influence, including European funding, you have, over the period, about £20 billion that LEPs will be able to shape and influence, and that influence will extend beyond those pots of money to other things that the Government are doing through the growth deals process we are entering into. I hope that people will see in time that this has been quite a radical shift, not just in where public expenditure takes place but in where influence is exercised from and how industry can exercise influence over the policy choices of Government to support growth.

Q125 Mr McFadden: I was going to say good morning but it is now good afternoon.
Danny Alexander: Good afternoon.
Mr McFadden: I would like to ask you in a little more detail about this question of capital and infrastructure. You made a statement to the House the day after the Spending Review, outlining all these infrastructure projects. Can you confirm, on page 11 of the Green Book that was issued at the time—the Chairman has a copy there—just what the bottom line tells us here about capital spending? This confirms that between 2014–15 and 2015–16 capital spending remains flat in cash terms at £50.4 billion which, according to your table here, is a 1.7% real-terms cut in the overall figure.
Danny Alexander: It does indeed tell us that public sector gross investment is £50.4 billion in 2014–15 and £50.4 billion in 2015–16. It also says that total capital DEL is going up, but public sector gross investment is the measure that we have used. If you look at the *Investing in Britain's Future* document that I published the day after the Chancellor's statement, that sets out longer-term plans for public sector gross investment to rise in real terms thereafter. Those figures are both significantly higher than we had originally set out in our Spending Round and also significantly higher than the plans that we inherited from the previous Government.

Q126 Mr McFadden: Let's just go through this piece by piece. First of all, on the position as set out in the table, I want to be completely clear that you are confirming the public expenditure position. We were talking about 2015–16 in the Spending Round. That is what it was all about. I will come in a second to future years, but in terms of 2015–16, compared to what is already announced in 2014–15, we are flat in cash and we are declining in real terms.
Danny Alexander: We are spending £50.4 billion in both years. It is fair to say that on the previous plans before the Budget, that was going to be a fall. We increased the budget in 2015–16 by £3 billion, and £3 billion a year thereafter, and have planned to have capital spending thereafter flat in real terms.
If I may make one further point, a key part of this is how you go about allocating that spending, and how you make sure that it is actually spent as opposed to having large underspends. On the first point, we went through this zero-based review precisely to assess bits from all around Government on the basis of impact on the economy. I think through doing that and through having this in the context of longer-term plans, we are getting a better growth impact than has been the case from capital spending in the past.

Q127 Mr McFadden: Do you see the point of asking? Quite a lot has been made by the Government of its capital expenditure programme, and can we just establish the fact that it is flat between the two years that we are talking about?
Danny Alexander: You have asked me that three times, and three times I have confirmed that the table in the Green Book is accurate. I am happy to confirm it for a fourth time, if you like.
Mr McFadden: We have talked about a number of other things as well.
Danny Alexander: But I would also say that in the context of that we have set out, I think, the largest programme of road investment since the 1970s. We continue to fund the largest programme of rail investment since Victorian times. We have made huge commitments on communications infrastructure and broadband and a significant programme of house building, all of which are good for the economy.

Q128 Mr McFadden: Let me ask you about some of the specifics. Your list of projects included things like HS2, the A14, the Mersey Gateway bridge and various rail electrification projects. Of the list of projects that were in your statement the day after the Spending Review, how many of those had never been in a previous statement? All these others had?

Danny Alexander: In terms of setting out the funding over the period, which is what I was doing in the statement, with the exception of HS2, which the Secretary of State had made a funding statement on before, all of the funding allocations for 2015–16 and beyond were new. They had not been set out before. The *Investing in Britain's Future* document sets out, in annexes at the back, existing programmes that continue to go forward and new programmes that are going to be funded. I think that has been entirely transparent. But I would say that, taking roads as an example, the A14 is a project that, you are right, we have talked about on a number of occasions but we have not been in a position before this to set aside the funding to pay for. There has been work going on to produce feasibility studies and so on. This is the first time that the Government has made a commitment to funding the A14 programme in full. You mentioned that, and that is just one example. I am sure we could go through others. On HS2 what we did in the Spending Round—and you may want to come back to this—was to set out a budgeting framework to make sure that now we have more clarity on the costs, the programme is delivered to the budget set out.

Q129 Mr McFadden: We will talk about HS2, and I think others will ask about that. Can I ask you about one other piece of the Government's case on this capital expenditure point? The Government has claimed a number of times that it is spending more on capital—I think you mentioned this yourself in your first answer to me—than under the plans inherited from Alistair Darling. Can you confirm what the public expenditure spent on capital public sector gross investment was in the first three years of the Government, compared with the plans inherited from Alistair Darling?
Danny Alexander: I don't have those numbers in front of me, but I do know that if you take the decisions that were made in the 2010 Spending Review, the autumn statement in 2011 and the autumn statement in 2012, over the four years 2011–12 to 2014–15 we are spending or planning to spend £9.5 billion more than the plans that we inherited from the previous Government.

Q130 Mr McFadden: Isn't it the case that the OBR has said that what you have spent in 2010–11, 2011–12 and 2012–13 is cumulatively £5 billion less than Alistair Darling was planning to spend?
Danny Alexander: I have not seen those figures. I am happy to look at them if you want to supply them to me. What I have set out, in terms of a comparison of the plans that we inherited with the plans that we have set out, is that—
Mr McFadden: I am talking about what you have actually spent compared with the plans you inherited.
Danny Alexander: Can I just make this point? If you compare the plans that we inherited to the plans that we set out, we are spending £9.5 billion more than our predecessors. There is also the issue of underspends. We have reduced underspends on average by a third, compared with capital underspends by our predecessors, through tighter financial management, over-programming in certain areas and more of a focus on delivering projects to time. So it may well be that there are differences between the underspend assumptions of the previous Government and ours, where we are seeking to get people to deliver the funding that we have set out. I am quite sure that we are planning to spend and spending more, and underspending less, than our predecessors. What's more, if you take public sector gross investment over this decade, as compared to the 13 years of the previous Government, we are investing more as a share of GDP in our economy over this decade than our predecessors managed during their 13 years in office.

Q131 Chair: You said in a reply a moment ago—a very interesting reply actually—that zero-based budgeting had not been given a great deal of public attention.
Danny Alexander: Oh, dear.
Chair: We like interesting replies in this Committee—
Danny Alexander: I do too.
Chair:—even if not all our witnesses want to give interesting replies. But you mentioned zero-based budgeting being applied to capital right across Whitehall in order to ensure value for money from capital projects—how on earth did HS2 survive that?
Danny Alexander: For a number of reasons. Maybe I should explain the process very briefly first, because it is a subject that you are interested in, and then I can say something about HS2 more generally. First, we asked all Departments to bid on the basis of their proposals for capital expenditure. We received a lot of bids of, it has to be said, varying qualities, but the expectation was that there would be a robust economic analysis set out alongside the bids. That was subject to scrutiny from a cross-Whitehall panel of economists and then brought to the Chancellor and myself to look at and apply our own judgments to. That resulted in a scheme that very heavily prioritised transport investment, science investment, broadband investment and so on, and other areas where we sought to deliver reform. In housing, for example, we are delivering many more houses per pound than previously, because we have changed the model of delivery of affordable housing, an area where we are getting better value for money, I would say, for the taxpayer. High Speed 2 is a project that the Government has committed to, as our predecessors did.

Q132 Chair: May I just reinterpret that? That means it is exempted from this value for money process. You are committed, so it has got a bye. Is that right?
Danny Alexander: It might have been available to us to say we are going to stop this, but we have made a very strong commitment to it on the basis not just of the short-term economic analysis but of our view about the longer-term economic transformational potential that this project has in the context of what is still a very divided economy, especially across England. There are substantial wider economic benefits that will come from a project of this scale, scope and ambition, connecting together eight of our 10 largest cities. We know from countries around the

world that improved connectivity of this sort makes a big difference to balance of your economy over a number of decades. We also know that capacity constraints on some lines are really starting to bite now, so this investment not only creates a very important infrastructure improvement in its own right but also releases capacity for existing services.

Q133 Andrea Leadsom: Good afternoon. To be clear, value for money for the taxpayer does not come into the HS2 project?
Danny Alexander: No, I am not saying that at all. Of course it comes in. In fact, that is the whole basis of the announcements that I made about this in the Spending Round, which is about ensuring that this project is delivered to budget. We are taking some of the lessons from the Olympics, for example, where we set out a funding package for the term of the project and built in robust incentives for those delivering the project to deliver it, not just to time but under budget as well. In a sense I would say the step we made on HS2 in the Spending Round was about financial control and delivery, on the basis that our collective judgment is that this is something that is good for the economy and therefore good value for the taxpayer.

Q134 Andrea Leadsom: Do you then refute the NAO's report expressing concerns particularly about the assumption that time spent travelling at the moment is unproductive whereas under HS2 time spent travelling on a train will always be productive at an average salary of £70,000 per annum? Do you feel that that is a reasonable assumption? Is that something that will be reassessed at the next financial assessment of HS2?
Danny Alexander: I do refute the analysis that suggests that this is the sole basis on which HS2 is understood. I would say that the appraisal and analysis that has been done on HS2 is completely consistent with what is done by DFT for all rail projects and with international best practices. You can look at the price that people, particularly business people, are prepared to pay to travel as another proxy for this, and that would also show that there is a strong value attached to higher-speed journeys.
I would also say that the specific analysis of transport projects does not, in general, take into account the much wider economic benefits of these sorts of projects. Can I just make one further point? If we simply followed the economic model in the way you are suggesting, this country might not have built the M1 in the 1960s, for example, or completed the M25 in the 1980s. These are transformational projects that go beyond just the travel time benefits of a particular rail service.

Q135 Andrea Leadsom: I think the point you would have to accept is that the broader economic benefits are not known until they are known, and with a motorway it has lots of things called junctions whereas with High Speed 2 it has a beginning and an end and one or two stop-offs. You are challenging the NAO's report and, according to NAO guidelines, each report is signed off by key Departments, including the Department for Transport. The Department for Transport's Permanent Secretary would have cleared this report before it was published. Where does that leave the position that time spent travelling is unproductive, because that is a significant part of the benefit to taxpayers of the project, is it not? The Department for Transport would have signed off the report, but now you refute its findings.
Danny Alexander: What I was saying is that I think that too much burden in the public debate has been based on this particular facet of the analysis.

Q136 Andrea Leadsom: The financial case is very largely based on the time spent on a train having a value.
Danny Alexander: This is one of a number of things that are taken into account. The methodology used is the same methodology used for appraising all rail projects. We are investing in rail projects all around the country. This is not costing us investment in the Northern Hub or in the railway stations around this country. There is another proxy you can use for that question, which is what price are people prepared to pay for tickets, and the analysis done there—

Q137 Andrea Leadsom: What I am asking you is, did the Department for Transport sign off on the NAO report that you are now refuting? Is that the case?
Danny Alexander: I do not know the specific answer to that question. I would not characterise what I am saying as refuting the NAO report. What I would say is that I think that too much burden is being placed on this particular point in terms of trying to criticise the HS2 project when, as I said earlier, I think there is a very strong economic case for HS2 as a project that can transform the economic geography of the United Kingdom in the way that the advent of the railways in Victorian times did.

Q138 Andrea Leadsom: The Adam Smith Institute has noted that UK high speed rail costs per kilometre are up to four times that on the continent because we have so many towns and villages. Does that have a bearing on the value for taxpayers' money of high speed rail in the UK?
Danny Alexander: It certainly has a bearing on the approach that we are taking to try to control the costs. You are right that, as the Secretary of State for Transport has told the House of Commons, there have been cost increases based on things like tunnelling work, changes at Euston station and so on, and those things all have to be factored into the cost. The approach we are taking now is to say that having done all that work, we are setting a budget for the project, £42.6 billion. It is a lot of money. It is the largest budget I think there has ever been for an individual project in this country. We are setting up the incentives within the project for the people delivering the project to ensure that they deliver under budget, taking the best lessons from the successful delivery of the Olympic Park and asking Lord Deighton, who has joined the Government and was involved in delivering that project, to take a role in ensuring the delivery of this project. I think that is the right balance.
If your wider point is whether it is more costly to deliver infrastructure in this country, the answer is

yes. We published an infrastructure cost review two or three years ago. We have been engaged in a piece of work with the construction sector to try to look at the cost benchmarks for infrastructure projects in the UK compared with other parts of Europe, for example, and we are taking a whole series of steps to try to bring those costs down. That is one of many ways in which we can get better value for the taxpayers' money.

Q139 Andrea Leadsom: How far do costs have to rise before the cost benefit analysis for HS2 just collapses? We already had, in the original £30 billion for the total project, including £17 billion for phase 1, what we were told was a 30% optimism bias, which in most people's terms would mean contingency, yet only last week we have announced another 40% contingency on top of what was already a 30% contingency bias, so clearly the costs are escalating. The Government lost a judicial review on fair compensation. Do you expect the costs of compensation now to escalate and at what point will the cost benefit analysis just make it unviable?
Danny Alexander: I am not looking for the costs to increase. I am looking for this project to be delivered within, and ideally under, the budget that we have set. That is why although the P95 estimate for phase 1 is £21.4 billion, which is within the £42.6 overall estimate, we have given HS2 Limited a target price for delivering phase 1 of £17.16 billion. It is meeting that price that the people who are running HS2 will be incentivised to deliver. So, far from planning for further cost growth, the approach to budgeting we are setting out here is precisely about trying to apply the best lessons of how to manage these big projects to deliver it within the budget that has been set aside.

Q140 Andrea Leadsom: John Tomaney, Professor of Urban and Regional Planning at UCL, said that, "The evidence for high speed rail to transform the economic geography of the UK is fairly weak. Where you have a dominant capital and you connect that dominant capital to peripheral cities and regions by high speed rail, the bulk of the gains accrue to the capital." What evidence is there that disputes that?
Danny Alexander: I think probably it would be best for that question to be addressed to the Department for Transport. I can only say that I represent a small city, a very long way from London, and the connectivity of Inverness to London is crucial. I am sure it is important to London's economy, but it is absolutely critical to the economy of the Highlands and Islands of Scotland, as I dare say John would agree. I suspect that that sort of lesson applies right the way across the country and benefits both ends of the line, not just one.

Q141 John Mann: You were very bullish last time you were in front of this Committee about the broadband, including rural broadband, targets to be met by 2015. Will those targets be met by 2015, as the Chancellor indicated in his statement, or will it be 2017, as British Telecom has made public?
Danny Alexander: We are working as hard as we can to deliver the rural broadband commitments that we have made to the time that we have suggested.

