



House of Commons  
Treasury Committee

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**Government Response  
to the Committee's  
First Report: The 2004  
Pre-Budget Report  
(HC 138)**

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**First Special Report  
of Session 2004–05**

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## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the HM Treasury and its associated public bodies.

### Current membership

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The Committee is one of the departmental select committees, the powers of which are set out in the House of Commons Standing Orders, principally in SO No. 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk) The Committee has power to appoint a Sub-committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-committee, and its Chairman is Mr Michael Fallon.

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997–98 onwards are available on the Internet at: [www.parliament.uk/parliamentary\\_committees/treasury\\_committee/treasury\\_committee\\_reports.cfm](http://www.parliament.uk/parliamentary_committees/treasury_committee/treasury_committee_reports.cfm).

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# First Special Report

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On 27 January 2005, we published our First Report of the current session, The 2004 Pre-Budget Report, as House of Commons paper No.138. We have now received a response from the Government (dated 18 March 2005) which is appended below.

## Government response

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The Government notes the conclusions of the Treasury Committee's report on the 2004 Pre-Budget Report.

### The Pre-Budget Report

**1. We reiterate our view that this is an unsatisfactorily short period of notice for what is meant to be an important event in the economic calendar. (Paragraph 2)**

As the Government has previously set out in its responses to the Treasury Select Committee's reports, it will announce the date of the Pre-Budget Report (and the Budget) at the earliest convenient opportunity. However, it may not prove possible to give two months notice.

### UK presidencies of the G7/8 and EU

**2. The Committee believes that the UK's joint leadership of the G7/8 and the EU in 2005 puts the Government—particularly as the international community comes together to address the consequences of the tragic earthquake and tsunami in the Indian Ocean—in a strong position to play a positive role in advancing discussions with our international partners on the reform of key global economic institutions and ensuring fairer treatment of developing countries by the world's major economies. We welcome the Chancellor's commitment to pursue reform of the major international economic institutions and hope that solid evidence of progress here will emerge over the coming year. (Paragraph 5)**

The Government agrees with the Committee that our joint leadership of the G7/8 and the EU in 2005 puts the UK in a strong position to advance discussion with international partners on key international issues, including the tsunami disaster, reform of key global economic institutions and ensuring fairer treatment of developing countries by the world's major economies. Building on the analysis set out in the Treasury's Pre-Budget Report paper 'Long-term global economic challenges and opportunities facing the UK', the Treasury's Budget paper 'Long term global economic challenges and opportunities for Europe', published alongside the Budget, sets out challenges that Europe must meet in face of dramatic changes in the global economy. Whereas in the past Europe has tended to focus on internal policy issues, as global restructuring continues apace—with the rise of the new emerging economies and global sourcing of goods—Europe must now look outwards. Therefore, the Government will aim, through its EU Presidency and beyond, to develop a

consensus on the need for a more Global Europe: a Europe, which by becoming more outward-looking and embracing greater flexibility in labour, product, and capital markets, delivers high employment for its citizens. At the same time a Global Europe must step up to its responsibilities to take action to reduce international poverty, advance fairer trade and support the drive to tackle climate change.

Under the chairmanship of the Chancellor of the Exchequer, G7 Finance Ministers reviewed the substantial response to the tsunami disaster at their meeting in London on 4–5 February 2005. For affected countries that request it, the G7 agreed exceptionally to defer debt payments up to the end of 2005, without payment of interest during this period. The G7 will review at their next meeting the need for further assistance, based on the full needs assessments by the IMF and World Bank of the reconstruction and financing requirements of the countries affected by the disaster. The EU has also agreed a substantial aid package.

The Government welcomes the Committee's support for further reform of the International Financial Institutions. The institutions should continue to adapt to meet the challenges of the modern global economy; with well-developed international capital markets, large emerging economies, and a renewed commitment to help developing countries achieve the Millennium Development Goals. Extensive reforms have been undertaken at both the World Bank and the IMF, and further reforms are being considered at both institutions, including through a review of the IMF's strategic direction by the Managing Director, Rodrigo de Rato. G7 Finance Ministers undertook at their meeting in February to support World Bank and IMF management in their strategic reviews of their institutions, and will discuss reform further at their next meeting.

The Government will also work with EU and other partners this year to agree the financing package needed to meet the Millennium Development Goals (MDGs), including the launch of the International Finance Facility, increased aid levels and up to 100% multilateral debt relief. Action on trade is also important to ensure that developing countries reap the benefits of globalisation and are able to drive their own development in the long term. The current Doha Development Round of WTO negotiations offers a vital opportunity to enhance fairer trade. G7 Finance Ministers discussed at their February meeting the challenges of meeting the MDGs and the opportunities in the coming year, separately publishing their conclusions on how to make progress. These can be found at [www.g7.gov.uk](http://www.g7.gov.uk).

