



# HOUSE OF LORDS

Revised transcript of evidence taken before

**The Select Committee on Economic Affairs**

**RT HON GEORGE OSBORNE MP, CHANCELLOR OF THE  
EXCHEQUER**

*Evidence Session No. 1*

*Heard in Public*

*Questions 1 - 20*

**TUESDAY 4 FEBRUARY 2014**

**3.15 pm**

**Witness: Rt Hon Mr George Osborne MP**

Members present

Lord MacGregor of Pulham Market (Chairman)

Lord Griffiths of Fforestfach

Lord Lawson of Blaby

Lord Lipsey

Lord May of Oxford

Lord McFall of Alcluith

Baroness Noakes

Lord Rowe-Beddoe

Lord Shipley

Lord Skidelsky

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## Examination of Witness

**Rt Hon Mr George Osborne MP**, Chancellor of the Exchequer

**QI The Chairman:** Welcome Chancellor. This is one of our occasional hearings about the economy more generally, but as you know we are near the end of our inquiry into the economic impact of and the outlook for shale gas and oil, so we would like to start with a few questions on that because it obviously very much involves the Treasury. We have a lot to ask you and I know you have to leave at half past four, so can we go straight on to the questions? I will try to make sure that we cover all our subjects by hurrying things up at a later state.

We start with a few questions on shale gas and oil. The Prime Minister has said that the United Kingdom is “going all out for shale”, but our Committee has received evidence that there is little practical progress so far. Indeed, I think it would be fair to say that there is general disappointment at the scale and pace of progress. What impact are you expecting shale to have on the UK economy, and when?

**Mr George Osborne:** First of all, thank you for inviting me to speak to you. I should just say that I think there are going to be two votes in the House of Commons, but I am slipped for those votes so you have my undivided attention until 4.30 pm. The short answer of course is that no one knows what the impact will be on the British economy, because no one ultimately knows at this point what the reserves are and how accessible they are. Clearly it has had a huge impact in the United States on the US economy and on US energy prices. Organisations such as the Institute of Directors have estimated that 70,000-odd jobs can be created out of this industry and that £3 billion a year of investment could flow from it, and I have no reason to doubt those estimates.

I think you are being a little unfair on the pace of getting us to the point that we are at. From almost a standing start we have created a new tax regime, a planning regime, a new institution in Whitehall as a single point of contact, and a new compensation regime for local residents and local councils—all this in a space that has been contested by a number of NGOs.

Now obviously we want to see results, and we want to see exploratory drilling, and my hope is that commercial drilling will follow, but I think we have done all we can to get ourselves to this point. Fortuitously today, one company, Cuadrilla, has just announced that it is going to seek planning permission for two sites in Lancashire and to begin hydraulic fracking there.

**The Chairman:** I think we acknowledge all that, but there is still concern, given the potential and the need for it, about the basic progress. One of our earlier witnesses—a chap called Chris Wright, who is a US energy and technology entrepreneur and chief executive office of Liberty Resources and Liberty Oilfield Services in the United States—gave us some very interesting evidence. At one point he was asked whether it would make sense for a business person to engage in shale gas development at the present time. He answered, “Not right now. I am in favour of strict regulation, and if you had rigorous but crisp and clear environmental regulations, and you had a way to align the community and move quickly, I would do it in a heartbeat, but that is not there today”.

**Mr George Osborne:** We are a different country from the United States, which has its advantages and disadvantages. Obviously it has a huge industry and particular mineral rights there which I think have helped the development of fracking. It also has a scale of industry that obviously we do not have at the moment, but I would point to a number of organisations or companies putting their money where their mouth is. I mentioned Cuadrilla today. Total is making an investment in this country—a company that could go anywhere in

the world with its investments. GDF Suez is another. There is Centrica, in Bowland in Lancashire. So you are now seeing interest not just from UK companies but from international businesses. That is quite a contrast to what quite a lot of our neighbours on the European continent are doing in this space. It is banned, for example, in France. I am not pretending that the shale gas industry here is anything like the size or at the same stage of maturity as the United States' shale gas industry, but I think we are the leaders in Europe in this space. We have overcome some of the objections that other countries have been unable to overcome; and a combination of the tax regime, the planning regime and the community benefit, in which we have tried to draw on some of the experience from the US of giving direct benefits to local communities, all points to a Government doing everything they can to give this industry a good start in life.

**Q2 The Chairman:** You have clearly indicated that a lot of government departments, clearly including the Treasury, are involved in all this. We got the impression that it is spread over a number of departments and that there is a bit of a lack of co-ordination and overall drive. Is there a case for a Cabinet Committee to co-ordinate and encourage shale gas development specifically?

**Mr George Osborne:** First of all, Cabinet Committee creation is bit above my pay grade; you will have to get the First Lord of the Treasury.

**Lord Lawson of Blaby:** As Chancellor you are Chairman of the Economic Affairs Committee. You could set up a sub-committee of the Economic Affairs Committee.

**Mr George Osborne:** Even in the all-powerful days of the Lawson chancellorship, you probably had to get Cabinet Committees, including sub-committees, agreed by his Prime Minister. It is not as though I think the solution to all Whitehall problems are another Committee. I am much more positive about what has happened than I would have been a year ago. A year ago I would have been nervous that different Whitehall interests in the

Department for Environment, Food and Rural Affairs, the Department of Energy and Climate Change, and the Treasury, with its concerns about tax revenues, would have conspired to make it difficult to get a joined-up approach to shale. What you have actually seen is all these departments working together, both across Whitehall baronies and across the two political parties in the coalition. We have established the Office of Unconventional Gas and Oil, we have the tax regime, and although there has been local controversy around some of this activity I detect a broad national consensus in favour of it, which is strikingly different from some other European nations. So I am much more positive than I think you are about this.