Q142 John Mann: Is it 2015 or 2017, is my question?
Danny Alexander: As you know, this has been organised on a contractual basis county by county across England and in Scotland, in the Highlands and Islands and other parts of Scotland. Some of those contracts go into the 2015–16 financial year. We are working as hard as we can to ensure that they are delivered to the time scale, but there have been issues in terms of state aid clearance. There have been issues in terms of—

Q143 John Mann: We know there are issues. What you are saying, then, is that the Chancellor, when he said in his statement that the target would be met by 2015, was inaccurate, and that that target has slipped, as BT has confirmed in writing, to 2017.
Danny Alexander: No, I am not saying that. I am saying that the Government is working hard—
John Mann: You just said 2015–16.
Danny Alexander: The 2015–16 financial year includes a very large part of 2015, so what I am saying is that we are working as hard as we can—
John Mann: No, be clear, just so there is some clarity here.
Danny Alexander: I am trying to be clear if I could get a word in.
John Mann: Your target is May 2015. That is not a long way into the 2015–16 financial year.
Danny Alexander: We are working as hard as we can to deliver this massive investment in rural broadband to the time scale we have set out. In some areas there are delivery issues that, by local consent between the county council and the provider, mean that it will slip into the 2015–16 financial year. What we have also done in this Spending Round is set aside additional funding so that we can go from the 90% obligation that we originally set out and reach 95% of the population, and through engagement with the industry, particularly the mobile industry, to have superfast connections of one sort of another reaching at least 99% of the population of this country by 2018. I think that is a good ambition that everyone should support.

Q144 John Mann: Thank you. So the target has slipped. What percentage of major infrastructure spend over the next three years will be outside London and the south-east, approximately?
Danny Alexander: I don't have a percentage figure to hand. I don't have a figure that I would guess at.
Chair: Perhaps you can come back to us with that, if it is not too burdensome to produce, because I think that would be an interesting number for us.
John Mann: What I am saying is—
Danny Alexander: I draw your attention to the *Investing in Britain's Future* document that we published. There is a very useful map that sets out major projects taking place in every region of the country, which will help to answer the question.

Q145 John Mann: No, it would be helpful to have the figures. It would also be helpful, unless you know now, to know what percentage of the major infrastructure starts in the next three years will be outside of London and the south-east. I don’t mean number of projects, I mean the actual projected expenditure. How much of the expenditure on the ongoing major infrastructure projects that are started in the next three years will be outside London and the south-east?

Danny Alexander: I don’t have a percentage figure to hand. What I would say is that, as the map and the document show, there are major road, rail, communications and energy projects taking place in every region of the country. There are major projects in London, like Crossrail. There are major projects in the north like the Northern Hub railway investment and many others. There is also an awful lot of infrastructure that is being delivered in the private sector, energy investments in particular, that is important. So it is not just Government spending.

Q146 John Mann: Of course it isn’t. The third set of statistics that would it would be useful if you gave us, if you don’t have them to hand, is what percentage of major infrastructure completions will be outside London and the south-east in the next three years. That also would be useful.

I do not know whether, Chief Secretary, you have ever been unemployed, signed on.

Danny Alexander: I was briefly in 1992 or 1993.

John Mann: So you know what it is like. Good. I am wondering, as a Liberal in the Government, what are you going to say when you are meeting people who are unemployed and are not going to be getting any money at all for the first seven days?

Danny Alexander: I think what I would say is that we currently have a three-day waiting period in a system where benefits are paid fortnightly, and we are moving to a seven-day waiting period under universal credit where benefits will be paid monthly. All the money that we are saving through that measure is being reinvested in measures that we know, on the basis of DWP assessment and research, make a significant difference to the prospects of Jobcentre Plus being able to help people back into work quickly. The best outcome for anyone who is unemployed is to get the support and help that they need to get back into work as quickly as possible. I think that the things that we are investing the money in really will make a difference in that respect, and that surely must be the right thing for all of us if we want to get people off benefit quickly and into work.

Q147 John Mann: I am just thinking of the woman I was talking to on Saturday who has now been reduced, by her employer Tesco, to a three-hour-a-week contract with call-off on top if there is more work. If she is made unemployed she will not be entitled to anything for seven days. So I just ask, again, thinking as a Liberal, how would you justify that decision with your Liberal tradition and philosophy if you were face to face with that young woman if she was to be made unemployed and was unable to get any money for seven days?

Danny Alexander: I would say, as a Liberal, I think the most important thing for people who are unfortunate enough to become unemployed, which is a serious thing for any individual in any family, is to get the support and help they need and that we know works up front, and to get people off benefit and back into work as quickly as possible. That is what we are investing in.

I would further add that with the creation of universal credit, which I think is one of the most important reforms in the benefit system undertaken since Beveridge, a person’s benefit will be paid in work and out of work—it will vary according to the number of hours that they are working—and that will create a benefit system that is much more supportive of people seeking to get back into work. At the moment we face a situation—certainly the benefit system we inherited had this situation in many sets of circumstances—where people are better off being on benefit than in work. We are changing that and providing the support necessary to get a job. I think that is the right balance.

Q148 Mr Love: Can I return to the infrastructure plan?

Danny Alexander: Yes, of course.

Mr Love: Earlier on, in a response to Mr McFadden, you stressed funding commitments as being the important part of the plan, yet the Engineering Employers’ Federation, echoed by a considerable number of others, has described the plan as falling short of a clear and fully funded plan. How do you respond to that criticism?

Danny Alexander: I don’t accept that criticism. I think that the programme that we set out was clear and gave the certainty that a lot of industry organisations, including the EEF, had been looking for around that sort of investment. Where the funding has been set out, the reforms will in due course be legislated for to back up that funding—for example the corporatisation of the Highways Agency—to give people confidence that those things will be delivered. I would be very surprised if any party in the House of Commons would want to say it wanted to reverse any of those plans.

Q149 Mr Love: The EEF went on to say, “Future commitments to fund have only been made subject to value for money and deliverability criteria. These can be used as grounds to retrench in the next Parliament.” How do you respond to that criticism?

Danny Alexander: I think this Committee would not welcome me coming here and saying value for money criteria are being set aside. Of course projects have to be delivered in a way that is value for money, but you will see in the roads package, for example, that we are committing to funding all of the projects in the current Highways Agency pipeline, in other words projects that have already passed the test that you have set out.

We are setting aside considerable resources, £10 billion-plus, to local road maintenance to deal with—it may sound trivial but it is very important in every constituency in this country—the massive backlog of potholes and road maintenance issues that have to be dealt with, which have been subject to a major campaign by important national newspapers, among others, and quite rightly so. We are for the first time not just undertaking feasibility studies but setting aside the funding for routes in this country that have been major bottlenecks for a very long period of time. The A303 is an example. I am sure Members around this table would have lots of other examples that they would cite. I think it is right to be ambitious about investment in our transport network, and I think people should have confidence that those plans will be delivered.

Q150 Mr Love: Let me go on to the transport network. You mentioned the A14 earlier on, but the A14 and the A19 upgrades have only received conditional future commitment whereas other road schemes, such as the A303 upgrade, only have a commitment to carry out a feasibility study. Surely all of these things can be called into question in the next Parliament?

Danny Alexander: I would hope that there could be a consensus established around this plan, because I think it is the right plan for the country. I would say that in the context of things like the A303 and those other routes, of course you have to conduct a feasibility study, not to work out whether you do something but to work out what precisely you do and what is the best plan for upgrading each of those routes, and you have to do so quickly. I hope that those reviews will all be carried out very quickly so that there can be a degree of certainty about precisely what is going to happen. Also, we have set out in the plans substantial increases in funding for the Highways Agency, precisely so that it knows not just that it is doing the feasibility study but that it has the funds to deliver the results of that study during this period.

Q151 Mr Love: There is a lot of criticism that we are very good on strategies and press notices and statements to the House of Commons but we are bad at getting the diggers on site. How do you respond to that criticism? None of these projects that you have outlined in your infrastructure plan will come to fruition in this Parliament, as has already been indicated, because capital investment will stay flat during the rest of this Parliament. All of the ones in the next Parliament are subject to caveats that could mean they are cancelled. How do you convince people that this is a reality that will happen?

Danny Alexander: I would say, first, as the previous Chancellor said in the House of Commons in response to the Chancellor's statement, that delivery problems are an issue that has dogged successive Governments. I would say that we have a good record of delivery. Over 30 major road projects have been completed since the 2010 Spending Review; 24 major road projects have been announced since 2010; eight are under construction; eight will start this year and the rest next year. We have invested in 190,000 new school places since 2010, 84,000 houses completed, 59,000 homes protected from flood defences, all as a result of capital investment by this Government. So I think we have a good record of delivery, but we are also seeking to make a number of reforms to make that better.

We can look at the things that hold up infrastructure projects—the planning system, which we are speeding up and reforming to give more of a tilt in favour of sustainable development; and the application of environmental rules that, without slipping on environmental standards, could be done much more quickly and effectively by the relevant agencies, the habitats directive for example. There is a whole range of changes that we are making to speed up the delivery of infrastructure projects, which I hope the Committee would welcome, because it is precisely to ensure that we can go more quickly from drawing up a plan to making the thing happen that we have set out these proposals.

Q152 Mr Love: If I may say so, the long list of achievements of this Government that you read out a few moments ago is part of the problem. It is part of the smoke and mirrors that you tell people all the marvellous things you have done on the basis of massive cuts in public expenditure, but let me go on—

Danny Alexander: I am not afraid to defend the record of getting better value for public money and delivering and focusing that money on priorities that are important to the country.

Q153 Mr Love: We could get into a tit-for-tat. That is not what this Committee is about.

Danny Alexander: Okay, I apologise.

Mr Love: How many projects have actually started and how many have not started; I think that is for the main Chamber.

I wanted to ask you one final question. Earlier on you prayed in aid the support of the CBI, yet the CBI in their commentary on the infrastructure plan said, "It's clear the Coalition sees it was wrong to cut capital spending so deeply in 2010". Are they right?

Danny Alexander: I would say that we inherited plans for deep cuts to capital spending from our predecessors. We have sought, wherever we can since then, to make further savings on current spending and added that money back into capital spending. We had to take radical action when we started out, but I think at each and every stage, wherever possible, we have sought to switch money into capital spending because we recognise that it is important for the economy.

Q154 Mr Love: This whole stop-start phenomenon, where you massively cut and then you have to reintroduce capital expenditure—we could take education as one example of that—is surely the least efficient way to carry out the infrastructure that is absolutely necessary for this country.

Danny Alexander: That is why I would expect and hope that this Committee would warmly welcome the massively ambitious long-term plan for capital investment that I have set out, precisely because it gives us a chance to move beyond that. The only other point I would make is that it is also important to make sure that the programmes we have are good value for money. For example, I think it is also the case that our priority schools buildings programme is more efficient and better value for money than the building

schools for the future programme that we took over from.
Mr Love: We would welcome it if it was a reality, but it is the reality that we are trying to get to.

Q155 Teresa Pearce: In response to a question from John Mann, you on the seven-day wait for claiming that people currently have to wait three days. That is not true, is it?
Danny Alexander: There is a three-day waiting period for Jobseeker's Allowance, yes.

Q156 Teresa Pearce: There is a three-day waiting period for it to be paid, not to claim it.
Danny Alexander: No, there is a three-day waiting period, which means that your initial payment effectively starts three days later.

Q157 Teresa Pearce: Is that correct? That is not what they told me at the Jobcentre Plus visit that I did last week. They told me that the day you claim, your money is paid from then. Are you sure?
Danny Alexander: I am sure.

Q158 Teresa Pearce: You are sure? Okay. The seven-day wait, does that include housing benefit as well?
Danny Alexander: It will apply to new claims for universal credit. So if you are—

Q159 Teresa Pearce: So not for Jobseeker's Allowance?
Danny Alexander: Let me just explain. If you are already in the universal credit system, which, as I explained earlier, covers a whole range of different benefits paid as one, and you become unemployed within a universal credit claim, your claim will not stop in those circumstances. It only applies to new claims for universal credit, so people who are outside the universal credit system altogether, and it will apply to all components of the benefit.

Q160 Teresa Pearce: So will it apply to anybody claiming Jobseeker's Allowance or will it not come in until universal credit comes in?
Danny Alexander: It will apply in the universal credit system that will be well under way in 2015–16 when this starts.

Q161 Teresa Pearce: So this applies when universal credit comes it. It won't apply prior to that?
Danny Alexander: I think in fairness on that point I would like to get back to the Committee, if I may.

Q162 Teresa Pearce: So when universal credit comes in, it is a week before you can claim. It is—
Danny Alexander: What it effectively means is—
Teresa Pearce: Can you just let me finish? It is paid a month in arrears. I went to visit the pilot up in the north-west last week, with the rest of the Work and Pensions Committee, and we were told that currently it is paid a month in arrears and it takes another seven days after that month for it to hit someone's account, so that is five weeks, at least, in arrears. What you are saying is that it will be five weeks in arrears but there will be a week missing because it will be a week before you can claim it at all.
Danny Alexander: It would mean that your first payment, rather than being reduced by three days, is reduced by a week. That is right.

Q163 Teresa Pearce: Including your housing benefit?
Danny Alexander: For new claims of universal credit. If you are already in the universal credit system, so supposing you are working on a low income and you are in receipt of universal credit—

Q164 Teresa Pearce: So people who are currently on tax credits will be in that system. Somebody who loses their job would go into universal credit—
Danny Alexander: People who are currently not in the universal credit system who lose their job—
Teresa Pearce: Who are currently employed.
Danny Alexander:—who are currently employed will then be subject, if they lose their job, to a seven-day waiting period.

Q165 Teresa Pearce: So they will not be able to pay their rent? They will have to say to their landlord, "I'm sorry, I've only got three weeks' rent instead of four"?
Danny Alexander: As I was explaining earlier, the whole point of the reform is precisely to ensure that people get off benefit and back into work more quickly, which is in the end the best thing for that person to be able to pay their rent, meet their bills, and all the other things that we talked about.

Q166 Teresa Pearce: What the Chancellor said is that it is better for people to be looking for work in that way than claiming a benefit, but I would say to you if you went to your landlord and said, "Sorry, I can't pay you rent this week because I am looking for work", he would have something to say about that.
This measure is meant to save £350 million a year, and the Chancellor said that this has been introduced because, "Where is the fairness in condemning people to a lifelong benefit because the system will not help people get back into work?" Yet, in the last two years, £736 million has been spent on the Work programme. You are already spending £736 million on the Work programme, yet the Chancellor says this is a system that won't help people back into work. Are you saying that the Work programme is a failure?
Danny Alexander: People come on to the Work programme having been on a Jobseeker's Allowance for a substantial period of time. What this is about is strengthening the initial Jobcentre Plus regime, which already works well for a lot of people, but we know from the evidence that DWP have looked at that introducing up-front work search, using the Universal Jobmatch software that they have developed more effectively, looking at the issues about linking up between the ESA system and helping people to manage their conditions all make a difference in the initial phase of someone's claim in getting them off benefit so that they do not ever have to go on the Work programme.

Q167 Teresa Pearce: I understand that and I understand the value of work, but what you are saying is that people need to be helped back into work rather than be given benefit.
Danny Alexander: Yes, that is what I am saying.