## The economy: the recent past

**3. The Committee welcomes the fact that 2004 has proved to be another year of solid economic activity in the UK, marking a long period of sustained quarter-on-quarter growth. The combination of 3%-plus growth, rising employment, modest inflation and evidence of some re-balancing of the economy away from household consumption towards investment is particularly welcome. (Paragraph 9)**

Data released since the 2004 Pre-Budget Report estimate that the UK economy grew by 3.1 per cent last year, consistent with the Government forecast of 3 to 3½ per cent growth that has been unchanged since the 2002 Pre-Budget Report. Moreover, data for the fourth quarter extended the UK's record of unbroken quarterly growth to 50 quarters—the longest since quarterly national accounts records began.

The Government also welcomes the fact that, as was forecast in previous Budget and Pre-Budget Reports, the balance of growth has shifted towards investment, with less reliance on consumption. Latest data show that whole economy investment grew at almost twice the rate of private consumption in 2004.

### The economy: the outlook

**4. While the Treasury's economic growth forecast for 2005 is more optimistic than the external consensus, the majority of the experts we asked suggested that the gap between the Treasury's growth forecasts and those of other major forecasters lay within the bounds of forecasting error. In any case, the Treasury's recent forecasting record in the area of economic growth has been good. (Paragraph 10)**

The recent economic forecasting performance of the Treasury and independent forecasters was discussed in Box A5, page 186 of the 2004 Pre-Budget Report. As stated there, 'analysis of forecast errors for current and year-ahead forecasts made since 1995 indicates that Treasury forecasts have on average outperformed the independent consensus'.

**5. The evidence the Committee received in the course of this inquiry indicates that there is little to suggest that the UK current account deficit is moving into unsustainable territory in the near term, although the volatile nature of currency markets does create risks. (Paragraph 11)**

The UK current account deficit averaged 2¼ per cent of GDP in the year to 2004Q3. This is fully consistent with the PBR forecast and well within the limits of sustainability. The current account deficit is also under half the record 5 per cent of GDP reached in 1989. It is expected to remain at sustainable levels over the forecast horizon.

**6. Recent signs that the housing market may be cooling and that the household sector is beginning to rebuild its saving ratio are welcome. In the longer term, the evidence we have received on the Pre-Budget Report highlights the importance of work being done in restoring consumer confidence in long-term savings and reforming the UK's pension system. (Paragraph 15)**

The Government is grateful to the work the Treasury Committee has undertaken on the important issue of restoring trust and confidence in long-term savings. It is important that this issue is resolved for the benefit of all in society, and will require the concerted effort of all, including the Government, Industry, Regulators, Consumers Bodies and Trade Associations. We look forward to working with the Treasury Committee, and other stakeholders, in the Forum recommended by the Committee in 2004. Furthermore, the Government commends and supports the work being undertaken by the FSA, particularly that relating to 'Treating Customers Fairly'.

The 2002 Green Paper set out the Government's strategy in helping to ensure future pensioners are able to build up retirement incomes that meet their expectations. Following an extensive consultation, measures in the Green Paper have been developed and taken forward through legislation in the Finance Act 2004 and the Pensions Act 2004 and the informed choice programme, as described in the 2004 DWP publication *Informed Choices for Working and Saving*.

The interim report from the Pension Commission has furthered our understanding of the long-term challenges facing an ageing society and we look forward to the Commission's next report and recommendations.

**7. The Committee notes the evidence we have received suggesting that migration into the UK has played a useful role in relieving skill shortages in the labour market and boosting non-inflationary growth. We welcome efforts to improve the functioning of the UK labour market by raising participation rates and agree that raising the UK's skill base is vital to meeting the competitive challenges posed by the global economy. The long term nature of labour market reform nevertheless means that in the near term the evidence many experts detect of a tightening labour market needs to be monitored extremely carefully. The amount of slack left in the UK labour market is likely to be a key determinant of how long the UK economy can continue to grow above trend without generating inflationary pressure and is thus an essential element in judging the timing of the cycle and whether or not the Government has met its fiscal rules. (Paragraph 21)**

Government closely monitors all labour market developments and carefully assesses how labour supply contributes to the degree of slack in the economy when determining the size of the overall output gap.

The Pre-Budget Report judgement was that despite the unemployment rate continuing to edge down over the past year, there still remains a degree of slack in the UK labour market as evidenced, for example, by the continuation of moderate earnings growth over the recent past.