**The Chairman:** It is not that I am not positive; I just want to see progress moving swiftly.

**Mr George Osborne:** So do I.

**Q3 Lord Lawson of Blaby:** If it ever gets going, and it certainly has not really got going yet, if, when it does get going, which means that exploratory wells are drilled, and quite a lot of them—more, it seems, than the Government are envisaging at the moment—and it is discovered that a significant proportion of our undoubtedly large reserves of shale are economically exploitable, do you expect that to have a significant effect on the price of gas in this country?

**Mr George Osborne:** I think it will have an impact, and I hope it will be a significant one. Of course, it depends on the conditionals that you set out in your question. Obviously it has had a bit impact on US gas prices, which have fallen by over 50%, and it has set in train a whole set of other developments in the US economy such as reshoring and the renaissance of the petrochemical industry there as well as other manufacturing industries. In the UK there are some differences with the United States. We are not as closed an energy economy as the US is. We are part of a European gas market. We have interconnectors. They do not have LNG export facilities in the same way as we have import terminals. We more closely track the world gas price than the United States does, and we have less ability to detach

ourselves from the world gas price. That said, if you saw significant shale activity in the US, which you are seeing but it has the potential to get even greater, if you saw it in China, if you saw it in a number of European countries, that would clearly have an impact on the world gas price, and we would be the beneficiaries of that, as well as the direct economic beneficiaries of producing gas and selling it on to the world market.

**Lord Lawson of Blaby:** Of course the cost of transporting gas overseas, unlike the cost of transporting oil or coal, is high, because the gas first has to be liquified, which costs, before it can be transported, and then it has to be gasified again when it reaches its destination, which again costs. So unlike oil and coal, the transport costs are heavy. So the question is not just whether the world gas price would be reduced if there was a lot of exploration and development of shale resources in China and various other places, as you say, but whether it could be of particular benefit, as some would argue it is in the United States, in this country, but you have only spoken about the world price.

**Mr George Osborne:** I am just setting out the context here. Maybe I am being too reticent here. I am a huge supporter of shale gas, and I think it has the potential to transform the energy debate in the western world. I am putting a huge effort into trying to push it across Whitehall. I think we have got to a good place, and I have a strong partner in the Prime Minister in trying to deliver all this. I also think, although I will probably spark a whole load of questions from you, Lord Lawson, that it is a very good answer to those who want to see affordable energy while at the same time the UK makes a commitment to the reduction of global carbon emissions. Indeed, Lord Deben, John Gummer, who you would not necessarily agree with on all matters environmental, made an interesting intervention in this space a couple of weeks ago. I am very pro this development, and I think it has the potential to bring gas prices down in the UK. I just do not want to overpromise. I do not want to go out there and say that it is the solution to all this country's economic problems.

**Lord Lawson of Blaby:** May I just ask one further question on shale gas, which really follows on from what you said about Lord Deben—I am never quite sure how to pronounce his name.

**Mr George Osborne:** The former Mr Gummer.

**Lord Lawson of Blaby:** The former Mr Gummer, who we all know and love. We have had two Ministers before you on this issue: one from the energy department, and the Secretary of State for the Environment. What concerned us was that there is a lot of concern about the process of fracking, much of it stoked up by green groups that have an axe to grind, by those who are opposed to carbon dioxide emissions—and I understand that and by those who are ill informed about all sorts of alleged adverse environmental consequences to drinking water and this, that and the other, which, based on the United States' experience, are demonstrably ill founded, provided that we have a decent system of regulation, which we do in this country. But neither of these Ministers was prepared to speak out on that. They said, and I am not misquoting them, that there is no point in politicians speaking out because nobody believes politicians any more. In my opinion, if politicians do not give a lead they are culpable, and if they do not speak out on people's fears there is a real risk that the public will think that there must be something to them, even when there may not be. Are you prepared to speak out about this?

**Mr George Osborne:** Yes, and I have done and will do so again. I am a Member of Parliament in the north-west of England, where quite a lot of this activity will potentially take place, and I have engaged in the debate there. The Prime Minister went to a potential site in Lincolnshire to talk directly about the benefits of shale gas. Prime Ministers can choose to talk about many things, and the fact that the Prime Minister chose to make this a big issue a week or two ago shows that there is a determined effort at the top of the Government to sell the benefits of this not just to the nation but to the local communities affected. The

community benefit regime, involving money per well head and the retention of business rates for local councils, is all designed to buy in local communities and to go out there and, as I say, positively make the case for the impact that this can have not only on your local community but on the country.

**Q4 Lord Shipley:** Chancellor, can I, first, pursue the issue of tax incentives and, secondly, ask about the apparent current decline in public support for shale gas? I heard you say a moment ago that you are putting in a huge effort across Whitehall to promote shale gas. Could you explain to us why you think that operators require tax incentives to develop shale gas and oil? What is the reason for that? A few weeks ago, the House of Commons Environmental Audit Committee, in a report on energy subsidies, said that, “hydraulic fracturing and horizontal drilling are both techniques that have been present in the UK for many years. They are not new technologies. Fracking is not a technology warranting financial support to become viable and competitive, and on that basis it does not warrant subsidy through a favourable tax treatment”. Why, just three days after that, did you announce in the Autumn Statement that there would be a new fiscal regime for the onshore oil and gas sector?

**Mr George Osborne:** You are absolutely right, and I should have mentioned the survey, but of course there has been onshore oil and gas extraction for, I think, 100 years in this country. There are substantial onshore fields that do not attract a huge amount of local controversy just because they have been there for some time. I think you can use incentives in the oil and gas tax regime to encourage particular investment that will not happen without those tax incentives or people may be reluctant to come forward with because it is a brand new form of activity and an area where there has been no substantial activity for many decades. We use this for particular fields and types of fields in the North Sea.

In my time as Chancellor, I have announced specific tax regimes for particularly difficult-to-extract oil and gas. Here, with shale gas, we come back to the point that Lord MacGregor made right at the beginning. I wanted to give this industry a big boost and to get this activity going in the United Kingdom. I thought that the incentives, which after all are there once the industry is making a profit, would encourage some up-front capital investment that otherwise might not be forthcoming because people would be concerned that this was not happening on a large scale and would ask themselves whether the UK was the place to put their money. I take it as a sign of success that these French companies and others have got involved.