Q168 Teresa Pearce: Yet the Chancellor said that people need to turn up with a CV, register for the online job search and start looking for work, and only then will they receive benefit. You are saying that you are going to help all these people but they have to help themselves before they even get there. You will have people who may have been in jobs for 30 years and not done a CV for 30 years, but you expect them to turn up and until they have done a CV to a standard, they will not get any benefit. Is that correct?
Danny Alexander: The benefit claim will be paid after the seven days. The point is that there—
Teresa Pearce: But he said here only then—
Danny Alexander: Sorry, it is a long question, if I could have a moment to answer it. The point is that the work search requirements start the moment someone makes their claim. There is a seven-day waiting period before the money starts to flow, but that does not mean they wait seven days until starting to do things such as registering on the Universal Jobmatch system, writing a CV and all of those things. There is already a strong regime of conditionality, as you will know, within the Jobseeker's Allowance system, which requires people to sign on on a regular basis and, when they sign on, to give evidence of the work search activities that they have undertaken. There is no change to that conditionality regime.
Teresa Pearce: You are just stopping the money.
Danny Alexander: What we are strengthening is the upfront work search requirements, which we know generally, on the basis of evidence, make a difference to people's ability to get into a job quickly, and I think we should all be trying to make changes to get people into work quickly.
Chair: Thank you very much, Chief Secretary. I have three colleagues wanting to come in and some of us will be starting to think of lunch before long. I just put that in as an idle thought.

Q169 Mark Garnier: Chief Secretary, good afternoon. Can I turn to the ring-fencing of budgets? To put this into a little bit of context, I will read a passage from one of the commentators, Tony Dolphin, "By the time the cuts have been fully implemented in the next Parliament, the Coalition's current approach means spending in areas other than health, schools and aid will have been cut in real terms by over one-third, and in some cases by as much as a half". Paul Johnson of the IFS said in his presentation that this ring-fencing is leading to continued change in the shape of the state. First of all, do you recognise that change in the shape of the state? Secondly, if you do, or indeed if you don't, have Ministers explicitly discussed changing the shape of the state as part of this ring-fencing approach?
Danny Alexander: In one sense, I do recognise that picture, yes, because as a matter of policy we have decided that some Departments will see more significant reductions than others and that, measured in monetary terms, does change the balance. I would say that in each case the ring-fences are justified in their own terms. If you look at the health system, for example, it is an area that is obviously enormously important to our country, and I suspect to every person in this room, but it is also something where there are significant cost pressures that grow year on year. So there is a very significant efficiency challenge within the NHS even within a budget that is rising in real terms.
In the school system, we have seen very big pressures in terms of rising pupil numbers. That is why we are investing in additional school places in areas of demographic pressure. On international aid, I would say that we have a strong obligation to support those people who, even given the difficulties that we are going through, are a great deal less fortunate than we are. So I would justify them in those terms but, of course, I guess each political party will have to decide its views on these subjects in its offering to the country at the next election.

Q170 Mark Garnier: A lot of people would come back on a number of those points. For example, with the health budget, evidence suggests that unless you are seeing an increase in the health budget by 4% a year, it feels like you are effectively seeing cuts. I suppose that is a sort of slightly moot point, but none the less, it still comes back to a fundamental point that there is a challenge, which is of course to reduce the budget deficit. It is absolutely correct that as a country we try to get our public finances back into order, but ring-fencing really is putting a terrific amount of pressure on other Departments.
In some cases we are seeing some of those other Departments pushing their costs elsewhere, and certainly if you look at the local government budget, out of which comes social services, we are now seeing a restriction on social services. For example, we are seeing people not accepting patients and we are seeing the bed blocker problem, and therefore social services are now pushing part of their costs back on to the health budget. That is the sort of anecdotal type of evidence that is coming through, but have you seen any hard evidence that some Departments are now struggling so much that they are trying to push some of their costs into those ring-fenced Departments?
Danny Alexander: Can I answer the question the other way around? I think one of the biggest problems we have with the successful delivery of public services is the lack of joining up of services at a local level. One of the things that I was seeking to do through the Spending Round, one of my biggest personal priorities, was to use the spending levers that we have in the Treasury to try to give a big shift towards joining up delivery at a local level. We know from, for example, community budgeting pilots undertaken in local government that there are really significant savings as well as improvements to services that come when, in the case of a troubled family for example, you are not having half a dozen agencies all giving a little intervention that makes no difference. They are pooling their resources, having one intervention that can transform that family's life. That is much better for the family, it is much better for

the public purse, and we need to give better financial incentives to get people to work together.

That is why I think one of the biggest, most radical and, I hope, longest-lasting reforms from this Spending Round is the pooling of money on social care. We are really getting the NHS and local government to work together to improve social care delivery, to stop vulnerable elderly people falling down the cracks between health and social care, and therefore saving money in the NHS, saving money for the local councils but, most importantly, giving a better service to some of the most vulnerable people in our country.

Q171 Mark Garnier: I broadly agree with that, but one of the interesting things that you raise is efficiencies. When you see a budget that is having the ratchet put on it quite heavily, like local government, what you are seeing is a number of efficiencies coming through, for example shared services between different councils. That is a really excellent way in which a lot of councils are responding to this. However, if you do not ring-fence a budget, you are not putting the same amount of pressure on that Department to try to drive efficiencies. So are we not finding ourselves getting to the problem where those budgets that are not ring-fenced, that are not being nailed down, are now driving genuine taxpayer efficiencies whereas ring-fenced budgets are not?

Danny Alexander: No, I do not think that is the case, but it is a risk that we should guard against. I think in every case we are driving efficiency much more than has happened in the past. I would pay tribute to the work of Francis Maude and the Efficiency and Reform Group in the Cabinet Office, because we now have a real pool of commercial expertise within central Government that was of real assistance to me in this Spending Round. I could go and looking at the IT contracts in the Department for Work and Pensions, or some of the procurement approaches in the Ministry of Defence, and evidence how we could make some of the savings that those Departments needed to make. But those people have also come back to me and said, “In many cases, we think there are many more efficiency savings to be had”. That is why I have launched in my statement a further process of efficiency reviews, Department by Department, reporting over the next two years, precisely to identify using commercial techniques where there are more efficiency savings to be made across Government, so that those savings can be used to support our economic priorities.

Q172 Mark Garnier: Can I turn to pensioners?

Chair: Very quickly.

Danny Alexander: I am happy to carry on, Mr Chairman, but I appreciate that others may have lunch obligations.

Mark Garnier: I am on a diet, so I am trying to avoid it.

Chair: One last quick question and then I will bring in two more colleagues.

Mark Garnier: Pensioners have also been ring-fenced in terms of budget. We have heard on numerous occasions, from people like Mervyn King and other commentators who have come and spoken to us in this Committee, that we are seeing a fairly significant transfer of wealth from the younger generation to the pensioner generation for a number of different reasons, not least that we are seeing pensioner benefits being ring-fenced. That is causing quite a big economic skew. Why in particular are you ring-fencing pensioners’ benefits in the budget?

Danny Alexander: We set out a policy for the reform of pensions when we started out—the triple lock to protect the value of someone’s pension, which had been eroded over a number of years. We are now seeing people being paid better state pensions than they were before and than they would have expected under the uprating plans that we inherited.

Q173 Mark Garnier: Why? It is very nice, but—

Danny Alexander: I think because it is right to say that we should provide a proper degree of support to our elderly people who have contributed to our society throughout their lives.

Q174 Jesse Norman: Chairman, I am reluctant to stand between you and your obligations to lunch but maybe I can keep my questions relatively brief. Chief Secretary, we discussed the issue of schools funding earlier with experts, and their comments were that the current system is “very unequal”. That was the IFS’s description of it. Could you just comment on who is affected by that inequality and whether you agree with it?

Danny Alexander: It is certainly the case that per pupil funding varies very dramatically between different parts of this country—between the greatest extremes there is a difference of up to £3,000 per pupil per year. Taking a deprived pupil in a Northamptonshire secondary school, the per pupil funding in that case will be about £1,700 more than an deprived pupil in a Derbyshire secondary school. So we have made a number of changes already to try to address that, particularly the introduction of the Pupil Premium, which is additional resources going to the education of disadvantaged children. One of the things we have announced in the Spending Round is that we are going to introduce over time a fair national funding formula for schools. The Department for Education will be setting out in more detail, and consulting on, how to do this. So I do not have much more to add in terms of how it might work, but the basic idea behind it is to say that over time we should move to a fairer basis for the base funding of schools.

Q175 Jesse Norman: But you would accept the IFS’s description that it is very unequal at the moment?

Danny Alexander: I think there are historic and unfair differences in funding between schools in different local authorities.

Q176 Jesse Norman: Thanks. Do you also accept the view that was put forward that although the Pupil Premium is validly targeted on the less well-off, there are at least two deciles above that of people who are not as badly off but nevertheless are eligible for appropriate funding and who may only just be floating above that cut-off point?

Danny Alexander: One of the ways that we have addressed that point is to move from a measure of the Pupil Premium that is just based on receipt of free school meals in that year to look at receipt of free school meals over, I think, a six-year period now. That would reflect the fact that there are people who move above and below that line throughout their lifetime, depending on changing family circumstances, and therefore bring a slightly wider cohort into the ambit of the Pupil Premium.

Q177 Jesse Norman: So people in parts of the country that have relatively low levels of income should not thereby have low levels of funding. Funding and income should more or less be correlative—the richest area should receive the lowest funding and vice versa. That is the expert view.
Danny Alexander: I think it is best to allow the Department for Education to set out the details in due course. I think I have expressed the intention behind our plans.

Q178 Jesse Norman: Do you think school transport should be included in the calculation, given how hard it often is to get kids to school, how much time is consumed by it and the cost of transport at the moment?
Danny Alexander: There is school transport funding that is outside the direct schools grant. That will continue to be paid to schools, so it is not counted in the per pupil allocations through the direct schools grant. That extra funding that particularly helps rural areas will continue to be paid. It is not something that we are making big reductions in in this Spending Round.

Q179 Jesse Norman: A final quick question. Obviously, the issue here is not just about the performance of the schools. It is also about equity and the richness of the educational experience.
Danny Alexander: What we need to have is a school system that is ensuring that every child, irrespective of the circumstances of their birth or the area that they live in, gets the quality of education that we would expect for all of our children. That is what we are seeking to achieve through this reform.

Q180 Jesse Norman: But you are agreeing with the point I am making, which is that it is not just about fairness. It is about fairness and the richness of the educational experience. It is not just about what their academic performance is.
Danny Alexander: It is about both of those things.
Jesse Norman: Yes, that is what I thought. Thank you very much.

Q181 Mr Ruffley: Chief Secretary, why can you not introduce the welfare cap in 2014 rather than 2015? It is a good idea. Why not 2014?
Danny Alexander: With a reform of that scale, we need to take time to get the precise operation of it right. The idea is a forward-looking proposal.

Q182 Mr Ruffley: So it is an operational reason?
Danny Alexander: We would be too close now to the 2014–15 financial year for this to start. If we introduced it in the autumn statement, let's say, for 2014–15, we would be too close to make it work properly for that year.

Q183 Mr Ruffley: Could you just provide some detail that is not immediately obvious from the Treasury documents? The Chancellor talks in his document about some cyclical benefits being excluded from the welfare cap. Can you list what those are?
Danny Alexander: Yes. We would seek to exclude from that Jobseeker's Allowance and other benefits that are passported from Jobseeker's Allowance, because that is part of the automatic stabilisers in the economy. I can't give a list of what all the passported benefits are but, for example, for people who move on to Jobseeker's Allowance and have housing benefit passported as part of that, that housing benefit would also be outside the limit that we are setting.

Q184 Mr Ruffley: So the excluded is JSA and passported benefits associated with JSA.
Danny Alexander: Yes.

Q185 Mr Ruffley: The Chancellor also says in his document, "Over the coming months the Government will consider whether it is appropriate to include other elements of AME in the cap". Can you indicate to us what is under consideration?
Danny Alexander: Not at this point. There is a—
Mr Ruffley: What does that sentence mean?
Danny Alexander: There is a very long list of other AME components.

Q186 Mr Ruffley: We are just honest seekers after the truth. "We will consider whether it is appropriate to include other elements of AME in the cap." I am asking you what elements of AME might be under consideration.
Danny Alexander: As I say, there is a long list of measures that are within AME.
Mr Ruffley: And I am asking you which ones might be under consideration for inclusion in the cap.
Danny Alexander: I am saying that we are looking at a number of measures on that list, and when we have reached a conclusion we will announce what we are going to do. Going back to when we came into office, about half of all public expenditure did not have any control framework associated with it, so there are other elements of AME where we have already introduced control frameworks. In public service pensions, for example, our reforms already have a back-stop cap arrangement in the legislation, so that does not need to be here. We have sought to control the cost growth of the basic state pension through bringing forward increases in the retirement age. I am sure that is a process that will continue in future. There are areas like debt interest which it would not be appropriate to include in a framework like this. Environmental levies already have a control framework associated with them, but there are other smaller elements of AME that we just need to look at and work out if they are appropriate to be included within this framework.

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Q187 Mr Ruffley: But you will tell us in due course?
Danny Alexander: Yes.

Q188 Mr Ruffley: The "comply or explain" sanction is thought by many commentators to be a fairly weak deterrent to Departments or Ministers who breach the cap. What other sanctions will the Treasury apply?
Danny Alexander: I do not think it is weak—I disagree with that analysis.

Q189 Mr Ruffley: Is that the only sanction?
Danny Alexander: The way that the cap will work is that, having set the cap, the OBR will give a forecast. If there is a breach in the future, perhaps with a small buffer above that to allow for statistical fluctuations, then the Chancellor of the Exchequer will have to report to the House of Commons either the action that he or she is taking to bring expenditure back within the cap or an explanation of why action is not being taken. In that sense, it is similar to a fiscal rule, which I think does impose a great deal of discipline on the Treasury and on the Chancellor and the Chief Secretary and the decisions that we make. So I think it is something that will have a real bite. I think it will also help to improve the forecasting of AME expenditure, which is a real weakness in Government, and by strengthening our forecast we get a better sense of where that money is going to go.

Q190 Mr Ruffley: Why are you not setting individual caps for individual benefits? Why are you just doing it in aggregate?
Danny Alexander: There are always statistical variations up and down for individual benefits. I think it is much more sensible to look at the sort of £100 billion or so of other social security together as one thing.

Q191 Mr Ruffley: But isn't it the case that it follows from that that if there is overspend in one benefit it might squeeze, without any intentional effect, other parts of the budget, if you have an aggregate policy rather than benefit by benefit?
Danny Alexander: It might do but, of course, it is a judgment for the Ministers of the day to decide what offsetting action they want to take or, if they decide not to, how they will explain that to Parliament.

Q192 Mr Ruffley: But you have ruled out setting individual caps for individual benefits.
Danny Alexander: No, the approach we are taking is the one we have set out, which is an aggregate limit across a range of benefits that brings those things together and treats them in aggregate for the purpose of this control mechanism.

Q193 Mr Ruffley: Final question, Chairman. State pensions are a quarter of total AME. Do you think that the triple lock is sustainable in the medium term?
Danny Alexander: Yes, I do, but it will clearly be a question for each political party to set out its views on at the election. My view is that it is sustainable and right. I think if you look at that in combination with the single-tier pension reform that we are also taking forward at the moment, that also results in significant savings in expenditure over the very long term. If you take that together with the action that we have taken on state pension age, which I think is the fairest mechanism through which to control expenditure in this area, because it relates to growth and life expectancy, I can well imagine that further decisions in that space will have to be made, and we are putting in place a mechanism there. I think that is the right way to control pensions expenditure, not to have a system that ends up with microscopic increases in the basic state pension, as we saw, for example, with the 75p rise in the previous Parliament.
Chair: Chief Secretary, you have provided an enormous amount of detail to a wide range of questions this morning, now this afternoon. We are very grateful to you for giving evidence, and for longer than had originally been discussed with the Department. Perhaps it is a reflection of your absorption of that detail that you have been very well-briefed by Sharon White, who therefore did not need to say anything on this occasion, but I have no doubt on some future occasion we will be looking forward to hearing from you. Thank you both very much indeed.

