HOUSE OF COMMONS

Treasury Committee

Oral evidence: Spring Statement 2022, HC 1226.

Monday 28 March 2022

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Watch the meeting

Members present: Mel Stride (Chair); Harriett Baldwin; Gareth Davies; Angela Eagle; Emma Hardy; Kevin Hollinrake; Alison Thewliss.

Questions 1 - 115

Witnesses

I: Richard Hughes, Chair, Office for Budget Responsibility; Andy King, Member, Budget Responsibility Committee, Office for Budget Responsibility; and Professor David Miles CBE, Member, Budget Responsibility Committee, Office for Budget Responsibility.

Examination of witnesses

Witnesses: Richard Hughes, Andy King and Professor Miles.

Q1 **Chair:** Good morning, and welcome to the Treasury Committee's inquiry hearing into the Spring Statement that the Chancellor has just recently delivered. I am very pleased to be joined by three members of the OBR. I will just ask them briefly to introduce themselves to the Committee.

Richard Hughes: Good morning. I am Richard Hughes, chair of the OBR.

Andy King: I am Andy King. I lead on fiscal issues at the OBR.

Professor Miles: I am David Miles. I focus on economic issues at the OBR.

Q2 **Chair:** Can I start by talking about headroom, because it seems to me that you can look at this Spring Statement in many different ways, but there are three things that I am focusing on? One is whether the Chancellor got the calls right around the level of the headroom, given the improved position compared to the last forecast. Secondly, did he get the balance right between how he played some of that out now as opposed to perhaps a bit further down the line? Thirdly—this is more of a political question—did he play it in the right way, given that he is trying to protect lower-income households predominantly?

Let us start with that first issue. Richard, could you just talk us through what he has had to play with in terms of additional headroom and how the forecasts are better and why, compared with last time, but also what the risks are now around those targets going forward?

Richard Hughes: If you look at the headroom he had against his target to balance the current budget by 2024-25, the amount that he had when we did our forecast back in October was around £25 billion—about 1% of GDP. Since then we have done a new forecast, produced last week, which gave him a £35 billion receipts windfall. Most of that came from income tax—about two thirds of it—and also from higher corporation tax.

He got a £35 billion receipts windfall to add to that £25 billion, but it is important to bear in mind that inflation is good for receipts, but it also puts pressure on public spending, so he lost about two thirds of that receipts windfall—about £20 billion out of the £35 billion windfall—from higher spending, including on debt interest costs. Index-linked debt as well as conventional interest rates went up, and that consumed some of the higher spending. Welfare benefits are also linked to inflation; that consumed some of that receipts windfall as well. That left him with a net improvement in his headroom of around £15 billion to get the current budget balanced by 2024-25, taking the grand total to about £40 billion worth of headroom.

In terms of what the Chancellor did with it in his Spring Statement, he spent about £10 billion of that on cutting the basic rate of income tax by 1p from 20% to 19%. That was basically the main medium-term decision that he made. He also delivered a lot more support in the near term in this fiscal year, but it was essentially temporary support, some of which was recouped over the medium term. That does not really affect the amount of headroom that he had in the medium term.

He banked the remaining £5 billion. Out of the net £15 billion he got, after you take the forecast spending and our forecast receipts, he spent about £10 billion on the 1p cut to the basic rate of income tax, and then he banked about £5 billion of that extra headroom to increase his overall headroom to about £30 billion. He went from £25 billion in October to £30 billion against his fiscal rules this time around.

Q3 **Chair:** Was that £5 billion prudent? If we come on to the risks that you highlight in your forecast report around what happens with the war, what happens to energy prices, the particular risk around interest rates and hence inflation, and also growth, is that enough? Has he been prudent enough? That, given the pressure that is going into the autumn of having to do more to help hard-pressed families, etc., does not seem a lot.

Richard Hughes: To put it in context, £30 billion is around 1% to 1.2% of GDP. That is slightly more than any of his predecessors have had since the OBR was set up. Only Philip Hammond as a Chancellor had more headroom than that.

Q4 **Chair:** Would it be right to say there is far more uncertainty now and in the future than there was in the past, and also that on many occasions targets had to be adjusted because they were not going to be hit?

Richard Hughes: It is a relatively modest amount of headroom even relative to our forecast errors in normal times—in conventional times. One per cent. of GDP is not very much compared with what our forecast errors were even before we had these enormous shocks like the pandemic. Again, the energy price shock can be considered as a once-in-a-generation type of shock to global energy prices. We have not seen rises like this in energy costs since the oil shocks of the 1970s.

The Chancellor is dealing with a much more volatile environment than his predecessors did. He faces risks from the context he is working in of high and volatile energy prices. Even if we just went back to the energy prices we saw a few weeks ago, that could take £7 billion off the headroom that he had. There are still risks around the pandemic we included in our EFO scenario, where you saw a vaccine-escaping variant emerge. In the year that emerged, it could wipe out his headroom entirely if he repeated the same kind of fiscal support.