**Lord Shipley:** Just to be clear, is this a means of there being lower taxation on the companies but those companies would be giving more money to the affected communities, or is it largely a means of simply giving greater profit to the companies to encourage their investment?

**Mr George Osborne:** First, I think that the UK will benefit, including the UK Exchequer, if there is a lot more shale gas activity in the UK. Secondly, there are specific community benefits that are bespoke to this type of development. There is the £100,000 per well to the local community; there is 1% of the revenues, which is also going to the local community; and there is the retention of business rates. These are all new regimes designed to ensure that a community sees the benefit of extraction in its own back yard. Whether it is the national tax regime or the local incentives, they are all helping to create a climate in which people around the world look at the UK and say that the UK has an open door to this activity and wants to see more of it.

**Lord Shipley:** Finally, can I pursue the point about leadership that Lord Lawson referred to? The latest survey by the University of Nottingham, which has been conducting regular surveys on the opinions of the UK public on shale gas, found in January that there has been a

drop from 39% support in July last year to 26.7% support now. Does that concern you? Do you think that that is likely to cause greater delays in the issuing of permits, licensing and permissions and so on?

**Mr George Osborne:** I do not think that it will cause delays. Obviously I would like even greater public support but I think that at the moment it is all quite theoretical. Once people start to see the benefits of this for the UK economy—the jobs that will be created and the lower energy costs—and once communities begin to see the money flowing, I think that they will all see the merits of this area of economic activity.

**The Chairman:** Sadly, we must leave shale gas there, much though we would like to go on about it, and turn to the wider economy.

**Q5 Lord Rowe-Beddoe:** Chancellor, the ONS announced last week that the preliminary estimate for growth for 2013 was 1.9%, the strongest rate since 2007. However, GDP growth fell to 0.7% in the fourth quarter compared to 0.8% in the third. Are you confident that the recent upturn in the UK economy is sustainable in the medium term?

**Mr George Osborne:** I think you are being a little unfair to draw attention to the difference between 0.8% and 0.7%, not least because I think that the previous number had been revised up. Indeed, the GDP numbers for last year have all been revised up and this is only the first estimate. Nevertheless, 0.7% is still a good sign of economic activity. Indeed, four-quarter growth—another way of measuring it—is just shy of 3%. I think that the recovery is sustainable but the job is not done.

I would point to a number of risks. Regarding the international risks, I would draw your attention to the weakness of some of the eurozone economies, which remains a cause of concern. Some of the US data in the past couple of weeks have been a little bit soft but, even in a good recovery, not all the data will be exceptionally strong. It is also worth having on one's radar the problems in some of these emerging markets. In an interconnected financial

system, a problem in an emerging market can have an impact on other financial markets. So there are those international risks.

Here in the UK—obviously this is straying into the party-political argument—I would say that those who want to come off our plan to deal with our public finances or pursue an anti-business agenda would also be threatening the recovery. I think that the recovery is under way. We have had some good surveys in the past couple of days, including one today on construction, but there is still much to do.

**Lord Rowe-Beattie:** As a previous chair of the ONS for some four years, I recall that at times political comment considered that 0.1% up or down was highly significant! Despite the recent upturn, do you still detect resistance on the part of UK businesses to invest?

**Mr George Osborne:** I think that that is diminishing. Clearly, business investment has disappointed and come in below our independent forecast from the Office for Budget Responsibility. That is explicable. For a start, there has been a huge amount of uncertainty in the world. In 2012, there was the near-death experience of our neighbours' currency, which of course cast a huge pall over investment across the western world and particularly in Europe. The repair of the banking system has taken longer than people expected and it is ongoing. Those are all reasons why business investment has not been as strong as we would have liked. That said, some of the most recent surveys show encouraging signs that it is picking up. Our independent forecaster expects stronger business investment growth this year. We certainly stand ready to do everything we can to provide that stable macro-environment and supportive tax and regulatory regime to encourage business investment.

**Lord Rowe-Beattie:** Thank you. It is reported that a couple of weeks ago at Davos you told a group of FTSE 100 executives at a breakfast to “step up and be counted” in order to boost the public perception of UK plc. However, John Cridland, the director-general of the CBI, is apparently quoted in the *Guardian*—I have not seen this—as saying, “I accept the

investment cycle is only now on the turn. People were wrong when they said this would be an investment-led recovery". Do you have a comment?

**Mr George Osborne:** It has definitely been a recovery that has been led first by the consumer rather than investment and exports, both investment and exports being hit by what has been happening around us, but I do not think that that is something that we should be particularly anxious about. What we want to see now is a handover to investment and exports. The consumer has been spending out of income rather than debt, so it is not a debt-fuelled consumer recovery. There was a very good piece of analysis by the economist of Citigroup, Michael Saunders, at the end of last week which pointed to household debt-to-income ratios and the like that supports that. So we have had income-driven consumer spending and now we would like to see more of a handover to investment and exports. That is not a particularly unusual pattern for a recovery—a point that the Governor of the Bank of England made—

**Lord Lawson of Blaby:** There has never been an investment-led recovery, ever.

**Mr George Osborne:** The Governor of the Bank, like Lord Lawson, was making a point just before the Christmas break.

**Q6 Lord Skidelsky:** Employment has been rising faster than output in the recent period. That means that output per person has been going down so that there is a productivity puzzle, as it is called. In 2010, for example, the Bank of England thought that output per hour would have increased by 10.4% by the second quarter of 2014, but in fact it has declined by 1.2% over that period. What are your thoughts on that? Why do you think there has been a drop in productivity?