Thursday 11 July 2013

Members present:

Mr Andrew Tyrie (Chair)

Mark Garnier
Stewart Hosie
Mr Andy Love
John Mann
Pat McFadden
Mr George Mudie
Mr Brooks Newmark
Teresa Pearce
Mr David Ruffley

Examination of Witnesses

Witnesses: **Rt Hon George Osborne MP**, Chancellor of the Exchequer, HM Treasury, and **Sharon White**, Director General for Public Spending, HM Treasury.

Q206 Chair: Chancellor, thank you very much for coming to see us this morning. You have deposited in the Library of the House of Commons a report by the Permanent Secretary into the pre-briefing or pre-releasing of Budget information. You put that in there a few moments ago, and it has just been circulated to the Committee, which explains the delay to the start of this meeting. There have been expressions of regret in the Committee about the fact that we have not had a chance to absorb this. We do not want a prolonged discussion of this, because it would deflect attention from what we feel are far more important issues of public expenditure control and the decisions that have been taken in the review. It is possible that colleagues may want to come back to this later in this session or in a subsequent session but, in the meantime, is there anything you want to say on this?

George Osborne: First of all, I should introduce Sharon White—although she was here earlier in the week. She is the Director General for Public Spending in the Treasury.

I have written to the Speaker today with the conclusions of the report that the Permanent Secretary to the Treasury, Sir Nicholas Macpherson, did into the pre-release of the Budget to the *Evening Standard*. I apologise for the fact that we only emailed it to the Committee half an hour ago. The report was finished yesterday, and I had a dilemma whether to produce it after this hearing, in which case you might say that I had deliberately done that, or to get it out as quickly as possible and copy it to the Committee.

Nicholas Macpherson has looked at the practice of pre-briefing information about the Budget to the media. He points out that this has gone on for a very long time. Chancellors pre-recorded Budget broadcasts with the BBC over many decades. The report makes clear that the approach to the embargoed briefing of information that was taken for Budget 2013 was not new and that, in all important respects, it appears the same as that taken at least since the March 2010 Budget, which was the last Budget under the previous Administration.

However, the central recommendation, which I accept in full, is that the Treasury introduces a ban on the pre-release of the core of the Budget and the autumn statement—that is, the economic and fiscal projections, the fiscal judgment, individual tax rates, reliefs and allowances. I am confident, as I think is Sir Nicholas, that this will prevent a repeat of what happened and the disservice that that did to Parliament.

Q207 Chair: What justifies the release of information that is non-core?

George Osborne: Inevitably, before a Budget, it has now become the practice, as carried out by my predecessors, that Chancellors do interviews. For example, I did an interview on the Andrew Marr programme, like Alistair Darling before me. I often talk about the themes of the Budget and explain the context in which the Budget is happening.

What is the key component of the Budget? It is the forecasts, it is the tax rates and it is the allowances. That is the meat of the Budget, and that is what Parliament would expect to hear first. That is specifically what we are making clear should not be pre-briefed. That information was pre-briefed, including in March this year, to certain news organisations, principally broadcasters, but also the *Evening Standard*. That is what was released early, with a breaking of the embargo by the *Evening Standard*, for which it apologised. It is sensible to ban the release of that information so that we do not get a repeat of what happened this year, for which I have already apologised to the House.

Q208 Chair: My question was about the rest of the Budget—the non-core—which is another way of asking, “Why don’t you stop doing interviews in the period immediately prior to the Budget, like Chancellors used to do?”

George Osborne: I think it is perfectly reasonable, in the modern age, to try to explain the context in which a Budget happens. We no longer have the closed economy of the 1950s, when the Budget was the be-all and end-all. The Budget is one of a number of economic statements that we make during the year. It has been perfectly reasonable for myself, for Alistair Darling and for others to try to explain the context in which the Budget is happening, just as Government Ministers constantly seek to explain the context in which Government policy is made.

When we think about the Budget, we think principally of the forecasts and tax rates, the allowances and so on. That is, after all, the information that everyone is in search of. I think that this approach will protect the integrity of the Budget and the integrity of Parliament in hearing this information first.

The Permanent Secretary considered whether we could have a pre-release to certain media organisations. The ONS pre-releases statistics, including very sensitive statistics on GDP and, in effect, locks journalists into a room, so that they have that information and they are ready at 9.30 to go with the information. We considered that. That is not sensible with the Budget, not least because you would expect media organisations not then to come and listen to a Budget speech that might be an hour long already in possession of knowledge about what is in the Budget. We have gone for the belt-and-braces approach of this ban.

Q209 Chair: We will find out later whether it is belt and braces and whether we carry on having pre-briefings, as we have had in recent decades, on what could at least be claimed to be non-core. Let us hope that we do not.

Can I get on to public spending? You have delivered what can only be described as a successful review, because you have kept within the envelope, which, bearing in mind the tightness of that envelope, is a remarkable achievement. I think that most independent commentators agree with that remark. How closely involved were you in this? How many bilaterals did you have with senior colleagues, and in which Departments were they?

George Osborne: Obviously, I was intimately involved in the entire process, but worked exceptionally well with the Chief Secretary to the Treasury—we worked as a team. I was always clear, particularly because it is a coalition, although I think this would apply in a single-party Government, that I was not the immediate court of appeal for someone dealing with the Chief Secretary. In other words, just because they had had a difficult meeting with the Chief Secretary, they could not pick up the phone to the Chancellor. I made it clear to both Conservative and Liberal Democrat Cabinet Ministers that they had to deal with the Chief Secretary. Then, the Chief Secretary and I would discuss the settlement, and indeed discuss it with the Prime Minister and the Deputy Prime Minister, so it was a collective decision of the coalition.

We worked very closely as a team. All the key bilateral meetings were carried out by the Chief Secretary. Ultimately, of course, if there is a fundamental dispute between the Chief Secretary and the Minister concerned, they could put in a call to me, but they did not receive much quarter, because I stood behind my Chief Secretary, which I think is what a Chancellor needs to do.

Q210 Chair: How many colleagues appealed to the Prime Minister?

George Osborne: I am not aware of any particular appeals to the Prime Minister.

Q211 Chair: You did not find the Prime Minister having a word with you and saying, "So and so has been on to me", or, "Michael has been on to me".

George Osborne: The Prime Minister took his duties as First Lord of the Treasury very seriously, and backed up the Second Lord of the Treasury and the Chief Secretary. The Prime Minister—

Q212 Chair: It depends whether he had to. I am asking whether he had to. That was my question.

George Osborne: As far as I am aware, unless there was a phone call or conversation that I was unaware of, there were no appeals.

Defence was handled as a separate process from some of the other Departments, in that the Prime Minister had set an ambition, which was that there would be no reduction in the front-line capability of our military. Right from the start, he had set that condition. In order to ensure that everyone would be satisfied with that, the Cabinet Secretary led a review of efficiency within the Department—there was a Cabinet Secretary-led review. That avoided what we had seen in previous Governments, particularly on defence—the appeal of the Defence Secretary and the service chiefs to the Prime Minister. That was avoided, because there was an agreed process for assessing what would and what would not impact on front-line military capability.

Q213 Chair: What you are describing sounds remarkably like a surgical operation, with very little blood—scarcely a display of the instruments of torture, and still less their use. There was not even a Star Chamber. It is quite remarkable, bearing in mind the unprecedented scale of the cuts, which you have not actually described—but they are large.

What really caused this, Chancellor? Why have we not been where we normally are in mid-term with spending rounds, with disconsolate and, indeed, very nervous spending Department heads panicking about their careers and how they will sell these cuts?

George Osborne: It is partly because the Government has set out deficit reduction and expenditure control as one of its absolute core purposes—one of its central missions of the Parliament. Secondly, everyone is aware of the international context in which we are operating, of the market pressure. Thirdly, there is a genuine collegiality through the Cabinet. Fourthly, it is a curious feature of coalition that it requires more formal processes and less informality, so that both sides of the coalition feel they are being fairly dealt with. As a result, there is less scope for going round the formal processes.

I try to set out a long time in advance what we are intending to do, certainly much further in advance than most of my predecessors, in other words to set envelopes clearly in advance and establish dates for these events clearly in advance. It has been the case until recently that one would not know the Budget date until a few weeks beforehand—sometimes three or four weeks beforehand. I set out these dates months in advance. The formality of a coalition allows a process to develop.

I should pay tribute to the Treasury officials and Sharon and her team, who did a fantastic job, and have been doing a lot of preparatory work for this spending round.

Chair: Okay—we will leave it there for the time being. Certainly, something unusual has happened.

Q214 Mr Love: May I turn to the cap on annually managed expenditure? The Institute for Fiscal Studies has said that the cap will not address those elements of annually managed expenditure that are currently expected to rise, and that spending on working-age social security, which will be covered by the cap, is actually due to fall. Is the proposed cap realistically going to make any difference whatsoever?
George Osborne: Yes, I think it will. First, working-age welfare spending is falling, because of conscious decisions by this Government to bring it down. The other areas of AME spending that are increasing all have different control frameworks. There is debt interest—we have to pay our debt interest. The best control framework is to try to keep your market interest rates at a competitive rate relative to other countries, and also to make sure that you are bringing the deficit down.
Pension expenditure has increased—expenditure on the state pension. I think that the best control mechanism that we have for that is the pension age. In Parliament at the moment there is a Bill that will create a mechanism that links the increase in the pension age to longevity in our society.
It is perfectly reasonable to take the areas of AME spending that do not have their own control frameworks and to introduce this cap. I think the cap will be effective. The IFS suggested that it might be better to individually cap individual benefits. I do not agree with that. I think it is perfectly reasonable for a Government and indeed a Parliament to make a choice about the collective expenditure on working-age benefits and pensioner benefits outside the state pension. That provides us with the kind of choices that we are elected to exercise.

Q215 Mr Love: I am not clear. We have called it a cap, but is it a target or a cap?
George Osborne: It is a cap that we will set in the Budget next year. If the Government breaches the cap—it is not illegal to breach the cap, if you see what I mean. It is not, in that sense, like a US Congress debt limit. It merely requires the Government to openly and publicly explain that it is breaching the cap that it told everyone it was going to stick to. You can imagine a situation where a Government—
Mr Love: Chancellor, that sounds like a target to me.
George Osborne: It is not. It a cap because, if you breach the cap the OBR will hold you to account for that, and you have to come and publicly explain to Parliament and to the public why you have breached the cap, and everyone knows you are increasing welfare spending. Working-age benefits spending almost doubled over the last decade, yet I am not sure that that was well understood by either Parliament or the public. It would now be extremely well understood. Of course, if a Chancellor wanted to come to the House of Commons and say, "I am breaching my welfare cap and these are the reasons why I am doing it", he or she would either win that argument or not—but at least they would have to make that argument.
Internally within Government, within the Treasury and the DWP, principally, this will act as a very constricting mechanism that forces—this is no disrespect to the DWP. They are very concerned about managing their DEL budget but, regarding their AME budget, they have much less incentive to manage. It is not controlled. This would impose a control on a very large part of Government spending.

Q216 Mr Love: That sounds exactly like comply or explain. There has been a lot of comment on whether or not there is going to be a firm ceiling on demand-led expenditure. Most people think that it is unworkable. What is your view about having a firm ceiling on expenditure?
George Osborne: It is a cap and, if the Government breach it, they have to explain and publicly account for that. I think that is the correct approach in a democracy. I am not asking for a debt limit of the kind that the US Congress has. This is a different kind of thing, which is more in tune with our parliamentary democracy, but it forces Governments to explain why they are spending more on welfare than they said they were going to spend. They will not be able to use straightforward cyclical explanations because we are removing the most cyclical benefits such as JSA.

Q217 Mr Love: So you will not be expecting Departments to reduce the amount of a benefit or the eligibility criteria in order to stay within the cap.
George Osborne: That would be precisely the choice that a Government would face. If welfare spending was getting out of control or breached the cap and the Government did not want to explain why it was breaching its own cap, it would have to take difficult decisions, as indeed this Government has already taken, on eligibility and on benefit rates.
Crucially, if you express a concern that the cap is not tough enough, this cap is set in nominal terms and it will take into account forecast inflation, but if inflation is much higher than forecast, that will present real choices and challenges to the Government. The Government can either say, "I'm sorry, House of Commons, I'm sorry, public, but inflation is higher than forecast and we are going to go with that", and everyone will then see what is happening, or they will say, "We will underrate working-age benefits", for example, as indeed this Government has done and has passed legislation to do. That is a real choice, and it will be made openly and publicly, rather than what happened in the years leading up to the crash, which was a stealthy increase—a massive increase—in the size of the welfare state and the size of welfare spending, which was buried away in the back of these documents.

Q218 Mr Love: We are well aware of the increase in annually managed expenditure, but what I am not clear about is whether you are simply relying on comply or explain. In other words, Departments can come and say, "I am terribly sorry, but annually managed expenditure has increased", or are you demanding that they take action on eligibility criteria or on the level of a benefit in order to keep within the cap?
George Osborne: I am saying that is the choice. I am saying that the Chancellor can either breach—

Q219 Mr Love: Tell us which choice you make.
George Osborne: I am intending to stay within the cap—I do not answer hypothetical questions.
Chair: Do you have one more?

Q220 Mr Love: I have several more. You mentioned earlier about the national pension and increases in the age at which you receive pensions. When we interviewed the Chief Secretary on Tuesday, he said that he sought to control the cost growth of the basic state pension by bringing forward increases in the retirement age, and he was sure that that would continue. What plans do you have to increase the state pension age, and when will you be bringing those forward?
George Osborne: We have brought them forward. In fact, it was discussed last week in Parliament. The pension bill has within it a proposal for a mechanism whereby changes in life expectancy are assessed, and that feeds through to changes in the pension age. As a Government, we have already taken the decision to bring forward the increases in the pension age to 66 and 67. The previous Government set increasing pension ages in legislation.

Q221 Mr Love: There was a tantalising line in the response from the Chief Secretary, who said he was sure that it is a process that will continue in the future, rather hinting that there may be further changes. Can you elucidate for us?
George Osborne: I do not think that this is any great hint or secret. This is actually in the published legislation that the Parliament is currently discussing. It is there in black and white. We are creating a mechanism that will review increases in life expectancy and enable the pension age to be adjusted accordingly.

Q222 Mr Love: So, outside of what the published figures are, you have no intentions of increasing that or bringing forward changes sooner than expected.
George Osborne: Our intentions are set out in the legislation that Parliament is currently discussing. By the way, this is an approach that has won quite a lot of support from international bodies.