### **The fiscal balance and the fiscal rules**

**8. The fiscal rules are an important part of the framework for macroeconomic management and in the Treasury's view will be met over the current cycle. However, the margin for meeting the golden rule in the current cycle on the Treasury's forecasts has nevertheless fallen further since the Budget and now stands at £8bn, or 0.1% of GDP. On current Treasury forecasts, the golden rule will be met—by a narrow margin. Many independent forecasters believe that this is too narrow a margin to be confident that the golden rule will be met. The Chancellor has assured us that he could foresee no circumstances in which the Government would not meet its fiscal rules. We note, however, the narrow margin by which the golden rule would be met on current Treasury forecasts, particularly given recent data. (Paragraph 27)**

The Government recognises that projections for the public finances are subject to uncertainty and that every forecast is subject to risks, both on the upside and the downside. For this reason the public finances are based on independently audited cautious assumptions, including a rate of trend growth  $\frac{1}{4}$  percentage points lower than the neutral view. The Treasury's forecasting record for net borrowing since the new framework was introduced in 1997 has been cautious and compares well internationally, both with most EU Member States and with international organisations such as the IMF, OECD and European Commission.

**9. The Committee believes it is important that the operation of the fiscal rules should be as transparent as possible. Given the significance for the fiscal rules of dating the beginning and the end of the economic cycle we believe the Treasury should clearly inform Parliament in a timely fashion of its preliminary analysis that the cycle has ended. To delay making an announcement, potentially for several months, to the next Budget or Pre-Budget Report, would not be in the interests of informed public debate. (Paragraph 30)**

The Government agrees that transparency is important for fiscal policy. The Government's transparent and consistent methodology for dating the economic cycle is set out in the published papers 'Fiscal policy: public finances and the cycle' (March 1999) and 'Trend Growth: Recent Developments and Prospects' (April 2002). The Treasury needs to consider a wide range of economic indicators and information in judging when the cycle has ended, a judgement which by its nature is backward looking. There is a lag in publishing statistics and some indicators also tend to lag the cycle. The Government updates its view of the size of the output gap in each Budget and PBR, and, on the basis of its economic growth forecast, shows when it expects the economic cycle to end. This provides an opportunity for these judgements to be subject to public debate and scrutiny.

**10. The Committee believes that clear, well designed and well understood fiscal rules have an important role to play in lending credibility to economic policy. The current rules have generally worked well since their introduction but are likely to be capable of further improvement and refinement in the light of the practical experience accumulated over recent years. With the start of both a new cycle and a new Parliament likely within the next year or so we believe that it is now appropriate to review the current fiscal rules with a view to initiating any changes that are found to be desirable early in the next cycle. It should be made clear from the start that such a review will not consider any proposals that lessen the UK's commitment to sound public finances or that unduly limit the ability of fiscal policy to support monetary policy in delivering economic stability alongside low inflation. (Paragraph 34)**

The Government agrees with the Committee's view that clear, well designed and well understood fiscal rules have an important role to play in lending credibility to economic policy, and welcomes the Committee's acknowledgement that they have worked well. The Government, of course, keeps the fiscal framework under review to ensure that it remains at the forefront of international best practice.

## **Revenues: overall tax receipts and forecasting**

**11. Despite strong economic growth and record employment, tax receipts are for the fourth consecutive year below the Treasury's forecast. The growth in receipts has been strong by historic standards but has not matched the Treasury's optimism at the time of the Budget. (Paragraph 35)**

As explained in the 2004 Pre Budget Report, receipts from income tax and national insurance contributions have come in broadly as expected in Budget 2004. At the time of the PBR growth in corporation tax receipts had been strong but lower than expected. However, the PBR noted that tax receipts were expected to be stronger in the remainder of 2004–05 compared to the first 7 months of the financial year. Trends in corporation tax

since the PBR have been consistent with this: Corporation tax receipts for the first ten months of 2004–05 are 17.4 per cent higher than in the same period in 2003–04, up from 12.5 per cent for the April to October period and above the Pre-Budget Report forecast of 15.4 per cent growth for the year as a whole.