**Mr George Osborne:** Productivity has disappointed. I guess I would say that if you had a choice—I am not saying that there is a choice—between the jobs growth that we have had and the productivity improvement that we might have had, I would rather have had the jobs

growth. It has avoided some of the scarring social consequences of high unemployment as well as the hysteresis effect, but that does not mean that we should ignore the productivity puzzle or challenge, and ultimately of course longer-term prosperity and a sustained recovery require an improvement in productivity. The question then is: why has productivity disappointed? It has partly been a European phenomenon and not just a British one. You could also point to a couple of specific UK issues. North Sea oil production has, for complex reasons, not been as impressive as we would have liked, despite the high levels of investment, and our financial sector was one of the most affected by the financial crisis. Ultimately, when I and the Treasury look at the problem, we tend to put the financial system centre stage. Credit allocation and the impairment of the banking system have probably—I use the word “probably” because ultimately no one has the answer to this—been the strongest causes of the weak productivity performance.

**Lord Skidelsky:** The implication of that is that you think it is a cyclical problem. When the repairs to the financial system are done and the economy moves forward strongly, one would then expect to see a productivity upsurge.

**Mr George Osborne:** It is partly cyclical, although that does not mean that you can just let it happen. You have to go in and repair the financial system, and that requires more activity than passivity. Whether it is the raising of capital in the banking system or sorting out the Royal Bank of Scotland, those are examples of active intervention, not necessarily just by the Government but by the Bank of England and the regulators, to try to improve the health of the financial system and accelerate the repair. There is probably also a longer-term productivity challenge for western economies such as the UK. In my view, that would centre around skills, education, the development of scientific discovery, innovation and so on, which we can talk about. Clearly, we all have to up our game, but I would put the primary cause of the immediate productivity puzzle as being the impairment of the financial system.

**Lord Skidelsky:** The alternative view, which emphasises longer-term supply side factors, is that there has been a fall in the output potential of the economy, partly due to hysteresis but partly due to longer-term problems of investment in the western world. I am thinking of things that Professor Gordon has written about and which have been described by some people as “secular stagnation”.

**Mr George Osborne:** I am not wholly persuaded by the secular stagnation argument that Larry Summers and others have advanced because I think it is too pessimistic about the potential of western economies—he is referring principally to the United States but also the UK and others—to be centres of innovation. However, I certainly think that it requires the British body politic to make sure that we build the infrastructure that is required, reform our skills and education system, support science and innovation, provide a competitive tax system, provide a stable macro framework and make sure that our public finances are under control. All those things are required, but I am not one who is prepared to say that the West should just give up and look at the latest Indian and Chinese discoveries and say, “That used to be us but not any more”. I am not one who says that we have to do that. I think that we can engage, and I do not agree with Larry Summers that the answer to all these problems is to pour in more and more public money. Ultimately, high budget deficits have caused an enormous amount of damage in western economies as well.

**Lord Skidelsky:** May I ask one last question?

**The Chairman:** Well, very quickly.

**Q7 Lord Skidelsky:** Do you think that countries should begin to address the problem of the policy implications of the threat to jobs posed by increasing automation and artificial intelligence, not necessarily by spending more in the public sector?

**Mr George Osborne:** I think that innovation in technology, whether it is in computing, life sciences or whatever, has over the decades proved to us that, while it makes some jobs

redundant, it creates new jobs. No one would have sat round this Committee 20 years ago and talked about the need for web designers, yet there are tens of thousands of web designers out there. So it is a bit dangerous to think that the latest piece of innovation is going to make human labour redundant; it just creates new opportunities for human labour. Some of the fastest growing, largest employing companies in the world are these tech companies that did not even exist 30 years ago.

**Lord May of Oxford:** They are destroying jobs and increasing the riches of the people at the top. There is a superb article in the current issue of the *New York Review of Books* which I recommend you read.

**Mr George Osborne:** I will certainly read it but there are two issues there. The first is, in the case of the tech companies, the accumulation of gains among the very small number of people who started those companies. In some senses, the way that I feel about this is: is that because these are new areas of human activity, and the people who are there first to create the companies that exploit those areas of activity see great gains from that? But these companies also employ tens of thousands of people and they are major sources of employment. I will send the precise figure to you, Lord MacGregor, but I think that something like a quarter of all jobs created in this city in the past year or two have been in the tech sector, and that is during a period of job creation. So I would not say that it is putting the world out of work.

**Lord Lawson of Blaby:** This is the luddite thesis, which of course is of considerable antiquity but so far has been conclusively disproved.

**The Chairman:** All right, we have agreed on that. Baroness Noakes.

**Q8 Baroness Noakes:** Chancellor, I want to talk about house prices. Average house prices rose last year by a little over three times the rate of inflation, and early figures from

January show that that has not abated. What do you think has caused the rise and do you think it is a cause for concern?

**Mr George Osborne:** Partly, house prices fell quite considerably during the recession—not as much as they fell in some US states or in Ireland. Nevertheless, they fell considerably and are now still 15% below their peak in real terms. Even on the recent OBR forecast that we published in December, they will not have their real value restored until the end of this decade. So partly we are recovering from the property crash.

Am I someone who says that we should be vigilant about this? Absolutely we should be vigilant. We have created in the Bank of England the mechanism for that vigilance: we have created a Financial Policy Committee and we have given that policy committee the tools to do something about asset price bubbles. As is clear from the committee's reports, at the moment it does not see what you would describe as a bubble but it is vigilant. In December—it did not get a huge amount of attention—acting in concert with the Treasury, the Bank of England turned the Funding for Lending scheme off mortgages and the Financial Policy Committee also made some changes to mortgage standards to tighten them up. So it has used some of these tools either by itself or in conjunction with the Treasury. I think that we now have a mechanism, which just did not exist before the crash, to look at debt levels in our economy and the prices of particular assets such as housing.

**Baroness Noakes:** While these mechanisms exist in the Bank of England FPC to counteract a potential bubble, the Deputy Governor explained to the Treasury Select Committee last month that he thought the issue was an imbalance between supply and demand. Of course, what the Government are doing and what your policies are doing are increasing that demand through the Help to Buy scheme. Is that a sensible approach—to have a demand-stimulative approach at one end of London and a contracting one at the other?