Q223 Mark Garnier: Chancellor, can I turn to the area of ring fencing of budgets? You will be well aware that there is quite a lot of commentary in the press regarding the effects that this is having on certain Departments and, more broadly speaking, the shape of the state. Is the ring-fencing of budgets, and the effect that it is having, a conscious decision by yourself, with the agreement of Ministers, to change the shape of the state, or is it merely an unforeseen circumstance of trying to protect certain Departments?
George Osborne: It is an expression of conscious political choice. It is an expression of the political desire by the Government to protect NHS spending, to protect schools spending and to hit our international development target. Much is made of the ring-fencing but, ultimately, it is just an expression of political will by Government and Parliament, in as much as Parliament votes the estimates. These are areas of public spending that we want to relatively protect.

Q224 Mark Garnier: But it is changing the shape of the Government to a certain extent.
George Osborne: It is not unreasonable, when you have an ageing population and developments in medical technology, that you are seeking to increase in real terms and protect NHS spending relative to other Departments. There are reports today about the pressures on health spending.
What is interesting, and perhaps not surprising in a democratic country, is that the biggest ring fence of all, one that has far and away the most impact on the decisions that we have had to take in this spending round, which is the health service ring fence—that pretty neatly mirrors what the British public want to see protected, when they are asked. It is an expression of the priorities of the country. I would say that that is the ring fence that requires difficult decisions in other Departments.
Too much is made, frankly, in the political debate, about the impact of the aid commitment. It is something that I feel very strongly about. I am proud that this country is meeting its aid commitment. I do not think that it forces the same difficult decisions on other Departments that the NHS ring fence forces.

Q225 Mark Garnier: I think that is right. Aid is 0.7% of GDP, as you rightly point out. There are, though, accusations, certainly within the media, that there are some Departments that are trying to meet their budgets by shifting some of their responsibilities on to other Departments, in particular DCLG in terms of the social services budget, having the effect at the front line that you are now ending up with bed blockers because of the funding of social services. Also, the Ministry of Defence is passing some of the responsibility for patients on to the Department of Health. Do you think these accusations that this is shifting budgets around by stealth are unreasonable, or do you think that there are some strange things going on?
George Osborne: There was a proposal early on in the spending round to shift some budgets into the health ring fence—medical training, medical research and Army medicine. Some of these surfaced in the press. We rejected those. We did not do those. Medical research and medical training stay in BIS, and Army medicine stays with the Ministry of Defence. We rejected precisely what your question implies might have been tempting for me to do, which was to tuck things into the ring fence.
The one area where we have undertaken a major reform is in social care. That is because—and it has been aired today in the reports on the NHS—the more you can invest in preventative care, the more you can make sure that someone who should be in a social care bed is in a social care bed rather than in an A and E ward. That is a big saving for the NHS.
That social care reform is not just about money. It is also about involving the NHS with local authorities in the commissioning of care services, which they were not previously involved in, so there is a real reform there. That has been near universally welcomed by everyone in the health and social care world. I have had some very positive feedback from the charities involved. If there had been any suggestion that we

were doing this for financial reasons, I would have got a warning from the people who care most about this subject but, actually, it has been very broadly supported. It is precisely this sort of thing where we want government to be working more closely together, and where, as we all know as constituency MPs, too many of our constituents fall between the cracks of two services.

Q226 Mark Garnier: It is interesting that you choose health and the change of approach in order to go for preventative rather than curing. There are some accusations that, as a result of ring-fencing certain budgets, there is no real drive for efficiency within those Departments that have been ring-fenced so, while I appreciate what you are saying about health in terms of the different approach, can you demonstrate that the Department of Health has tried to drive managerial efficiencies? Ditto with DFID.

The other interesting thing that people are concerned about is the fact that pensioners have been ring-fenced, probably for quite reasonable reasons but, nonetheless, we are not taking difficult decisions with pensioners.

George Osborne: I am not sure that pensioners would like the idea that they are being ring-fenced. None of these services is immune from the demand for better value for money. Far from it. The NHS has a real-terms increase, but that is still a challenging budget when you have an ageing population and new medical technology, and when there is pressure on health care costs around the world to increase. They have undertaken a major programme of reform, the so-called QIPP savings—£20 billion of savings that they need to find—and all sorts of other savings that we have initiated in things like procurement and through a reduction in administration.

In education, there has been a big reduction in the Department for Education's administration budget. The cost of building a new school, for example, is 40% less than it was under the building schools for the future programme. There is also an aggressive programme of efficiency in DFID.

On pensioners, I would not use the phrase "ring fence", but I would say that we have made a commitment to the pensioners that we are going to have a triple lock—we are going to give them a generous state pension—and we live by that commitment.

All these things force choices elsewhere, particularly at a time when money is short, but it is a political expression of what the Government wishes to achieve and of the support it wants to give to society.

Q227 Mark Garnier: I have one last question, which is on a slightly different subject: your proposals for education in terms of reducing the difference between some of those—in central London, for example—boroughs which get a large amount of per pupil funding, and those in my county, for example, where we are 148th out of 156 shire counties in terms of per pupil funding. Certainly, your announcement was very much welcomed by those of us in the F40 group, but there is a little concern that the changes that will be proposed in the future may take quite a long time to be driven through. This progression to mean over the long term may be over a period of 10 years. Have you got any idea of what sort of period you will be proposing in order to try to reduce this imbalance?

George Osborne: I do not want to pre-empt the work that the Secretary of State for Education is doing in this space, or the consultation that he will launch and the engagement with Parliament that he will have. We have set out the ambition. We will obviously want to do this in a way that achieves a smooth transition from what I think everyone accepts is a rather erratic funding pool that we have at the moment, where children from very similar or indeed identical backgrounds in different parts of the country can get very different sums of money. It is not a kind of urban/rural issue, by the way.

I came with this example. A schoolchild from a deprived background at a secondary school in Northamptonshire can get £1,700 more than a similar child in Derbyshire. We must do it in a way that does not have a disruptive impact on education in Northamptonshire, in this case. We are confident that we can do that. It will of course involve a transition, and it will not be done overnight, but I will leave it to the Secretary of State to spell out how that is going to be achieved.

Q228 Mr Mudie: Going back to the discussion we had about the cap, the Government portrays people as seeking to get benefits that they do not deserve. Every Government is aware of and pays lip service to—no, my question is not in that brief, so you will not see it.

George Osborne: They are all handwritten.

Mr Mudie: I am just interested where you get the brief from and the questions from—whether you have seen our brief. This question is not in the brief, Chancellor.

George Osborne: I have anticipated all sorts of things, which I suspect will not come up—

Mr Mudie: I am sure you have.

George Osborne: I try to work out what I would ask, but you do not always ask what I would ask.

Mr Mudie: You overestimate our intelligence—we cannot match you, Chancellor.

I was just saying: every Government pays lip service to people who are on benefits and are entitled to benefits—when I say on benefits, they are entitled to benefits, but they do not claim, particularly pensioners. We are all very sad that they eke out an existence, occasionally, when they could be helped, and the state wants to help them. Does your cap not encourage the DWP not to seek out, not to advertise, not to look for and not to encourage people who are entitled to benefits? You want them to have benefits, but the Department says, "If we actually did this, we are going to breach the cap", or, "We will have to look at other expenditure".

George Osborne: The short answer to that is no: it certainly should not. It is not good policy to have a benefit and then not encourage people to take it up. I would much rather control eligibility and rates, rather than try to massage take-up. This Government, like its predecessor, has a big advertising campaign to encourage, for example, the take-up of tax credits, and that operates in May and June. We have not abolished that. We are not trying to massage take-up. We are trying to control welfare spending and force choices on Governments in the open space.

Q229 Mr Mudie: The Government debt is estimated to be just short of 80% of GDP this year. It is predicted to rise to a peak of 85.6% in 2016–17. However, one of our witnesses on Tuesday, Professor McWilliams, forecast that it would peak at 92.3%, not in 2016–17 but in 2017–18. Do you see Professor McWilliams as being too pessimistic? Would you confirm to the Committee your confidence that your targets and your figures will be reached?
George Osborne: The forecasts are not my forecasts. They are the forecasts of the OBR.

Q230 Mr Mudie: Do you accept them?
George Osborne: Put it this way: I have the option of rejecting the forecast, when it is produced at the time of the Budget.
Mr Mudie: Do you accept the OBR's forecasts? You have framed your Budget with their support, in the light of their forecasts.
George Osborne: Yes, I do accept their forecast.
Mr Mudie: Good.
George Osborne: I chose not to reject it, so I accept it.

Q231 Mr Mudie: I am just asking a straightforward question: do you think our expert is being too pessimistic? That is a fair question. Therefore, do you confirm your figures to the Committee?
George Osborne: I set out the OBR's forecast twice a year. I do not give a running commentary on the forecast in between those events, and I respect the independence of the body that Parliament has created. I have taken Chancellors out of the forecasting business. Of course, that does not mean that there are not lots of other people in the forecasting business, but there are official forecasts produced by the OBR. I always have the option, before a fiscal event, of rejecting those forecasts, but I did not choose to do so at the time of the Budget.

Q232 Mr Mudie: On debt, you did forecast when it would fall in the fiscal targets, and you have dropped that one. So you do forecast. You are not willing to stand by the figures in your Budget book that say that, in 2016–17, debt will peak at 85.6% of GDP. It is in your Budget book.
George Osborne: I think that you are putting words into my mouth
Mr Mudie: I put them into your Budget report.
George Osborne: Of course this is my Budget report, and I have accepted the forecasts of the OBR but, in between the Budget and the autumn statement, I do not give a running commentary on the forecasts. People can see the forecasts that I have produced, or rather the OBR's forecasts that I have accepted. That is sensible, rather than the finance minister giving a running commentary.

Q233 Mr Mudie: Okay—so, you will not give me an answer. Do you stand by this year's debt figures?
George Osborne: When you say, "Do I stand by them?", I publish them, they were the OBR's figures—I published them, and I chose not to reject them. I published them at the time as the Budget in March, and I will publish a new set of forecasts in the autumn. It will be open to me to reject the OBR's forecasts, but I suggest that there would be a very high bar to rejecting them.
Mr Mudie: You have thrown me, Chancellor. Here is the Chancellor of the Exchequer, who stands at the Dispatch box and gives the fiscal figures, and he is invited, two months later, to the Treasury Committee, but he will not stand by the debt figure that he gave two months ago to Parliament.
George Osborne: I do not know what you mean by "stand by". I gave those forecasts in March; of course I—
Mr Mudie: Do you stand by them?
George Osborne: I stand by my Budget.
Mr Mudie: Well done.
George Osborne: But I do not give a running commentary on the forecasts in between fiscal events. I do not say whether we are likely to come in above forecast or below forecast in between the two fiscal events. It would be grossly irresponsible of me to do so. Most Chancellors have tried to avoid it in the past, even when they were doing the forecasts themselves. I certainly want to avoid it when we have an independent body that does it anyway.

Q234 Mr Mudie: Are debt servicing costs going down? If not, when do you anticipate it? Do you anticipate keeping the promise that you made, not the forecast that you made, that, by the end of this Parliament, debt servicing costs will be lower?
George Osborne: The cost of debt interest to the state has gone up, but it is significantly below what it was forecast to be in the plans that I inherited from my predecessor.

Q235 Mr Mudie: Yes—but I will ask the question again. Are debt servicing costs going down, as was promised would happen by the end of this Parliament? Debt costs are going up at the moment.
George Osborne: I do not think that I ever—

Q236 Mr Mudie: In the two years to go before your promise—not your forecast, but your promise—that they will go down, are they going to go down at the end of this Parliament? If not, Chancellor, fair enough, the world moves on, but when do you anticipate that debt servicing costs will go down?
George Osborne: Debt servicing costs will go down when the national debt falls as a percentage of our economy, and that will happen when we get our deficit under control and our budget close to balance. Debt interest will continue to increase while we have a high budget deficit, so what we have to do is to get the deficit down, and I look forward to your support for all the measures that we take to get that deficit down. However, crucially, market interest rates have been lower than were forecast, so the cost of servicing that debt is less than it was forecast to be. Indeed, the area of Government spending where, relative to the last Government, we have made the biggest saving was on debt interest, which I am sure you would applaud.

Q237 Mr Mudie: You need everybody's support, because you are clearly not doing it on the deficit. The deficit has stayed the same for three years. You have given up until after the next election. Are you not concerned—

George Osborne: Interestingly, opposition to what I am doing on the economy is crumbling. That is another way of saying that I am getting more support for what I am doing.

Mr Mudie: I do not think that it is. Your debt forecast—

Chair: You can have one more go and, after a quick reply, we will move on.

Q238 Mr Mudie: Professor McWilliams simply put the proposition that it was worrying for us not to get a situation where the debt was falling because, with the rating authorities lowering our ratings, he felt that the markets, in his words, might reach the limit of their tolerance, and that might have an effect on foreign exchange, which works through to inflation. He saw the danger of a financial crisis. Do you have any worries about that?

George Osborne: I certainly believe that, if Britain does not show that it can live within its means and control its public finances, we would come under severe market pressure. That has been evident with lots of our neighbours who have come under severe market pressure. I think that the path that we are setting out to achieve that is the right path, and it is commanding global confidence. The ambition of all this is to get the public finances under control and to get the debt falling.

I started off in this job with an 11.5% budget deficit, when we were borrowing £1 in £4 that we were spending. The amount being added to the debt was a great deal. Now we are reducing the deficit and our borrowing has come down from about £160 billion to about £120 billion, so we have reduced the amount that we are adding to the debt. Of course I want to get the debt falling, and that is the purpose of the consolidation, not overnight but over a period of years.

Q239 Chair: We were discussing forecasting earlier. You would agree that forecasts are almost always wrong—that is one thing that we know for sure—so it was sensible to get out of the forecasting business. The forecasts of the Treasury have been no better than anybody else's. Unfortunately, the public still believe in them, so you find yourself being criticised for not aligning yourself and not delivering on the forecast that was made by the OBR. What are you going to do to address that problem?

George Osborne: It has helped public understanding that there is now an independent forecaster, that there is not a suspicion that the Treasury is manipulating the forecasts for political advantage, and—

Q240 Chair: I am sorry to interrupt, but that implies that somehow the forecast might be better than before and less unreliable, whereas in fact we know that it is no less unreliable.

George Osborne: Robert Chote—I should declare that Sharon is married to Robert—has done a good job, in a series of interviews, of trying to explain to people what the forecast is and how you can come in below forecast or above forecast. Because it is an independent person who is explaining that, both to this Committee and to the public through the interviews that he does, people are not suspicious that it is a Chancellor trying to pull a political fast one.

Q241 Mr Newmark: Following on from what Mr Mudie said, the public still do not really understand the difference between debt and deficit. Notwithstanding what Mr Mudie has said, in very difficult circumstances you have, using simple terms, brought the deficit down by a third, but there is still a deficit, which means that we still keep adding to our debt. That is the challenge in communicating with the public.

Following up on Mr Garnier's point, you have also managed to bring down the deficit while keeping to a promise of ring-fencing the NHS and taking, I think, 2.2 million of the lowest paid out of tax altogether. Over 24.5 million people have seen their basic rate of tax cut by £705. That is all good news through to 2015.

However, looking beyond 2015, there is still going to be a tension between spending cuts and rising taxes. The Institute for Fiscal Studies has stated, "We are on course not for sharing the consolidation 80% on spending and 20% on tax as the government originally planned but for an 85:15 split. Returning to an 80:20 split for the consolidation as a whole would mean a £6bn tax increase in the next parliament". How committed is the Government to an 80:20 split between cuts and increases in taxation?