**12. We note that the Treasury continues to project a rise in the ratio of tax receipts to GDP over the forecast horizon, from 36.2% in 2004–05 to 38.4% in 2009–10. We also note that the Treasury is projecting the fastest growth in receipts over the next two years since 1997. This forecast implies an acceleration in receipts growth in the final four months of this year and even stronger growth in receipts in 2005–06. While there are grounds for optimism, there are significant risks to this forecast and the Treasury needs to monitor developments closely. (Paragraph 37)**

The lags in the tax system mean that the impact of the strong economic growth over the last year or so had not been fully reflected in receipts by the time of the Pre-Budget Report. With staggered payments for corporation tax for example, a strengthening of receipts is expected through the year. In addition, the payment lags related to North Sea taxes—North Sea corporation tax and petroleum revenue tax – meant that little of the additional revenue from higher oil prices had yet fed through to the monthly public finance data at the time of the Pre-Budget Report. Receipts data for November, December and January supports the view in the Pre-Budget Report that receipts growth would accelerate during the remainder of this financial year.

Receipts growth in 2005–06 should benefit from the continued period of relatively strong UK output growth. The increase in the ratio is also due to the recovery in receipts arising from financial company profits and the normal fiscal forecasting convention for the treatment of fiscal drag.

The Government will continue to monitor developments in tax receipts.

**13. We would welcome a clearer explanation of how the Treasury forecasts the cyclical components of tax receipts and how this has influenced their current projections. This should include how the Treasury estimates the long-term averages of components such as corporation tax and financial company profits, what factors it bases these estimates on and how quickly it expects them to return to their long-run averages. (Paragraph 38)**

Corporation tax is a particularly cyclical tax and has varied between 1.6% of GDP and 4% of GDP over the last 25 years. With the overall economy a little below trend and financial company profits as a proportion of GDP below its long term trend, there is scope for a sizeable rebound in corporation tax receipts, especially as a larger than expected backlog of unused losses or allowances may have temporarily depressed taxable profits.

**14. We recognise the Treasury’s statement that it bases its forecasts on cautious assumptions. However, following a prudent start in the run up to the year 2000, we note that the Treasury has now over-estimated the growth in tax receipts in four consecutive years. Many other countries and outside forecasters have also over-estimated the growth of tax receipts during the world economic downturn.**

**However, given that the economic recovery is now under way it is important that official forecasts for tax receipts are accurately constructed and avoid an over-optimistic trend. (Paragraph 41)**

The 2004 End of year fiscal report noted that the one and two year ahead net borrowing forecasts made since the introduction of the new framework have been on average cautious. This was not the case before the new framework was introduced. In addition, the Treasury's forecast differences have tended to be smaller than those of the OECD, IMF and the European Commission.

When considering the Government's forecasting record, it is better to focus on an aggregate measure of the public finances such as net borrowing.

We welcome the Committee's acknowledgement that the Treasury bases its forecasts on cautious assumptions. A key reason for using cautious assumptions is to guard against assuming an overoptimistic trend in receipts.

## **Corporation tax**

**15. We ask the Treasury to review the assumption that financial company profits grow as a share of GDP, given the contrast with the assumption used for the FTSE All-Share index which is that it grows only in line with GDP. We also ask the Treasury to publish data on the backlog of unused losses and allowances in the financial sector which the Treasury notes have "temporarily depressed taxable profits". (Paragraph 44)**

The Treasury regularly reviews and monitors forecasting assumptions. The Pre-Budget Report noted that one of the factors which may explain the lower than anticipated growth in corporation tax receipts from the financial sector was that companies offset higher profits against past losses or capital allowances to a greater degree than expected. A detailed explanation of recent receipts will have to await the 2004 tax returns and will not be available until 2006. Detailed statistics on corporation tax receipts up to 2002 is available on [www.inlandrevenue.gov.uk/stats/corporate\\_tax/menu.htm](http://www.inlandrevenue.gov.uk/stats/corporate_tax/menu.htm).

**16. There are widespread doubts amongst experts and outside commentators about the Treasury's corporation tax forecasts. While it is true that corporation tax receipts have grown by over 30% in some previous years, this has typically taken place when the economy was recovering strongly, or where there was a significant stock market boom. To reinforce the credibility of the corporation tax forecasts, we recommend that the Treasury publishes a breakdown of its corporation tax forecast, differentiating between the various sub-sectors involved. In the absence of further information, the evidence we have received suggests that the balance of risks to the Treasury's corporation tax forecast is to the downside. (Paragraph 48)**

The current forecasting methodology for non-North Sea corporation tax has separate models for corporation tax accruals from different sectors, including industrial and commercial companies, life assurance companies and for financial companies (excluding life assurance). However, the calculation of corporation tax receipts (corporation tax accruals adjusted for repayments, Budget measures, late payments etc) is done at an aggregated level. A sectoral breakdown of corporation tax receipts is not presently

available, although the Government will continue to investigate how it can provide more detail about its corporation tax forecasts.