**Mr George Osborne:** Help to Buy has two elements. First, there is a shared equity scheme, which is available only for newly built properties. Over 20,000 people have applied for that scheme, so that is 20,000 properties that are newly constructed off the back of it. Secondly, there is a mortgage scheme. The early data from that scheme suggest that the average house price that people—that is, those using the scheme—are paying is around £150,000, that the vast majority of them are outside London and indeed outside the south-east, and that the scheme is largely for first-time buyers. That all suggests to me that it is doing what it was designed to do, which is to address a failure in the financial system rather than a failure in the housing market. The failure in the financial system was that people were being asked for deposits that were not remotely affordable by those who did not have parental support or some kind of family support. They were far beyond the deposits that anyone in this room would have been asked to pay when they bought their home. That was a failure of the financial system rather than a failure of the housing market.

Going back to my comments on shale gas, I am one of the first to say that this country needs to build more homes. I was a promoter of the planning reforms that—dare I say it?—did not enjoy completely plain sailing in the House of Lords, but they were designed to make sure that people could build homes and that this country could attempt to address our historic problem of housing demand outstripping housing supply. The latest figures, which are literally from today's PMI construction index, show a strong growth in residential housing construction, which I find very encouraging. However, I do not pretend that this problem is going to be solved in a few months or a couple of years. This is a big challenge for our country. We have to build more homes and we have to create an acceptable political and social climate in which people will want to see homes built so that their children have some prospect of living near to where they grew up.

**Baroness Noakes:** Do you think that government policies are sufficient at the moment to result in that increased supply?

**Mr George Osborne:** The planning reforms are clearly working. You see planning approvals up, planning applications up and the percentage of planning approvals up, as well as more construction. I mentioned the Help to Buy shared equity scheme, which is supporting the construction of new homes, and we have other schemes to support the builders who need help with their cash flow. A large social housing programme is under way as well. So across the board we are pulling a lot of levers, but this is a historic problem for the United Kingdom.

**Baroness Noakes:** Are any further changes needed to the planning regime, not that they would necessarily be popular?

**Mr George Osborne:** At the moment, we have just got this new planning regime and I am keen to see it bed down and have its effect. I think that it is having a positive effect in creating new homes, and those homes are being built in appropriate places. However, I imagine that if we all assembled again in 10 years' time, we would still be talking about the challenge of making sure that our housing supply keeps up with housing demand. We are all legislators here and we all have a responsibility to the next generation.

**Q9 Lord Lawson of Blaby:** On the mortgage side of the Help to Buy scheme, you said that the average loan under it is for properties worth around £150,000. Nevertheless, the cap is set for properties worth up to £600,000. Would it not make a lot of sense now to bring that cap down to £300,000?

**Mr George Osborne:** I have set in train an annual review process where we work with the Financial Policy Committee in the Bank of England to look at the parameters of the scheme. That review will take place this autumn. I would just say this: my experience of these schemes—I do not have as much government experience as many of the people in this

room—has been that we set up schemes, you hedge them around with all sorts of conditions and restrictions, and then, sure enough, you turn round a year later and they have not worked. Some of these—the precursors of Help to Buy, which were things called First Buy and Homebuy—all had quite a lot of restrictions placed around them and were not as effective as Help to Buy has been in a very short space of time. When we were designing Help to Buy, we wanted to make it a simple, easy-to-access scheme that was not hedged around with too many restrictions. The limits or parameters of the scheme can be assessed, with us, by the Bank of England. But, as I said, despite quite a lot of predictions from people that it would be used only for £600,000 homes in London, the early data show that that has not been the case; it has been used by many families who would not otherwise have a chance of owning their own home. Since I suspect that everyone around this table owns their own home, I think we should all be grateful that we are supporting an idea that will help others to own their own home as well.

**Q10 Lord McFall of Alcluith:** Chancellor, with Lloyds' announcement yesterday on PPI mis-selling, this takes the bill to £20 billion for the industry itself. Apart from the perverse and fractured nature of banking, does this figure, which represents more than 1% of GDP, add up to a real economic stimulus?

**Mr George Osborne:** I would not say, as some have over the past 24 hours, that it has been the principal cause of the British recovery. If our economic recovery is going to be based simply on consumer fines, I am not sure that it is going to be very sustainable, so I reject that analysis. I do not see this as an economic stimulus, I see this as proper redress for the mis-selling of financial products. We are making sure that the claims firms are behaving in an appropriate way, and that they will be properly regulated in that sense, but let us not take away from the fact that people were mis-sold products, and of course it has cost the banking industry a lot, but that is because it put a lot of people out of pocket.

**Lord McFall of Alcluith:** Yes, but you would accept that £20 billion represents more than 1% of GDP?

**Mr George Osborne:** Yes, I accept that fact.

**Lord McFall of Alcluith:** Okay, so we will just forget about the stimulus element. Also, on London, Vince Cable was on BBC Radio 4 at Christmas and he said that London was “becoming a kind of giant suction machine draining the life out of the rest of the country”. Do you agree with that?

**Mr George Osborne:** Maybe he has a different perspective as a Twickenham MP than I do as an MP from Cheshire. I would say that London is a huge asset for the United Kingdom. It is a truly global city that provides an enormous economic boost to the whole of the United Kingdom, but it is very far from being the only economic asset that we have. Look, for example, at employment growth in the private sector in every region and every nation of the United Kingdom. That has been positive over the last couple of years, and when I see the development of science in the Manchester area, the videogames industry in Dundee or some of the remarkable aerospace in Belfast, I see an economy that across the United Kingdom is strong, so I would not tear down London; I would build up the rest.