George Osborne: The 80–20 split was a guide that we set out in 2010. I think that it was before this Committee that I said that it was not an exact number, but a guide based on the best international evidence that we have, and that has been reinforced by events around the world since. The further consolidation after the year 2015–16 is built into the tables as a spending reduction—a spending consolidation. I am clear that tax increases are not required to achieve this, and that this can be achieved with spending reductions. It is a coalition Government, however, and the document makes clear that both coalition parties are not, as a collective, signed up to the exact mix of spending and tax. What they signed up to is the path of deficit reduction—the path of borrowing, in effect. Of course, it would always be open to my coalition partners—we are talking about a post-election period—to advocate increases in taxes.

I am not sure where the Opposition is, because they say that they would match current spending but not capital spending. I do not know whether they have committed to these spending plans. I do not know whether they would have big tax increases—I suspect that they would, but that is for them to explain.

Q242 Mr Newmark: They have also said that they would increase borrowing to lower borrowing, but that is their Alice in Wonderland world of economics. Do you see any room for manoeuvre for further tax cuts? I draw your attention to this. If we are trying to encourage investment, would you cut capital gains

tax, for example, from, say, 28% to 20% to encourage more investment?
George Osborne: I am not going to speculate on individual taxes or tax rates. I do not think it is appropriate to do that between Budgets and autumn statements. I am a low-tax Conservative who believes that it would be good to have lower taxes, but they need to be sustainably lower, and I am not for deficit finance tax cuts that end up with you having to increase taxes a year or two later to make good the mess you have made of the public finances. The way to a sustainably lower tax economy is to get your public finances under control, and I have principally done that through constraints in public spending.

Q243 Mr Newmark: Notwithstanding the IMF doing a massive U-turn on their criticism of your strategy, listening to you, it sounds that there is still going to be a period of austerity going beyond 2015. The Cabinet Secretary is said to have warned that austerity may have to go on until 2017 or possibly longer. Do you agree with him?
George Osborne: That is a statement of what is in this book. This book sets out that, in 2016–17 and 2017–18, further consolidation will be required. We have not spelled out how that is going to be achieved. What this spending round did was spell out how it is going to be achieved in 2015–16. For those who want to commit to a similar path of deficit reduction to this Government, they would have to explain how they would achieve it. I have said that I think it can be achieved through spending consolidation, but there is no doubt that, whoever is in Government after the election, they are going to have to go on taking difficult decisions to get public spending under control and to get the deficit down to achieve what George Mudie says that he wants to achieve, which is to get the debt falling and to get the public finances under control.

Q244 Mr Newmark: What is your vision of the role and size of the state when austerity has finished?
George Osborne: I am not sure that this is a vision of the size of the state. I have always avoided giving a percentage of GDP as a target. In other words, the state should spend 40% or 38% or 42%—

Q245 Mr Newmark: What do you think? Is 50% good? 45%? 40%?
George Osborne: I am avoiding a precise target because, first, GDP can change. As a society and as a Government you have to make a decision about what you think is good value for money for the taxpayer—

Q246 Mr Newmark: What do you think the size of the state should really be?
George Osborne: It is about what should be collectively provided by the people of this country and the classic balance between spending and taxation. I would make a broader observation. When spending to GDP rises sharply above 40%, what has happened historically, and what happened again recently, is that the country gets itself into trouble. Even when left-wing Governments try to increase tax, they run into all sorts of problems and popular opposition to that. I do not set myself a precise target.

Q247 Mr Newmark: Although 40% sounds to me like it is sort of a reasonable target, from what you have said.
George Osborne: I make an observation that, when it gets far above 40%—when I became Chancellor, it was 48%, which is totally unsustainable.

Q248 Mr Newmark: Before we move to John Mann, who I think is going to talk about infrastructure—
George Osborne: Thank you for the prompt.
Mr Newmark: I am just warning you.
George Osborne: I will get my infrastructure.
Mr Newmark: I am going to talk about infrastructure briefly. Part of your infrastructure strategy is going to be led by Lord Deighton, who is your newly appointed Commercial Secretary. There is going to be a focus on big projects as well as science. I am curious about how you see Lord Deighton delivering this. I draw attention to the tension between longer-term projects such as HS2, which I think somebody else might well ask about, and the short-term shovel-ready projects, which will create jobs and growth more quickly.
George Osborne: I do not believe in infrastructure projects as job creation schemes, so I am not buying into the digging holes and filling them up again theory. That is a very inefficient use of state resources. There are much better and more sustainable ways to get people into employment. You should invest in infrastructure, and it does not matter how long it takes to build, but you should invest in infrastructure if it good value for money and brings a broader benefit to the economy and to society.
I am perhaps anticipating a line of questioning here but, as a Parliament, we make a judgment not just about what is of maximum economic benefit to the country, but about what is just for the country. If you look at economic returns on transport projects, they will basically tell you to spend everything in the south-east of England and around the M25. We reject that because, as a country, we do not want to see the only investment going into the south-east of England. We also want to improve the economic performance of the rest of the country, so a huge amount of investment is going around the country more broadly. When we allocated capital in this Budget—this is something that I mentioned earlier in response to questioning from Andrew Tyrie—we did not do that on a Department-by-Department basis. We did not have individual negotiations with Cabinet Ministers on their departmental capital budgets. We took all the capital decisions to the centre. We got a panel of economists from different Departments in Whitehall to rank them in terms of their economic benefit. We then exercised political judgement about where we were prepared to alter that ranking in order to achieve a proper geographical spread and in order to ensure that certain Departments did not see a massive reduction in their capital budget. We then took that to a collective—to a Cabinet Committee, the Public Expenditure Committee—PEX. That was a rational and coherent way to approach the capital budget of

the Government and to ensure that it closely follows what is in the ideal economic interests of the country, in as much as you can assess it.

Q249 Chair: You said earlier how valuable the signalling of your fiscal intentions had been in assisting the achievement of good outcomes. Why, then, are you so reticent about saying that you want to get back to what was, after all, the average of the last Labour Government, which was 40% of spending as a proportion of GDP?

George Osborne: I do not mean it to come across as reticent. The spending plans that I have set out for 2017 get the share of the national economy taken by the state down to around 40%. I think that is a good path to take and a good point to get to—or else we would not have set it forward.

In some quarters of both the right and the left, there are those who say that you should set a target, whether it is 35%, 40% or 45% of national income. Personally, and it is not that I mean any disrespect, that is not the approach that I think should be taken. I do not think you should precisely target a percentage of national income taken by the state. You should, however, be aware when you are straying into areas that are unsustainable.

Q250 Chair: Can I ask you to have another go at the question? The question was, you have come out firmly in favour of signalling and the benefits of signalling. Here is the most important signal of all in this field of policy, and you are not saying—you are not prepared to give a target.

George Osborne: This is a choice of language. I am clearly signalling that I think it would be good if the state was consuming around 40% of GDP, because that is where I am aiming to get to. What we do then is a matter for the Chancellor at the time, which I obviously hope will be myself. That is the question for then. In the way I have set up the fiscal mandate, the debt target and so on, I have not used state spending as a percentage of GDP as a target. I have set a clear signal about what I think is the appropriate size of the state, but I have not made a fetish of it—

Chair: Okay—you have answered the question.

Q251 John Mann: I have three questions. It would be helpful if, for the third question, Ms White was able to dig out the figure for the number of houses built to completion in the last financial year. I will leave her time to dig that out.

My first question is on infrastructure. You just said to Mr Newmark—and I think I quote you verbatim—that, when it comes to infrastructure, it does not matter how long it takes to build. As you did, I saw your staff busily tweeting—I am sure that they were tweeting it out. I would disagree. I think it does matter how long it takes to build.

When you became Chancellor, in my constituency there were a number of shovel-ready schemes waiting to go, such as the Langold Dyscarr refurbishment, the Serlby Park new school and the Elkesley bridge flyover. All of them were shovel ready, but none of them has begun. My first question is in relation to those specific projects in my constituency. When will the shovel be used?

George Osborne: First, I think that you misrepresent what I was saying. I am saying that, with infrastructure, if there are projects that can be done right now and that take a few months to do—a few days in the case of filling in potholes—if they make sense in terms of good value for money, we should do them, but we should not shy away from committing to much longer-term projects just because they are not going to be delivered this year or next year or in the lifetime of this Government. I think that previous Governments of all colours have been too short-termist in this approach, and things like High Speed 2 are multi-Parliament projects, as indeed is Crossrail, which is at least a two-Parliament project. If you take into account when it was actually conceived, it has been a multi-Parliament project. There is a mix of infrastructure programmes, some of which are going to take a long time to deliver, and some of which can be delivered very quickly.

On the specific projects in your constituency, the previous Government made a huge number of promises and it had a considerable period of time to do the things that you are talking about. I am happy to write to you about the road project that you mentioned. My understanding on Serlby Park primary school and secondary academy is that it is part of the priority school building programme. The feasibility work is starting imminently, and building work is to commence in 2014. It is due to be completed in 2016.

Q252 John Mann: That will be the first one, then, but they were all projects that your Government reconfirmed in your first Budget. We wait for a single penny of actual infrastructure spending by you in Bassetlaw.

Let me ask you about your own area. If your own accident and emergency department in your local hospital is proposed for closure in the next three years, will you fight that closure or will you support it as a contribution to meeting the NHS funding gap?

George Osborne: The decisions on hospital configuration—there is a statement today on one of them in south Manchester—should be driven by the clinical decisions of the NHS. We have now created a system in the NHS where there is an independent NHS board with a mandate set by the Government of the day. When it comes to individual hospital reconfigurations, that should be driven by the decisions of local clinical commissioning groups.

Any Member of Parliament will want to make representations on behalf of their constituents on what they think is the best thing for their constituents but, hopefully, local clinicians will have a pretty good idea of what is in the best interests of those constituents.

Q253 John Mann: My prediction is that, in the next three years, at least 30 accident and emergency departments will be closed, including some in the constituencies of Members of Parliament sitting around this table. Am I wrong in that prediction? You are the man who has the access to the figures and the finances.

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George Osborne: There are a set of independent reviews under way, and I am not going to pre-empt those independent reviews, but it sounds to me like you are being a little bit alarmist.

Q254 John Mann: So you do not think that there will be as many as 30. Would you say that there could be as many as 15? Would that be an alarmist figure?
George Osborne: The key thing here is that these are independent decisions of clinical commissioning groups in an NHS that now operates, in terms of its clinical priorities, within a mandate set by the Government of the day. I am not going to pre-empt that.

Q255 John Mann: The term that is used is the “funding gap”. That is the term used by the NHS chief executive. You are in charge of funding, and you have just given the three-year funding projection. I am simply asking. You say that I am alarmist in suggesting that 30 accident and emergency departments will close in the next 30 years. If I was to say 15, would that be alarmist?
George Osborne: I am not getting into a numbers game. Hospital reconfiguration decisions are decisions for local clinical commissioning groups. As I was explaining earlier, we have increased health funding in real terms. That was opposed by the party that you represent in Parliament—by the shadow Health Secretary. I have explained that the health service faces challenges because of an ageing population, but the way it is meeting those challenges is through an efficiency programme, which is well established. Indeed, elements of it started under the previous Government. I think that is the right approach.

Q256 John Mann: Do we have the figures?
Sharon White: We do not yet have final outturn figures from the last year but, roughly speaking, there have been about 84,000 afordable houses built this Parliament, which is about 30,000 or so a year.

Q257 John Mann: Is that a forecast?
Sharon White: No, that is real construction. Plans for the future are for about 50,000 a year.
Mr Love: Welcome to your initiation.
Sharon White: Thank you very much.
Chair: John, do you have any more?

Q258 John Mann: Yes, I have a question on housing. The number of houses has fallen to a remarkably low level under your Chancellorship, particularly the number of one and two-bedroom new houses being built. My question is this. You were very happy to claim from the taxpayer for nearly 10 years for your empty bedrooms in your house yet, at the same time, you are willing to charge those who are the poorest in society for their empty bedrooms. I wonder if you would like to comment on the morality and ethics of this disparity?
George Osborne: As a Government, we have had to make difficult decisions on the welfare bill—I have had to make them as Chancellor. That includes the housing benefit bill, which was completely out of control under the previous Government, where some people were getting £100,000 a year in housing benefit. We have also taken difficult decisions on the spare room subsidy. It is up to those who oppose those decisions to say so publicly and to promise to reverse them, should they come into Government. I have not yet heard promises from you or your party that you will do that, from which I can only assume that you tacitly consent to what we are doing.
John Mann: So you are not prepared to answer my question.
George Osborne: The issue of morality is this: burdening our children with debts that we are not prepared, as a generation, to tackle is quite immoral.

Q259 Chair: References were made a moment ago to single pennies not being spent in Bassetlaw. I refer you to the reference to the A27 Chichester bypass, which I note in table A4. I am very pleased to see it, and it is better than nothing. I note that it is bottom of that list, and I hope that that is because we are on the south coast, rather than because we are going to be last in the queue. I am sure that you are not up to speed with something as detailed as that but, no doubt, you can give me reassurance that a single penny will be spent shortly.
George Osborne: I do not think that you should read too much into the order.
Chair: Good.
George Osborne: I should point out that the fact that you are the local MP did not influence the decision. If you were the Chair of the congressional committee on the budget, you would have various air bases, naval bases or army bases everywhere you wanted in your district, probably, but we do not go in for that pork-barrel politics in Britain thankfully.
Chair: I have noted that too.

Q260 Mr McFadden: The Chief Secretary, when he gave evidence to this Committee the other day, told us that the seven-day wait for benefits for people newly unemployed that you announced in your statement would apply to housing benefit for rent as well as to unemployment benefit. Is that correct?
George Osborne: It would apply to the housing benefit component or element of universal credit as universal credit comes in. The seven-day wait will come into effect next year for jobseeker’s allowance and employment and support allowance, and then, from 2015–16, with universal credit, to what is known as the passported benefits, which will include—it will not be called housing benefit any more—support under universal credit for housing.

Q261 Mr McFadden: This is a new element in the benefit system, is it not? On the jobseeker’s allowance side, there is already a three-day wait, which you are extending to seven days. Can you confirm that, with housing benefit, there is currently no waiting period?
George Osborne: That is my understanding, although some elements of housing benefit are passported through your eligibility for JSA. The universal credit did not have any waiting period built into it. We have built into it, for those who are assessed as capable of work—this is an important point—a seven-day waiting period.

Q262 Mr McFadden: Would this apply to all newly unemployed people? For example, would this apply to someone leaving the armed forces who did not have a job?

George Osborne: It will apply to newly unemployed people, with two important provisos. First, there is a linking period, a six-month period whereby you can come in and out of work in a six-month period. There is already a three-month linking period around conditionality for jobseeker's allowance. There is going to be a six-month period with universal credit. In other words, we do not want to disincentivise someone from taking what might look like a temporary job that could turn into a permanent job because they fear that they will lose eligibility for benefits. That is already a feature of the benefits system, as you well know. That is going to be a six-month period under this, so that people will not have to wait for seven days if they take work for a month. If they become unemployed again, they will not have to wait seven days, but if they had been in work for more than six months, the waiting period will apply. Anyone being made redundant will have some kind of redundancy package as well and, hopefully, some notice of what is happening to them, so that they can make decisions about their future.