### **Expenditure: current expenditure, end-year flexibility, investment spending, local services**

**17. The Treasury's forecast for central government current expenditure in 2004–05 requires substantial spending restraint by government departments over the last four months of the financial year. This illustrates the importance of the recent reforms aimed at ensuring a smoother profile of spending over the course of the year. This is an area we will expect to examine further at the time of the 2005 Budget. (Paragraph 51)**

The Government concurs with the committee's assessment of the importance of recent reforms in ensuring a smoother profile of spending over the year. Monthly outturn data is affected by a range of factors and the data is still subject to revision, but it is reasonable to expect a more stable pattern of spending following the introduction of accruals accounting, which records spending when activity takes place, and the End Year Flexibility scheme, which prevents the year-end surges of expenditure which occurred under previous budgeting regimes. However, the profile of spending across the year will not flatten completely as the timing of some payments—for example seasonal payments—will continue to be fixed in a particular period.

When the PBR was published, the expenditure growth rate was expected to moderate over the remainder of the year. Current expenditure in December confirmed this expectation, with the monthly outturn 1.6% lower than in the previous year.

This pattern has resulted in 75% of total spending occurring in the first 9 months of the year, with 25% expected in the final 3 months. This profile is broadly in line with the normal pattern of spending in previous years: 75% of spend occurred in the first 9 months of 2003–04, equal to the average since 1998–99.

**18. We welcome the continued use of the End-year flexibility arrangements and the move away from potentially wasteful year-end surges in spending. We note, however, that the build up of EYF entitlement by departments has reached the point where it poses at least a theoretical risk, should there be major calls on their entitlements across departments, to the achievement of the Government's fiscal targets as the end of the cycle draws near and the available margin is small. The Treasury should make clear what arrangements are in place to ensure that this will not happen. It would also assist transparency and debate if the figures for outstanding entitlement for each department (following drawdowns in the Winter and Spring supplementary estimates) were updated and published at the time of the Pre-Budget Report and the Budget. (Paragraph 54)**

In the past, in part due to the positive incentives the EYF regime places upon departments, underspending elsewhere in government has more than offset take-up of EYF entitlements by departments, leading to net increases in EYF stocks.

Looking forward, departments have an interest in maintaining reasonable contingency levels of EYF entitlement to allow sensible management of spend in future years, and so there is no realistic prospect of full drawing of outstanding EYF entitlements. In practice,

therefore, any net drawdown of EYF entitlements would be significantly less than the total EYF stock. HM Treasury regularly reviews plans for DEL spending and EYF drawdown with departments to ensure that public services are delivered within the fiscal rules.

The stock of department's outstanding EYF entitlements is published each year in the Public Expenditure Outturn White Paper (PEOWP), and drawdown from that stock is published in Winter and Spring Supplementary Estimates. Actual EYF entitlements available to departments depend on outturn figures for underspending across departmental budgets. Outturn data is subject to revision and so firm EYF entitlement figures are only available at publication of the PEOWP.

**19. This Committee attaches the highest possible importance to ensuring that the Government's plans for historically large increases in public sector investment are delivered efficiently. However, despite recent improvements it is apparent that some departments, local authorities and public corporations are still failing to deliver capital spending at the planned level. We first identified this problem during our 2003 Pre-Budget Report inquiry and the Committee is disappointed that it has not yet been resolved. It seems inconsistent to say that reforms will enable departments to manage current spending more smoothly throughout the year but yet rely on a very large surge in public sector net investment in the final quarter to meet the forecast. We recommend that the Treasury take further action to improve the management and delivery of public sector investment and to monitor its effectiveness closely. (Paragraph 58)**

The Government is committed to delivering and sustaining a step-change in public sector investment to overturn years of under-investment in essential public services and has set ambitious plans to achieve this. Within central government, outturn data for capital DEL has tended to come in close to the relevant Budget forecasts (as set out in tables 4.2 and 4.3 of the 2004 End of Year Fiscal Report). Where there have been capital underspends, departments are able to carry this forward through End-Year Flexibility entitlements. Across the public sector as a whole, investment through local authorities and public corporations has tended to come in under forecast—although local government/public corporation investment figures are still very provisional and subject to revision—which will reflect devolved decisions on priorities.

The Government is constantly focused on improving delivery of capital programmes to reduce delays and promote best practice—but it is important to focus on quality as well as quantity of investment. Current initiatives to support the delivery of public sector investment include taking forward the recommendations of the Lyons Review asset management, implementing the Kelly Report 'Increasing Competition and Improving Long Term Capacity Planning in the Government Market Place' to improve the management of key markets and continued steps to improve departmental programme and project management.