**Lord McFall of Alcluith:** I do not think he said it with the intention of tearing down London. I think he was focusing on the rebalancing of the economy, and when you get the Centre for Cities think tank saying that London accounted for 79% of national jobs growth in the private sector between 2010 and 2012 and created 216,000 jobs over that period—almost 10 times more than the second fastest growing city, Edinburgh—it begs the question: how do we rebalance the economy? What are the Government doing in that sense?

**Mr George Osborne:** A lot of people live there, so you would expect proportionately more jobs to be created there. But over the last year, 450,000 have been created in our economy, 75% of them outside London. As a Member of Parliament in the north-west of England, I am

not suggesting that regional policy is perfect. I would say that we need to do more to invest in higher education, science and innovation outside London. I would suggest that the key infrastructure projects, such as High Speed 2, are important for changing the economic geography of this country. So there are lots of things that we are doing and that I want us to continue doing to address the historical issue in the UK of some of this imbalance.

But look at the positive signs; before the economic crash and the decade before it, private sector employment in the West Midlands fell. That is a pretty shocking fact. Since the economic crash and since the recovery has started to take hold, private sector employment is up across all regions, including in the West Midlands.

**The Chairman:** We must move on, because we are getting quite close to the end.

**Q11 Lord Griffiths of Fforestfach:** Chancellor, earlier you mentioned that the recovery has come and that you are looking forward to a medium-term recovery, not just a short-term one. In your answers to us, you have championed shale gas, investment and exports? Do you think that you should also be championing saving?

**Mr George Osborne:** First, there is an important issue that people who have saved all their lives deserve our support, because they are doing the right thing for themselves and the right thing for the country. I would say that like many groups of the population, they too have had a difficult time over recent years with the very low interests. It has been pointed out by both the current and the previous Governor of the Bank of England that some of the policies adopted, such as quantitative easing, which depressed rates, also increased asset prices, and of course that would have helped savers who had savings in equities, for example. The question then is what you can do to support savers. I would point to two very big changes that have taken place in this Government, which are largely unsung successes of the Government because they have not been particularly controversial between the political parties and so have not had a huge amount of attention. The first has been the auto-

enrolment of pensions, which was proposed by Lord Turner's report under the previous Government and implemented by this Government. That has led to huge increase in the number of pension savers, with the prediction that there will be millions more in the next few years. The second is the single-tier pension—the legislation has passed through Parliament—which removes a lot of means-testing and creates a stable environment in which it makes sense to save. In other words, you can be sure that each £1 you save is not going to be taken away from you and means-tested. Those two reforms, as well as some other things that we have done, such as the indexation of ISAs, ISA limits, and more flexible pension drawdown, which this Government introduced shortly after coming into office, have tried to create a more supportive climate for savers.

**Lord Griffiths of Fforestfach:** Do you think that with National Savings & Investments, the old Post Office Savings Bank, and so on, you could do more in index-linking savings certificates and making it attractive for people to save, because frankly the rates of return on saving for the average family have not been great in the past four or five years?

**Lord May of Oxford:** Hear, hear.

**Mr George Osborne:** I will not answer the question directly, because this is properly something that the NS&I needs to do within the remit set by the Government and our overall requirement when it comes to raising money. We had an index-linked product a couple of years ago that proved somewhat more popular than people estimated at the time.

**Lord Griffiths of Fforestfach:** Right, and then it was closed down. A final point. When saving was a real issue, we created, I think in the First World War, a national savings movement, and it seems to me that at present, because we have implemented effectively changing policies, they have been very short term, so we have put a lot of emphasis on how to get people to spend, whether it is consumer spending, investment spending, export spending and so on. I just wonder whether there is not a case, if you want a sustainable,

medium-term growth policy, for involving you as the Chancellor championing saving in the way other areas of economic policy are being championed.

**Mr George Osborne:** It is the first time I have been accused of adopting a Keynesian approach. Lord Skidelsky, I think, could have issue with that. As I say, when you think what auto-enrolment and the single-tier pension really mean, they are a transformation of our private savings market and a massive reform of the basic state pension, all in a period when the Government have an awful lot of things on their plate. They are foundations for a savings culture, because they remove the problem for low and middle-income savers of whether it makes any sense to save. They may not be the sexiest government policies, but I think that when you look back in decades to come they will probably be some of the most significant.

**Q12 Lord May of Oxford:** The money and credit statistical release from the Bank of England published a few days ago showed that loans, including overdrafts for small and medium-sized enterprises, in the previous month had decreased by about a third of a million. Also in that general vein, a study on business lending at the Royal Bank of Scotland found that the RBS was turning away three out of four small businesses that approached it for loans before it even came to the formal consideration process. I want to ask you whether are concerned about the availability of credit to SMEs in the UK.

**Mr George Osborne:** The short answer is yes, in the sense that the repair of the banking system and the impact that that has had on the availability of credit to small businesses has been one of the biggest challenges of the recovery. But there are more encouraging signs. You are correct to say that net lending remains negative, but gross lending has been increasing recently, and a survey today by the CBI on SMEs shows that small-business investment intentions are at their highest level since 1995. So I think there are signs that the healing of the banking system is beginning to be felt in SMEs starting to have access to credit, but I would say that this remains patchy. When you point specifically to the problems in the

Royal Bank of Scotland, Lord May, I agree with you that this warrants serious investigation. This was partly off the back of work done by someone who was working for the Government in producing this report.

**Lord May of Oxford:** We own the bank, basically.

**Mr George Osborne:** And the bank, under the new management of Ross McEwan and his team, has done a very good job of engaging with those criticisms and launching a proper investigation, supported by Andrew Large, formerly of the Bank of England, looking at the specific allegations but also trying to change the culture of that bank so that it is a much more retail-focused bank. Ross McEwan, the chief executive, sets as his ambition that RBS will be the best small-business lender in the country. That is significant, not just because we own too much of it but because it is such a big player in the corporate banking space.