I do not know whether you wish to ask me about this, but the money we save from the seven-day wait is all being reinvested into our job centres to give more intensive help for job search and longer interviews for people who are looking for work, with weekly signing on for half of JSA claimants and a longer interview at three months. This is not money being snaffled by the Treasury or being used to reduce the deficit; this is money going into support for unemployed people to help them get into work.

Q263 Mr McFadden: That was a long answer, but the question was pretty simple. Anyone who is leaving the armed forces is likely to have been in them for more than six months. This change, this new element to the benefits system, of having a waiting period for housing benefit, will apply to people leaving the armed forces.

George Osborne: Anyone who has been in work who is assessed as capable of work will have to wait seven days before claiming their benefit. We want people to be very focused in that initial week, which is the week when there is a very high chance of people finding work—we want them to be focused on that. This is not extraordinary in the world. They have these waiting periods in Sweden. In New Zealand there is a two-week wait. Actually, if anything, Britain was slightly unusual in having just a three-day wait for JSA. We have changed that.

Mr McFadden, you are influential within your party. If you oppose this proposal, please say so.

Mr McFadden: I am going to take that as a yes.

George Osborne: What am I going to take your answer as? Do you oppose it, or do you support this proposal?

Chair: It is for Pat McFadden to ask the questions.

Mr McFadden: Any responsible Opposition, if they were going to make different choices, has to say where that money comes from, but we will come to that at another time.

George Osborne: We will certainly have to wait for it.

Q264 Mr McFadden: Do you know what this is like, Chancellor? Have you ever struggled to pay your rent?

George Osborne: I have had a fortunate upbringing. My father set up his own business and it was successful. I have worked since I left education.

I come back to this point. This money is not being used for anything other than trying to help people get into work, by using the best international evidence to provide support for people, longer job interviews, more help with their CVs and more help with their language if they do not have English. This is a set of changes based on the best international evidence of what works to help people get into work.

Q265 Mr McFadden: There has been some comment about your spending review more broadly—in economic terms, it did not change much and is pretty much a continuation of your current trajectory—that, in timing terms, it was not really necessary to have it now, and it could have waited another year or so, given that it applies to spending in 2015–16, and that the real purpose is to set a series of political traps and choices for the Opposition. Do you think that is a responsible way to conduct policy and to make important public policy decisions that affect people losing their jobs, in order to create political traps for your opponents?

George Osborne: First of all, I entirely reject that characterisation. The idea that it is straightforward to deliver a major spending consolidation like this is nonsense. It requires hard work within a Government. We have made a set of choices as a Government about what we want to support, whether it is the NHS, social care or science spending, which we have not discussed today. We have also made a set of choices around welfare, about making sure that the money this country spends is well spent on trying to get people into work.

I do not need to set traps for the Opposition, because they busily fall into those traps of their own accord.

Q266 Mr McFadden: I will ask you one final thing. More broadly, you have made great play of fairness. You have said those with the broadest shoulders should bear the biggest part of the burden. The ONS published figures yesterday showing that those on the lowest incomes are paying 36.6% of their income in tax, compared with 35.5% for the wealthiest. How does that fit with your fairness argument?

George Osborne: I saw the ONS data and the press coverage of it. The poorest fifth have paid a higher average tax rate than the richest since 2006, in other words the period when you were a Minister in the Government. We have taken decisions that have reduced income inequality. The remarkable thing about the ONS numbers yesterday was that they showed a reduction in inequality in our society. Overall, inequality is now at its lowest since 1986. The ONS highlight the increase in the personal allowance as one of the things that is assisting in that space.

Mr McFadden: They also highlighted the VAT increase.

George Osborne: In the end, when you are left with a very large deficit, you have to take decisions about what you are going to do to reduce it. It is up to anyone who disagrees with those decisions to promise to reverse them. We have taken decisions that have ensured that the richest fifth or indeed tenth—you can measure it either way—have borne the largest share of the burden in dealing with this consolidation. That has been borne out by what the Institute for Fiscal Studies has said. They were remarkable numbers yesterday. They show that income inequality in our country is reducing now. You will have to account for the record of the previous Government, but this Government has a proud record in this space.

Q267 Teresa Pearce: You have just mentioned income inequality reducing in the recent figures. Is it true that those figures do not take any account of the recent welfare changes?

George Osborne: The ONS numbers are only for the year 2011–12, so—

Teresa Pearce: So they do not take account of the—

George Osborne: Nor, indeed, of the very substantial increases in the personal allowance since 2011–12.

Q268 Teresa Pearce: On the seven-day waiting period, where people are going to lose a week's rent, did you do an impact assessment on that particular measure?

George Osborne: We do an impact assessment in the sense that the whole thing is subject to an equality assessment, including—

Teresa Pearce: On that particular measure?

George Osborne: That measure was subject to an equality impact assessment, like all other measures.

Q269 Teresa Pearce: Did it show any evidence of increased rent arrears for housing associations and local authorities?

George Osborne: What the package as a whole demonstrates is that it will help people get into work, which is the best route out of poverty.

Q270 Teresa Pearce: So you have no analysis of the possibility of increased rent arrears. You have made no forecast of that.

George Osborne: We are confident that this measure will help people into work. People with debt problems can be best assisted by being in work.

Q271 Teresa Pearce: This is almost increased conditionality, in a way.

George Osborne: It is an element of conditionality.

Q272 Teresa Pearce: But the Welfare Reform Act has already brought in extra conditionality, increased sanctions and increased interventions. Is this measure being brought in because you think all those things did not work?

George Osborne: No, it is a further step in reforming welfare. I do not think we have reached an end point in reforming welfare. This will come to Parliament and there will be votes, certainly on secondary legislation. If people—such as yourself—do not support this measure, they will be free to vote against it.

Teresa Pearce: I am sure we will, but, until we have—

George Osborne: I am glad you have made that clear, because no one else in your party has.

Q273 Teresa Pearce: Until we have all the information, how can we know? Only this week it became clear that people will have their housing benefit cut and not just their jobseeker's allowance. It is very difficult to make a decision as to whether you support something or not until we have all the detail. I will move on. Chancellor, have you ever been to a food bank?

George Osborne: No, I have not visited a food bank.

Q274 Teresa Pearce: Do you know the main reason for people being referred to a food bank?

George Osborne: Food bank use has gone up—

Teresa Pearce: There are a number of reasons. Do you know the most common reason?

George Osborne: Food bank use went up tenfold under the previous Government. One of the things this Government did was to ask job centres to better advertise food banks, which make a very strong contribution to our community, because they are voluntary outlets.

Q275 Teresa Pearce: Clearly you do not know, so I will tell you. The main reason for referral to a food bank is benefit delay. If you are not going to get your benefit at all—not just a delay, but you just do not get it for a week, including your rent—this will increase people being referred to food banks, will it not?

George Osborne: I do not accept that link. We took a conscious decision to advertise the use of food banks at job centres. I know that this is a common feature of questions from Labour MPs. They seem to forget that use of food banks went up tenfold under the previous—

Q276 Teresa Pearce: Has it gone down since?

George Osborne: No. Use of the food banks has continued, partly because we are—

Teresa Pearce: Continued to rise.

George Osborne: Because we have actually—

Q277 Teresa Pearce: How many times a year can somebody go to a food bank?

Chair: Could you just answer the previous question? Why has it gone up? Then you can come on to the next one.

George Osborne: One of the reasons for the increased use of food banks is that people have been made aware of the food bank service through local job centres. I do not see that as a bad thing. It is a good thing that those services are advertised at job centres.

Q278 Teresa Pearce: It is a good thing that people can go to that place of last resort to feed themselves, I agree, but they can only go three times in a year. A family can be referred to a food bank only three times a year. If food bank usage is going up, it is not that people are using them more, it is that more people are using them.

George Osborne: More people might be using them because more people are aware of them, because job centres are making people aware of them.

Q279 Teresa Pearce: But more people have a need. Can I ask you a couple more questions? In your statement on the seven-day wait, you said that £350 million a year will be saved, and all that money will enable us to afford extra support and help for people to get into work. Will that money be invested in Jobcentre Plus?

George Osborne: That will be invested in Jobcentre Plus and other support services for the unemployed, including, for example, we want to monitor people's learning of the English language. That will not be provided by the job centre, but I can give you this assurance: this money will be reinvested in the support services for the unemployed, and for those, including the unemployed, who need assistance with their language.

Q280 Teresa Pearce: I have just a couple more questions. In response to John Mann, regarding the bedroom tax, you said that one of your reasons for bringing in the bedroom tax is that there were families on £100,000 a year of housing benefit. How many families?

George Osborne: It was a small number.

Q281 Teresa Pearce: How small?

George Osborne: I do not have the number.

Teresa Pearce: There were five.

George Osborne: £100,000 was the maximum, but there were lots of people on £70,000, £60,000, £50,000 and £40,000.

Teresa Pearce: Okay, but—

George Osborne: I can give you the numbers. I can tell you that the housing benefit bill was completely out of control.

Teresa Pearce: Two more questions.

George Osborne: It is perfectly open for people to oppose these measures. If you do not support the housing benefit cap, say so and campaign to oppose it, or to reverse it. That is not what the Labour party is saying.

Q282 Teresa Pearce: Chancellor, you were asked for your reasons why you thought that the bedroom tax was fair, and you gave that as a reason. However, in 2011, you brought the cap in. Nobody gets that amount in housing benefit now, so how can it be your rationale for something now?

George Osborne: That was bitterly contested by the Labour Opposition, by the way.

Q283 Teresa Pearce: I am asking you for your rationale.

George Osborne: Our rationale—

Teresa Pearce: You gave your reason as something that does not exist.

George Osborne: Our rationale is that it is perfectly reasonable, when you are trying to make savings across Government, to make savings to help improve—

Teresa Pearce: So your rationale is to save taxpayers money.

George Osborne: Our rationale for what we are doing is to make savings across Government, not just in Departments but in welfare bills; to make the welfare system fairer, including greater equality between the way that those in private rented accommodation are treated and those in social accommodation; and to ensure that we have, as a system, something that reflects a fair balance between the people who pay taxes towards the welfare system and the people who are recipients of welfare.

Q284 Teresa Pearce: I have two more questions. We are talking about good use of public money. What is the maximum that can be claimed as housing benefit for a one-bedroom flat in London?

George Osborne: I do not know.

Q285 Teresa Pearce: It is £250. What is the maximum that a Member of this House can claim for a one-bedroom flat in London?

George Osborne: I do not know the number.

Q286 Teresa Pearce: £350. Is that fair?

George Osborne: It is up to Parliament to make its decisions known—rather, it is now up to IPSA.

Q287 Teresa Pearce: So you do not have a view of whether that is a fair use of taxpayers' money.

George Osborne: I want to reduce the cost of politics, but I also want to reduce the cost of welfare.

Q288 Mr Ruffley: On the help to buy, the mortgage guarantee scheme, when are we going to see the details of how it will operate?

George Osborne: Shortly—in the next couple of weeks.

Q289 Mr Ruffley: You said that this scheme will be, in your words, self-financing, because lenders will pay a fee to the Government, which will cover the administration costs, the expected losses and the cost of capital to provide the guarantee. Lots of outside commentators and this Committee have suggested that pricing the commercial risk might be difficult. Among other reasons, predicting repossessions is a very difficult science or art. How are you going to go about pricing that risk and ensuring that the fee is set at a level that protects the Exchequer?

George Osborne: We want it to be self-financing. At the same time, of course, we want it to be a scheme that works and provides help to those who cannot currently access higher loan-to-value mortgages because of the impairment of the mortgage market. In terms of assessing the repossession rate and repossession risk, this will be spelled out in greater detail in the next couple of weeks. We have done lots of modelling of what has happened to repossession rates over many years. One of the surprising things about the recent recession in 2008–09 was that repossession rates were not as high as people predicted. We have not just used that recession. We also looked at the 1990s recession, when rates were higher. We have taken a long-term view of repossession rates.

Q290 Mr Ruffley: Will you be able to provide this Committee with those detailed workings?
George Osborne: Yes.

Q291 Mr Ruffley: I am grateful. In our report on the 2013 Budget, we reflected what a lot of people in the City and outside commentators had said about the mortgage guarantee scheme. We said that existing constraints on the supply of new housing—largely as a result of planning laws—will mean that the primary effect of easier credit, at least in the short-to-medium-term may be to raise house prices. What estimate has the Treasury made of the impact of the guarantee scheme on house prices? Have you made an estimate?
George Osborne: The estimate is provided by the OBR. They provide a house-price estimate, and they provided this at the time of the Budget. The Budget included the help to buy announcement, so the OBR were well aware of that. They did not change their house-price inflation forecast as a result.

Q292 Mr Ruffley: Between now and 2015, what is that standing at?
George Osborne: I do not have that, but I can get the number. What they say is that house-price inflation is going to rise broadly in line with long-term average rate-of-earnings growth. I do not have it, but I could find the figure in this document.
It is not just the OBR that has come to this view. I notice that the ITEM Club has also taken the view that "the risk of higher prices does not appear to us to be a major concern". Interestingly, the response from the home builders—the crucial word is "builders"—is that they think that impaired mortgage finance has been the principal constriction on the supply of new building, and they think that, as a result, that will help enormously with the construction of new homes. Also, planning applications, because of the planning reforms that we have introduced, are up 10% in the last year.

Q293 Mr Ruffley: Do you think that there are wider economic benefits to the economy of rising house prices?
George Osborne: Like all things, you want moderation in house prices. As the OBR says, you want house prices to rise broadly in line with long-term average rate-of-earnings growth. You do not want house-price bubbles, nor do you want housing crashes.

Q294 Mr Ruffley: The IMF have suggested that there should be fiscal disincentives to holding on to land without developing it. What work has the Treasury done on that?
George Osborne: This has been a suggestion over many years, and it has been tried in various forms by various Governments. It is one of those things that looks good on paper, but it is quite hard to turn it into a practical charge, tax or levy that would work. I am happy to hear evidence about how it could be made to work in practice. I am not saying that it is impossible to make it work in practice, but I have not yet seen proposals that I think are practical.

Q295 Mr Ruffley: Has the Treasury actually studied any proposals recently?
George Osborne: Over time, over many years, the Treasury has always looked at various forms of land value tax and so on, but no proposal has ever been put before me.

Q296 Mr Ruffley: You do not find the ones that you have seen attractive.
George Osborne: I am sorry?
Mr Ruffley: You do not find them attractive, the ones that you have seen.
George Osborne: It is one of those things that sounds good in theory, but it might come unstuck in the detail. If I were ever to bring forward such a plan, I would have to be pretty assured it was going to work in practice.

Q297 Mr Ruffley: That is helpful. There are lots of different estimates of this, but the LGA suggests that there are about 400,000 planning consents for residential homes where development has not begun. Have you got any estimates as to how many of those are likely to come on stream as a result of the mortgage guarantee scheme? Have you made any estimates?
George Osborne: No, I do not have an estimate in front of me. The purpose of this is to repair an impaired mortgage market, which is clearly not functioning properly. If you look at the comparisons over the years, the number of first-time buyers is half what its average has been. The average deposit that the first-time buyer needs has gone up from 36% of income to 79% of income. That is not functioning. It is a block on aspiration. It is also a block on home building. However, I have not put forward an estimate for the number of new homes that will be built.
As we develop the details of the scheme—it is not operational until the end of this year—I am happy to look at those estimates. We made an estimate of the number of new homes that would receive the equity, help to buy—

Q298 Mr Ruffley: How many is that?
George Osborne: It is around 70,000. We have had a very high take-up of that.