**20. We ask the Treasury to provide us with a comprehensive note outlining the sources, with a breakdown, of the £512m re-allocated from central programmes to local authorities. We also ask for more detail of the areas where reduced ring-fencing and increased charges will reduce the pressures on council tax by £1/3bn. (Paragraph 60)**

As the Chancellor of the Exchequer set out in his evidence to the Treasury Select Committee on 16 December 2004, full departmental spending allocations will be available through the publication of the Main Supply Estimates, which take place in due course.

**21. We welcome the announcement that in 2005 there will be an additional £50 payment to pensioners over 70 to help with council tax and other living expenses, but the level of this payment should be reviewed at the time of the Budget. (Paragraph 61)**

The Government is committed to its vision of guaranteeing security in old age and ensuring that pensioners share in rising national prosperity. The £50 payment to the over 70s and the £100 payment made in 2004 is intended to help our older pensioners meet the cost of council tax and other living expenses. Council Tax Benefit is available to help those on lowest incomes meet their council tax bills. In addition, over-60 households qualify for the £200 winter fuel payment; for over-80 households this payment is £300.

The Budget announced an additional payment guaranteeing that council tax paying households with someone over 65 will receive £200 towards the cost of council tax.

A range of Government policies aim to make utility bills more affordable for low income and vulnerable customers by improving energy efficiency, tackling fuel poverty and providing financial support with fuel bills. The Fuel Poverty Action Plan, published in November 2004, set out how the Government is working to tackle fuel poverty and extend the Warm Front scheme. Cold Weather Payments provide extra help with heating costs to vulnerable people during periods of very cold weather in their local area.

### **Reporting issues; the National Audit Office**

**22. We commend the Treasury on the publication of the End of year fiscal report. It could usefully be expanded to provide updates on certain other data which would help debate and scrutiny. (Paragraph 63)**

The Government welcomes the Committee's commendation of the End of year fiscal report, and will continue to review its coverage and consider including other data where that could usefully add to transparency.

**23. We recommend that the Treasury provide more detail on the process by which key assumptions are referred to the National Audit Office, including how they decide which assumptions to refer, and how much notice they provide to the NAO of the assumptions that are due for audit. We note the comment of the IMF that it would be worth considering whether such outside scrutiny of other key variables would enhance transparency and credibility. This is an issue to which the Committee will be returning. (Paragraph 66)**

The Code for Fiscal Stability requires that the Government invites the Comptroller and Auditor General to audit changes in key assumptions and conventions underpinning the fiscal projections. The 11 assumptions currently audited are described in Box B2 of the 2004 Pre-Budget Report. In addition, the Government asks the Comptroller and Auditor General to audit significant 'spend to save' compliance packages where these principally affect operational activity rather than requiring legislative change.

HM Treasury is transparent about its fiscal projections and the assumptions underpinning them, including the assumptions audited by the NAO. It welcomes the scrutiny of independent experts and international organisations.

### Departmental efficiency savings ('Gershon' savings)

**24. We are surprised that advice from the NAO and the Audit Commission on each [department's] Efficiency Technical Note does not appear to have been provided directly to the department concerned. It is not clear what the role of the central scrutiny panel was in the process, but we consider that its existence sits uneasily with the evidence we received that it is departments that are accountable for this process and that individual efficiency proposals are not a matter for the Treasury to take a view on. (Paragraph 73)**

The advice provided by the NAO and the Audit Commission (AC) was passed directly to departments following meetings of the scrutiny panel.

The scrutiny panel—made up of the NAO, the Audit Commission, the Treasury and the OGC Efficiency Team—discussed departments' Efficiency Technical Notes (ETNs) and the advice of the NAO and the Audit Commission. The panel helped to ensure that comments were coordinated and communicated clearly to departments. Departments were then responsible for taking this advice into account before publishing their ETNs.

**25. It is not possible under the procedure adopted to determine what advice was provided by the National Audit Office and the Audit Commission nor the extent to which this was acted upon by departments. We welcome the Chancellor's assurance that this is an evolving process and that the National Audit Office and the Audit Commission will be asked to provide further advice. We recommend that this advice and each department's response be published. (Paragraph 74)**

The measurement of efficiency is complex and in many areas the Government is breaking new ground. We have stated that further work is needed in some difficult areas, building on the advice of the NAO and Audit Commission. We are in discussion with the National Audit Office and the Audit Commission about their future role in efficiency measurement. We remain unpersuaded of the benefit in of publishing the NAO/AC's advice as it was based on early and developing drafts.