**The Chairman:** Which leads us on to Lord Lipsey.

**Q13 Lord Lipsey:** Have you seen off the uncontrolled bonus culture in the City?

**Mr George Osborne:** I think it is a much more responsible culture than it was. The volume of bonuses is down very considerably. I think it is 85% less than it was before the crisis. Even more importantly, we now have much more rigorous procedures in place, not just in this country but around the world, to make sure that payments of bonuses are deferred and you can claw back money where the investment by the banker has gone wrong. We also have much more transparency over pay. Indeed, I would suggest, the regime in London, and across the UK, is tougher and more transparent than in any other banking centre in the world.

**Lord Lipsey:** But transparency does do something to the people at the very top, because never a day goes by without some top banker waving his bonus. What seems to be going on, however, is that at the layer below that the bonuses go on being paid out as they always were, although obviously at a lower level because the profits are at a lower level because of

the mess that was made. Every kind of device is found to get rid of the restrictions, which I know were imposed by the European Union. This does not seem to me like a culture that has got itself under control.

**Mr George Osborne:** The European Union rules were rules which the United Kingdom voted against, and we are challenging them in the courts precisely because we thought it would create perverse behaviour and have these incentives to get around bonuses by paying more of these fixed allowances so that you get back precisely to Fred Goodwin-style arrangements where you cannot claw back the money when something goes wrong. We want to continue in the direction in which the world and the UK has been travelling in the past few years of having much more claw back and much more accountability, so we made these warnings about what would happen with these European rules. The Governor of the Bank of England made the same warning before the House of Commons Select Committee a couple of weeks ago. Unfortunately, we were outvoted in the European Union.

**Lord Lawson of Blaby:** But that does not stop us having our own regulator laying down what can and cannot be done in the form—I am not talking about the level—in which the bonuses are paid. The Parliamentary Commission on Banking Standards, which you set up, made recommendations in this area.

**Mr George Osborne:** Which we are implementing.

**Q14 The Chairman:** Can I now turn to the question of Scottish independence and the referendum, in which this Committee has been taking a great interest. The Scottish Government would like an independent Scotland to retain sterling as a part of a formal monetary union with the rest of the UK, with monetary policy set according to economic conditions across the sterling area. What is your view of that proposal and what conditions would you seek to apply in any negotiations on that?

**Mr George Osborne:** The first thing to say is that, while this is a decision for the people of Scotland, I am working hard with my colleagues across all the mainstream political parties in Westminster to try to prevent Scottish independence and to say to the people in Scotland that we are better together and that the rest of the United Kingdom very much wants Scotland to stay part of the union. Secondly, I think that, frankly, Alex Salmond's claims about the currency were pretty effectively demolished by the Governor of the Bank of England. It was a very non-partisan technical speech from a Canadian citizen, who pointed out that the conditions for a successful monetary union require the ceding of sovereignty and the creation of a banking union. That is why I said last year in Glasgow that I thought it was unlikely that a workable monetary union could be created. I will have more to say on the subject over the coming weeks.

It is also worth noting today that the person who runs BP has said that the uncertainties around the currency created by the SNP are causing further big uncertainties. That is a further example of the potential economic damage and the cost to the people of Scotland of independence. But this is ultimately a decision for the Scottish people.

**Q15 Lord Lipsey:** Are we not having two destabilising referendums at the moment: the one on Scotland, on which the chairman of BP has commented, and a threatened one on Europe—temporarily averted by this House last week but looming in 2017—which may cause new doubts in the midst of recovery as to whether Britain will continue as a member of the European Union?

**Mr George Osborne:** Well, wise as the House of Lords often is, I thought that it was unwise to kill off the opportunity for the British people to have their say through that particular piece of legislation. But you can rest assured that we will be offering the people that referendum before 2017.

On the question of the Scottish referendum, the people of Scotland voted for a majority nationalist Administration in Holyrood, who had said clearly that they wanted to have a referendum on an independent Scotland. We have brought the issue to a head this year. The argument has been made and now the people of Scotland have a very simple yes/no choice to make on independence. I hope that the people of Scotland will choose to end the uncertainty by voting to stay in the union but, as I say, that is a matter for them.

On the European issue, which I am happy to discuss, I do not think that we can be entirely ignorant of the fact that the British people are very unhappy with the European Union as it is and Britain's relationship with the European Union as it is. They want reform and so do I. The reforms that we believe we can achieve are reforms that we should put to the British people in a referendum. If they are reforms that improve Britain's relationship with the EU and improve the economic performance of the EU, then I will be recommending that people vote yes to stay in.

**Q16 The Chairman:** Coming back to Scotland, there are two questions. The first is that the Scottish Government also aspire to a share for an independent Scotland in the ownership and governance of the Bank of England. If it came to negotiations, what would you be saying about that?

**Mr George Osborne:** If you will allow me, I do not want to get into a discussion about the negotiations. I am working hard with my Labour and Liberal Democrat colleagues, and indeed with many people in Scotland, to make sure that we never get to the stage of negotiations because the people of Scotland decide that it is better to stay in the union and in the United Kingdom. The monetary arrangements would of course be a big issue if Scotland chose to vote for independence. You have now heard from the Governor of the Bank of England, from me and from a number of other people that the assertions that the

SNP makes about this are simply not credible. That is why I say that I think a workable monetary union is unlikely.

**The Chairman:** But it also extends to governance questions. Would it not give the Scottish people a clearer vote if it were based on an awareness of what the red lines from the UK Government would be—in other words, some understanding of what the outcome would be—if they voted yes?

**Mr George Osborne:** As I said, if the people of Scotland look at what has been said by Labour, Conservative and Liberal Democrat politicians across the United Kingdom and if they listen to the Governor of the Bank of England, they can see that it is highly unlikely that you could make a currency union and that Scotland could keep the pound. I think that that is pretty clear to the people of Scotland. Again, they will make their own decision but I think that they can look with some considerable scepticism at the assertions being made by Mr Salmond and the SNP.