Q299 Mr Ruffley: It is quite an important question, is it not, what the estimate of increased supply is? Unless there is increased supply, you could see house prices going up. If there is more demand and there is a fixed supply, or if supply is not increased significantly, you have a house-price inflation problem, have you not, Chancellor?
George Osborne: That is not what the OBR are forecasting. They are our independent forecasters, and they are aware of the scheme. Secondly, there is plenty of evidence from the home builders that one of

the biggest impairments to supply has been mortgage finance.

Thirdly, with respect to the Committee, I do not think that the fears that the Committee has expressed are justified. This is a three-year scheme, which is targeting a specific problem that has arisen because of a financial crisis, and we are stepping in to repair that bit of the financial transmission mechanism. One thing that we have learned over the past five or six years is that more effort has been required than anyone anticipated to repair broken financial transmission mechanisms, whether that is the funding for lending scheme or the work that we have undertaken with the banks or indeed, now, help to buy.

Q300 Mr Ruffley: I can certainly see why this scheme will help first-time buyers, provided that supply is increased.

I want to ask one final question to Ms White, if I may. What estimates has the Treasury been looking at, or what estimates do you think the OBR have been looking at, Ms White, on the likely increase in supply, in the next three years, of residential housing?

Sharon White: As the Chancellor has already said, the OBR's assumption that house-price inflation will not go beyond earnings growth is an implicit assumption on housing supply. Within the Treasury internally, our work in terms of the spending round has certainly looked at the impact of new capital on social housing supply, which we are expecting will roughly average about 50,000 a year over the next four years.

Mr Ruffley: On social housing?

Sharon White: On the social housing side.

Q301 Chair: Chancellor, you said that it was a three-year scheme, so this scheme falls away without the need for a reference to the FPC.

George Osborne: Yes.

Chair: I just want to be clear.

George Osborne: Yes—the scheme falls away, and there is a sort of double lock, in that the FPC will also be invited to give a comment if the Government of the day proposes to extend the scheme. There will be a clear red card available in the system.

Q302 Chair: You do not have concerns that the impression will develop of a one-way bet in the housing market, which is how bubbles get started in housing—when Government starts subsidising it. After all, it took the best part of a generation for politicians to get out of subsidising this market.

George Osborne: Our analysis of what went wrong in the British economy includes the fact that a financial crisis has impaired the financial transmission mechanisms. One of those things is mortgage finance. The funding for lending scheme has already helped—

Chair: You have said that already.

George Osborne: It has helped with the pricing of mortgages, but it has not helped with the availability of high loan-to-value mortgages for first-time buyers. I should make it clear that the mortgage guarantee element of help to buy applies not just to first-time buyers.

Q303 Chair: I was asking you about the impression leading to changes in behaviour among house buyers about a one-way bet in the housing market—not about whether there has been impairment in the transmission mechanisms.

George Osborne: People are very conscious, when they buy houses or flats, that the price can go down as well as up, and they have had a reminder of that over recent years, but it is a deeply held aspiration of many people in this country to own their own property.

Q304 Chair: You do not have any concern that we might be in the early stages of a repeat of the housing bubble and, in that sense, that we would be replacing the too-big-to-fail problem in banks with a too-big-to-fail problem in the housing market.

George Osborne: The best thing that I can do is to quote the director-general of the CBI, John Cridland, and I certainly agree with him. He said, "Clearly there are dangers in the long term of asset price bubbles, but we are a very long way away from that". I do not think that the situation at the moment looks like an asset price bubble.

Q305 Chair: So, at this stage, you are firmly committed to ending this scheme in three years.

George Osborne: It is a three-year scheme, and—

Chair: Was that a yes?

George Osborne: Yes. As I was saying, it is a three-year scheme, and it will come to an end after three years. If I or any other person doing this job were to extend the scheme or launch a second version of the scheme, the Financial Policy Committee will have a clear role in highlighting the dangers of that, if they perceive there to be dangers.

Q306 Chair: So, if you are still Chancellor, you are going to come before the House and announce that you want to continue it, and you will then refer it to the FPC. Is that going to be the sequence?

George Osborne: I suspect that it would have to be the other way round.

Q307 Chair: So you would go to the FPC informally.

George Osborne: I will set out in greater detail later this year how this will work. The way I envisage it working is that a Chancellor would say, "I am considering extending this scheme", and would write to the FPC about that and get the FPC's view on whether or not that was sensible. A Chancellor who turned up in the House of Commons and said, "I want to extend this scheme, but I am going to ask the permission of the FPC", might find themselves coming unstuck a few weeks later if the FPC did not give their approval.

Q308 Stewart Hosie: Is this a housing policy, or is this a house construction policy?

George Osborne: It is both. It will help the supply of newly built homes, and the Home Builders Federation have welcomed it. It also helps with the situation we find ourselves in in this country, where many people in their 20s, 30s and 40s simply cannot afford the very high deposits that are required these days. I do not think that is a normal state of affairs in the mortgage market, and that is due to an impairment in the mortgage market.

Q309 Stewart Hosie: If it is both and has an element of construction policy, it does not matter if this assistance goes to someone buying a second or third home, does it?
George Osborne: We have made it clear that it is not for people who want to buy a second home. We have taken a number of decisions. We have capped the value of the house that you can buy. We have also taken a decision, which is set out in the infrastructure document that we published the day after the spending round, that both elements of the scheme are not available to those who have an interest in another property.

Q310 Stewart Hosie: That is slightly illogical if it is partly a construction policy—even if I agree with it.
I wish to ask specifically about the mortgage guarantee scheme. You have said that details are going to come forward but, in particular relation to this lock that the FPC have, the mechanism by which they could stop this scheme, when are we going to get the details—the proposals—and how will that be put out to consultation?
George Osborne: I was proposing to set out in detail, when we produce the detail of the fee, how the scheme is going to operate. One of the schemes is already operating—the shared equity scheme—but, on the mortgage scheme, we will set out the details of how it is going to operate, and we will then of course engage with the industry. At the same time, I would set out the process for the FPC.
In a sense, no Parliament can bind its successors. A future Chancellor, providing they can get a majority in Parliament, can make changes. What the FPC is able to do is to alert everyone to the fact that this is not something that they think is sensible. That would destroy the Chancellor's initiative at the time, if they were trying to do this. It is a pretty powerful weapon that we are giving the FPC. It is really a self-constraint. This is a time-limited scheme. This is not something that we want to see as a permanent feature of our financial landscape.

Q311 Stewart Hosie: It is a powerful tool, but it is only a veto on the continuation of this after three years. Is that correct?
George Osborne: Yes. The point that I made to Mr Tyrie was this. This scheme is designed for three years. It comes to an end after three years. In the hypothetical situation in which a Chancellor said, "I'm going to extend the scheme", that is when the FPC's warning lights, if they wanted to activate them, would come into effect. If the FPC said, "Actually, X, Y and Z have happened, and it is sensible that the Chancellor is extending this scheme", they would say that. However, I am certainly intending the scheme to come to an end after three years.

Q312 Stewart Hosie: Let us just stick to the three-year time limit at the moment. If a future Chancellor says, "I would like this to go on", and the FPC takes the decision, they would only be able to determine yes or no, presumably on the basis of fiscal stability and macro-prudential grounds—the stuff that is within the FPC's remit—would they not?
George Osborne: Part of the FPC's remit is to look at asset- price inflation and levels of debt. The remit is sufficiently broad that they could take into consideration any adverse impact of this.

Q313 Stewart Hosie: But the adverse impact would have to be economic at a macro-prudential or systemic level. Otherwise, you are giving the FPC more micro powers, which I do not think they expect to have.
George Osborne: The reason the lock is there is because people have been concerned that, if this scheme becomes a permanent feature of the mortgage market, and the Government is therefore a long-term player in the mortgage market, it could contribute years hence to the asset-price inflation that I have been asked about. Those are all macro-prudential concerns. The scheme is absolutely intended to end after three years. This is only something I have put in to reassure those who feared that it would become a permanent feature of our financial system. I would not expect other interventions that we have made, and indeed that the previous Government made, in the financial system to become permanent features of the UK economy.

Q314 Stewart Hosie: I appreciate that. How much discussion have you had with the FPC about this?
George Osborne: I had lengthy discussions with Mervyn King, who is chair of the FPC. I do not meet the FPC as a group, but I discussed this at some considerable length before the Budget with Mervyn King.

Q315 Chair: And what did he say?
George Osborne: I do not want to speak for Mervyn King, who is more than capable of speaking for himself but, obviously—
Chair: Did he express warm support for the scheme?
George Osborne: Actually, he has been supportive, including in this respect, of things that we are doing, sometimes jointly with the Bank of England, sometimes off our own bat, to repair the broken financial transmission mechanism. If he had said, "I strongly object to this scheme", that would probably have killed it at birth.

Q316 Stewart Hosie: I have two further questions. If there was a systemic risk and if an asset bubble suddenly bubbles up much more quickly than the three-year horizon, and the FPC say to you, "You must stop this—it is dangerous", within the three-year timeframe, what do you do?
George Osborne: That is highly unlikely. I do not think that, in the current environment, a house-price bubble is going to emerge in 18 months or three years. You have to provide some kind of timeframe to mortgage companies and banks that will be investing in systems to deliver this scheme. That is why I judge three years to be the shortest period in which it would make sense for the industry to develop those systems and market the scheme while, at the same time,

protecting us from a long-term detrimental impact, which I do not believe will happen.

Q317 Stewart Hosie: Let us go 18 months down the line, when the system is up and running, and there is still a scarcity of mortgages, particularly higher loan-to-value mortgages, high deposits are still being demanded and so on. When do you come back to Parliament and say, "I need to run this for four, five or six years"? How much advance notice do you give us of an extension of this scheme, should you deem it necessary?
George Osborne: That is a hypothetical question. Frankly, that decision, if it were ever to come to that, would be made in the next Parliament. I do not see why that decision would need to be made in this Parliament. The three years deliberately covers the next general election and allows a new Government, hopefully the Government of which I am part, to make that decision. I cannot really see the circumstances in which the decision to extend the scheme would arise in this Parliament.

Q318 Stewart Hosie: The run on Northern Rock started in the autumn of 2007. We are now into the summer of 2013. I do not think that anybody saw this going on quite this long. We may well have at least a decade and longer of austerity. Is it not right to plan for an extension to a scheme like this, assuming things might not pick up quickly?
George Osborne: It is not a decision that I envisage anyone having to take. It is designed as a temporary, three-year scheme. If there was a need to extend the scheme, I do not think that, technically, that would be very difficult to do. Politically, it would be extremely difficult to do if the FPC was recommending against it, which is why we are putting in the FPC lock. As I say, that is a decision that a Government would take early in the next Parliament, rather than in this Parliament.

Q319 Stewart Hosie: My final question is, in that circumstance, when a Government wants to, but the FPC say no, does the FPC veto trump, or would the Government overrule?
George Osborne: Parliament is sovereign in our country, but Parliament and Governments have a strong aversion to doing things that our independent Financial Policy Committee says are not a good thing.

Q320 Chair: The FPC is going to advise on the continuation of this scheme purely on the grounds of financial stability. There are also other aspects to this scheme beyond financial stability, including fiscal implications. Who is going to advise on those?
If I may broaden the question a little, financial stability can be defined narrowly or broadly for these purposes. Are you expecting them to define it broadly?
George Osborne: I would expect them to take a fairly broad view of the merits of an extension, should the Government put it to the FPC. That is a perfectly reasonable set of questions. The only thing that I would like to point out is that this is a three-year scheme, and I am not envisaging it being extended. It is a three-year scheme, and that is what the banks and the mortgage companies are going to plan for. That is what the systems are going to be designed for. The whole thing is designed as a three-year scheme, not as a scheme that is three years and could be extended to four, five or six years. That is not the intention.

Q321 Chair: You said earlier that, taking the estimates of others, you expected house prices to rise in line with earnings. If house prices rise faster than earnings, would you want to examine whether this scheme should be wound up early?
George Osborne: It is sensible to have a three-year scheme. I do not want to create uncertainty with the institutions that are being asked to deliver this that it might suddenly end early. It is difficult to see how this three-year scheme, given the current financial climate, would fulfil the fears that the Committee have expressed.

Q322 Chair: I was asking a narrower question about the relationship between earnings and house prices.
George Osborne: This is not something that you should examine every month. You should look at long-term trends and averages.

Q323 Chair: To be clear, can we take it from your answer that Mervyn King did not raise objections to this scheme?
George Osborne: Yes.

Q324 Chair: Can I return for a moment to the document that you put round right at the beginning, about the leaks? From what I can tell, having quickly tried to flick through it while we have been in session, this document seems to be about pre-briefing under embargo by officials.
George Osborne: Yes.

Q325 Chair: It does not relate in any way to what has probably been the main source of leaks, which is those authorised by Ministers, often through special advisers. Do you have any rules for those, which you are intending to put in place to reduce selective leaks by Ministers of Budget information?
George Osborne: The report was commissioned for a very specific purpose, which was that the contents, or much of the contents, of the Budget—the essential elements—appeared in the *Evening Standard* before I stood up, or as I stood up. That was obviously a situation that I found pretty unacceptable, and which I am sure Parliament found unacceptable. There has been a specific practice, which has gone on for some years, of pre-briefing certain media organisations, mainly the broadcasters but also the *Evening Standard*.
Chair: If I may stop you, Chancellor, you are repeating exactly what you said at the beginning of the meeting.
George Osborne: I am glad to hear it.

Q326 Chair: Unfortunately, it was a response to a question that I did not ask. I am asking a question about rules and procedures relating to pre-briefing by Ministers and by advisers on their behalf.

George Osborne: Special advisers are Treasury officials, and they are covered by this document, although the report makes it clear that this practice was not overseen by a special adviser. It is not in the interests of the Chancellor of the Exchequer or his Ministers in his Department—or her Ministers—to get up on Budget day and find that most of the good things have been in the papers beforehand. Occasionally, that happens to Chancellors. It has happened to me. However, that is unauthorised, and it is as frustrating to me as I am sure it is to Parliament.

Q327 Chair: Do you have rules and procedures laid down for Ministers and for your advisers that go beyond what is there for officials?

George Osborne: There is a ministerial code that covers—

Chair: We are talking about specifically with respect to the Budget—I am sorry to interrupt.

George Osborne: There is not—I have never seen a separate code specifically about the Budget.

Q328 Chair: So there are no rules. There are now going to be very clear rules for officials as a consequence, but none for—

George Osborne: I would certainly expect Ministers to abide by the rules that officials have to abide by.

Chair: We have begun and ended on a relatively detailed procedural point, caused by this release of a document just as we were about to go into public session, but most of today has been about a very interesting spending round. We are very grateful to you for having supplied the wealth of information that you have this morning, and for answering our questions. Thank you very much.

George Osborne: Thank you.

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