**26. Given the size and importance of the overall efficiency programme, we believe consolidated progress reports [across government] are required. We therefore welcome the Chancellor's undertaking to provide further details in the Budget and we recommend that this become a regular feature of forthcoming budget and pre-budget reports. (Paragraph 75)**

The Chancellor provided an update on the progress of the efficiency programme in the Pre-Budget Report 2004 and will provide a further update in Budget 2005. Furthermore, departments will be required to publish progress in their departmental reports. The Treasury will report overall progress on efficiency as part of its reporting against its SR2004 PSA target 9.

## **Savings and welfare: ISAs, Saving Gateway, financial inclusion, childcare**

**27. The Committee welcomes the Government's clear statement that it remains committed to ISAs, a commitment which is in accord with our previous recommendations in this area. But given the lengthy public debate about the future of ISAs we do not see that any useful purpose will be served by more consultations on extending the limits on ISA savings. A clear statement of intent in the Pre-Budget Report to keep the current higher ISA limits would have been preferable. (Paragraph 76)**

The Government first introduced the Individual Saving Account (ISA) in 1999 with two main objectives: to develop and extend the savings habit; and to ensure that tax relief on savings is fairly distributed. The subscription limits were therefore set with the objectives of the scheme in mind.

The maximum investment limit was set at £5000, with a maximum of £1000 in cash savings. But for the first year these were increased to £7000 and £3000 respectively to encourage take-up and smooth the transition to the ISA. These higher limits were subsequently retained until 6 April 2006.

Budget 2005 announced the extension of the existing higher Individual Savings Accounts limits to 2010.

**28. The Committee is encouraged to hear that the initial evidence suggests that the Saving Gateway has been successful in encouraging new, sustainable saving among the less affluent. Given the importance of encouraging saving among the less affluent we look forward to the Government moving as quickly as possible, subject to evaluation of the initiatives, to national availability of the Saving Gateway scheme. (Paragraph 77)**

In addition to tax relief, the Government is using cash contributions to incentivise saving, to provide a more understandable, transparent and equitable framework of support for savers, and greater incentives for those on low incomes who benefit less, or not at all, from tax relief.

The 2004 Pre-Budget Report announced a new, larger, £15 million Saving Gateway pilot scheme to run from 2005. The pilot will test alternative match rates, different monthly contribution limits, the effect of an initial endowment, and the support of a wider range of community financial education bodies. It will also be made available to a wider range of income groups than the first pilot. The pilot will inform the development of matching as a central pillar in the Government's strategy for promoting saving and asset ownership.

**29. The Committee welcomes the funding assistance the Financial Inclusion Fund will give to the provision of basic financial advice to consumers and looks forward to rapid progress on tackling financial exclusion by the Financial Inclusion Taskforce. But the problems created by financial exclusion and poor access to basic advice when consumers get into debt or other financial difficulties are entrenched. We reiterate our earlier recommendation that the possibility of securing additional funding from the financial services industry to support the activities of non-profit organisations in this area should continue to be pursued. (Paragraph 79)**

The Pre-Budget Report document 'Promoting financial inclusion' announced that the Financial Inclusion Fund would be £120 million over three years. Primarily this Fund will support the Government's aims to increase access to forms of affordable credit and to see a significant increase in the capacity of free face-to-face money advice.

'Promoting financial inclusion' recognises the significant contribution of the financial services industry in supporting not-for-profit organisations delivering access to affordable credit and money advice. The Government will continue to work with the financial services industry, the not-for-profit sector and other interested parties.

The Government will invite the Financial Inclusion Taskforce to consider ways in which the capacity and skills of volunteers and staff within the third sector lenders can be enhanced, including promoting the way in which corporates can play a role in providing assistance.

The Government will also consult stakeholders on the case for, and practicalities of, extending the Community Investment Tax Relief to investments in 'community development finance institutions' (CDFIs) personal lending activities. The Community Investment Tax Relief has played a valuable role in incentivising investment from the private sector, into CDFIs enterprise lending since being set up in 2002.

**30. We welcome the indication by the Chancellor that he is prepared to look further at the proposal to allow lenders to apply for repayment to be made by deduction from benefit payments in certain circumstances. (Paragraph 80)**

The Government wants to ensure that those on low incomes excluded from mainstream sources of credit and reliant on high cost options, are able to access affordable loans. 'Promoting financial inclusion' therefore sets out a series of measures to increase the availability of affordable sources of credit.