**The Chairman:** One last point on this. The Treasury recently announced the acceptance of all UK gilt liabilities in the event of Scottish default. Does that weaken the rest of the UK's—that is, the British Government's—negotiating position with an independent Scotland, as I think Alex Salmond has tried to claim, or does it underline Scotland's likely extremely weak position in relation to international markets if it goes on its own?

**Mr George Osborne:** I think the latter. I am not getting into pre-negotiation but we had to make it clear to gilt investors that a gilt issue by the United Kingdom would be honoured by the United Kingdom, otherwise they would start to charge us a higher premium for our debt. But therein lies the clue. The higher premium would be paid by an independent Scotland; in other words, Scottish people would be out of pocket, paying more to the international debt markets. It is another reason why people would be worse off in an independent Scotland.

**Q17 Lord McFall of Alcluith:** In that regard, what lessons have we learnt from the European crisis regarding the economic, financial and fiscal features needed to make a single currency work?

**Mr George Osborne:** This was very much the substance of Mark Carney's speech, and he drew parallels from the euro crisis. He pointed to the requirements for successful monetary union, which, as we have painfully discovered over the past few years in Europe, are supervision over each other's fiscal policies and a seeking of sovereignty, to use Mark Carney's phrase, and the requirement to have a banking union and, indeed, a common bailout fund, which Europe calls a single resolution mechanism, to bail out banks that fail, although our much preferred approach to all these things these days is to bail in those banks. The parallels with the euro are striking, as well as the conditions that have had to be imposed on some of the smaller member states with the euro, and, again, I think that the people of Scotland can draw their own conclusions.

**Q18 Lord Lawson of Blaby:** Chancellor, in a speech last month, I think, you said that in your opinion the United Kingdom's withdrawal from a European Union which succeeded in reforming would be bad for Britain. Does it not follow from that that United Kingdom withdrawal from a European Union which did not succeed in reforming would be good for Britain?

**Mr George Osborne:** I am not going to get into a hypothetical discussion because I think that we can be successful in our reform and renegotiation, and that will be good for Britain and indeed for the European Union.

**Lord Lawson of Blaby:** But I have to say—and I am sure you are well aware of this—that my friends on the continent of Europe who used to hold senior positions and are still closely in touch say that there is no way that substantial or significant reform, whether you would like it or not, is going to be agreed, all the more so because any such agreement has to be

unanimous within the rules of the European Union. So I reiterate my question. If no significant reform is agreed, which is what they believe to be the case, and they are extremely experienced and well plugged in, it would be in Britain's interest to withdraw from the European Union. That seems to be the logic of your position, with which I would concur.

**Mr George Osborne:** As I said, I do not want to engage in a hypothetical discussion because I think we can be successful in our reform negotiations. When we look at all our friends on the continent, we will see quite a lively debate about the failure of the European economy and what needs to be done at a European level to reform it. You will see our friends in the Netherlands talking about their frustration with the commitment to ever-closer union and you will see our friends in Germany talking about the unsatisfactory nature of the treaty basis for the euro. In other words, I see plenty of opportunities to make an argument that is actually a European argument and comes back to some of the things that we talked about earlier in relation to energy and productivity. I think that we can make an argument to all the people of Europe that this continent is in danger of pricing itself out of the world economy. We need to reform to make sure that we offer prosperity and a better future to our children.

**Lord Lawson of Blaby:** So you at least agree that if and when the promised 2017 referendum is held, the Government's advice as to whether one should vote in or out will depend on the extent of the reform that has been negotiated?

**Mr George Osborne:** I do not remember you, when you were in office, Lord Lawson, predicting your own failure in your endeavours, and I do not predict the failure of the Conservative Government in reforming our relationship with the European Union.

**Lord Lawson of Blaby:** But it is not within our power, is it?

**Mr George Osborne:** Well, it is within our power to make a persuasive case for the reform required at a European level and, from what I hear from many countries, I think that we will have a willing audience for that message.

**Q19 Lord Shipley:** And obviously in 2017 it will be a different Government of whatever persuasion; it will not be the same as the current Government. The UK has had great success as a world financial centre. Does that not depend for its future on the UK staying within the European Union?

**Mr George Osborne:** I remember an argument made about 15 years ago that unless we joined the euro, Frankfurt would become the financial centre of Europe. Actually, since then, London has grown in stature and Frankfurt has not to the same degree. I think that London, and indeed the financial services in Edinburgh and elsewhere, have many, many strengths that are borne out of the advantages of the UK economy, but I believe that we can strengthen those advantages by reforming the European Union and persuading the British people that it is good to remain in the European Union.

**Q20 Lord Skidelsky:** Do I have time for a light-hearted question?

**The Chairman:** Yes, you have. Everyone has been very disciplined so far, so off you go.

**Lord Skidelsky:** Keynes once wrote—this was one of his more famous remarks—that practical men who consider themselves entirely exempt from intellectual influences usually turn out to be the slaves of some defunct economist. I would not for a moment say that you are the slave of anyone or, indeed, exempt from intellectual influences, but which, if any, economist, defunct or living, have you found most helpful in thinking about economic policies during your chancellorship, or indeed before it?

**Mr George Osborne:** The Rogoff/Reinhart work on financial crises has proved to be pretty prescient. They warned us some years ago, when many people were predicting a rapid recovery from financial crisis, that that was not the lesson of financial crises. So if you asked

me to name one economist, or one economic team, I would look to them as having a lot of good insights. As for other influences, I thought that Lord Lawson's chancellorship was pretty successful.

**Lord Lawson of Blaby:** Thank you.

**The Chairman:** On that happy note, we have managed to cover a great deal of ground within the time allowed, including shale, on which we were very anxious to hear your views and on which we will be reporting shortly. Chancellor, thank you very much indeed for responding in the way that you have. You have been crisp but pretty comprehensive in dealing with a lot of our points. We are very grateful and I hope that some time after the Budget Statement we will be able to have another session with you that will not include shale, so we can have longer to deal with the general economic issues. Thank you very much.