One of the announcements made relates to exploring commercial mechanisms that allow loans to be made to those on low incomes, at lower rates of interest than found in the alternative credit market. The aim would be to reduce some of the increased costs and risks of lending to vulnerable groups. The Government will work towards a scheme where, in certain circumstances, private and third sector lenders could apply for repayment to be made by deduction from benefit where normal repayment arrangements have broken down.

This facility would be subject to criteria designed to ensure that it is only available where loan products are appropriate.

**31. The Committee welcomes the announced doubling of the threshold above which savings will reduce working-age income related welfare benefits. It would be helpful to have an indication of how substantial the obstacles are (financial or otherwise) standing in the way of both this and other measures designed to help the less affluent in society being introduced earlier than the proposed date of April 2006. (Paragraph 81)**

The Government is committed to removing disincentives for those on lower incomes to save. It has pledged to keep under review the treatment of savings in income-related working age benefits, so as not to penalise saving unfairly. Budget 2004 announced that,

from April 2006, the threshold above which savings begin to reduce eligibility for Income Support, Jobseeker's Allowance, Housing Benefit and Council Tax Benefit would be raised from £3,000 to £6,000. These changes to thresholds have substantial operational impacts on the Department for Work and Pensions, its agencies and Local Authorities who have to prioritise the necessary IT changes alongside substantial existing programmes of modernisation. The introduction of these changes from April 2006 will ensure that the necessary administrative and IT systems are in place and have been adequately tested and that staff have been given sufficient time to be trained in new procedures.

**32. The Government's objective of guaranteeing affordable, high quality childcare for all those who need it is welcome and it is important that the expansion of childcare provision is adequately funded if the parents are to be assured of the quality of the care their children will receive. (Paragraph 83)**

The Government welcomes the Committee's conclusion on childcare. The Government recognises the Committee's concern that the expansion of childcare provision is adequately funded to ensure parents of the quality of care. Every commitment in the *Choice for parents, the best start for children: a ten year strategy for childcare* is affordable and has been funded in full. How fast and how far progress towards the long-term goals can be made is dependent on the availability of resources, the increase in childcare demand, the speed of workforce change, improvements to delivery and the experience of local implementation. But the Government is clear about the direction of travel and clear about the social and economic benefits of this policy and investment in childcare. Quality childcare is vital to the long term development of the country and will help boost employment, tackle child poverty and help child development.

## **Tax avoidance**

**33. We note and welcome the evidence that the new tax avoidance disclosure regime put in place at the time of the 2004 Budget is working well and is having an effect both in terms of allowing the revenue departments to close off avoidance schemes earlier than was the case previously and in having a measure of disincentive effect on the tax avoidance industry. Without wishing to challenge the legitimate right of individuals and businesses to manage their tax affairs in the most effective way for their purposes, we regard it as an equally legitimate objective for the government to seek to protect the tax revenue against inappropriate avoidance schemes. (Paragraph 88)**

The Government welcomes the Committee's positive assessment of the introduction of the disclosure rules for direct taxes and VAT. The Government has always made clear its determination to tackle tax avoidance and the disclosure rules are achieving their effect of allowing earlier and more targeted action against avoidance schemes.

**34. The Paymaster General's announcement that future legislation to outlaw income/NIC avoidance schemes not yet identified will be backdated to 2 December 2004 raises significant issues. We support the Government's determination to tackle unreasonable tax avoidance schemes, which can have the effect of penalising the general public, but we recognise that some experts have indicated that their approach could lead to challenge in the courts. This can only finally be tested as and when the Government introduces any legislation on the basis of the announcement. It would be**

**helpful if, at this stage, and without jeopardising their position, the Inland Revenue were to publish a paper setting out their thinking on the principles which will guide future decisions as to whether a scheme is reckoned to be within or outside the terms of the announcement. (Paragraph 93)**

The Government welcomes the Committee's comments on the Paymaster General's statement on avoidance of income tax and National Insurance Contributions on rewards from employment. The Government believes that the statement itself sets out the principles and context and encourages individuals, employers and their advisors to read the whole statement and its context to understand how it might apply to them. Parliament will of course have the usual opportunity to debate in full any future proposals on legislation in this area.

**35. We welcome the Government's decision to reconsider its plans for the introduction of some of the proposed changes for taxation of life assurance companies, and look forward to a full consultation process in line with the principles set out in the Code for Fiscal Stability. (Paragraph 94)**

The Government welcomes the Committee's comments. Consultation is ongoing with industry representative bodies, insurance companies and professional advisers who specialise in this field to ensure that the final form of the legislation more accurately meets Ministers' policy objectives.

**HM Treasury  
18 March 2005**

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\* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.

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