Q5 **Chair:** On the energy point, Richard, when you cast the figures you actually moved the end point when you took the data, because of the movement in energy prices and what was happening internationally. I know it is a small period of time since then, but what is your feeling? Are you feeling a bit twitchy about where energy prices might go compared to the forecast?

Richard Hughes: The market has been hugely volatile, both in the run-up to producing our forecast and since then. As you say, we kept our forecast open longer than usual. We were planning to close it before the Russian invasion of Ukraine on 24 February. We kept it open so that we could capture some of the market reaction to that, but the market has been trying to figure out what this war means for future energy prices and what the sanctions regimes introduced mean for energy prices since then.

Just to put it into perspective, before the pandemic the price of gas was around 50p per therm. At its peak it went up to £5 a therm after the Russian invasion. When we took a read of the markets it was at about £3 per therm. It has since fallen back to about £2.50. These are enormous moves in energy prices, and where they settle down in large part comes down to where geopolitics emerges over the medium term. For the moment, they do fall back from around £3 per therm down to around £1.20, but we rely on both oil and gas for about three-quarters of our energy here in the UK, so it has a big effect on the macro economy and then also a big effect on the public finances, depending on how things settle down.

Q6 **Chair:** With the primary target, the stock target, what percentage likelihood have you placed on that being met?

Richard Hughes: I think it is a number somewhere in the sixties. It is important to say that that is based on a view of more or less symmetric risks around our forecasts, and we do have to take account of existing Government policy. What we know is that within Government policy there are risks and pressures. For example, the Government are planning a super-indexation of fuel duty next year to recoup the 5p fuel duty cut this year. That would mean that petrol prices rise by 6% in order to deliver that super-indexation.

Q7 **Chair:** On that point, because I know we will come to fuel a bit later, if political pressure is such—and many people think it will be—that he cannot actually deliver that rise again, what would that cost? What would that take out of the headroom?

Richard Hughes: That alone would cost £3.6 billion, just not delivering the super-indexation of fuel duty next year. We are also assuming in our forecast that the real value of benefits is being eroded over time because of delays in the uprating of benefits. It takes a while for benefits uprating to catch up with inflation because of the lags, and that puts around £12 billion of pressure on the public finances. Although £30 billion sounds like a lot of money, just the two things I have mentioned get you halfway there.

Q8 **Chair:** Just getting back to this figure as to how likely it is that you hit the central forecast number, as you look back at those figures in the past, do you think that they have been generally realistic, or that they have been over-optimistic or pessimistic? What is your view generally of the track record of the OBR in that respect across different fiscal events?

Richard Hughes: A challenge that we and all forecasters face is that our models are based on a reversion to the mean over the medium term. We are not catastrophists. We do not forecast recessions coming if we do not see them in the data, but we know that recessions come roughly once a decade and bigger shocks like financial crises come once every 20 years. They can have much more lasting effects than recessions do, and we do not forecast recessions.

Q9 **Chair:** What has the performance been, as you look back over previous fiscal forecasts? You have said there is an X percent chance that these targets will be met. Do you think, by and large, the forecasting has been, in that respect, overly optimistic, pessimistic or about right?

Richard Hughes: Most of these rules have been missed. In our time they have been missed partly because we have had a pandemic and we faced shocks that were not in our forecast, and therefore Government have had to deal with them. The other reason that we miss our forecast is that we condition them on the basis of Government policy, but Government's policy responses to shocks is asymmetric. When they get good news, they spend it, and that brings them back to our forecast. When they get bad news, they also spend, because they have to protect the economy, and that pushes them further away from our forecast as well.

The policy risks around our forecast are not symmetrically distributed around the mean. They are skewed toward the downside, and we cannot anticipate what Government are going to do. First, we do not anticipate recessions, and, secondly, we do not anticipate what Governments do in response to recessions, nor can we anticipate what they would do in response to windfalls, because we have to condition what we are forecasting on Government policy.

Q10 **Chair:** Can we quickly talk about the income tax element of what the Chancellor did as compared to the more immediate measures that he brought in? Could you just talk us through what the choices were around that in financial terms? Crudely speaking, he has an amount of money to put into these various measures. What if he had not done the IT change and he pulled forward some of the support nearer into the present than 2024? Could you just talk us through that, please?

Richard Hughes: The income tax change cost him around £9 billion to £10 billion over the medium term, and used up two thirds of the additional headroom that the forecast had given him over the medium term.

One thing that is important to emphasise about his fiscal rules is that they are based on a rolling three-year horizon, which means it only really matters what you are doing in the medium term. He has much more flexibility in the near term about what he wants to do, so long as whatever he does is temporary. Temporary support that is withdrawn does not affect what happens to the current balance and debt falling in 2024-25, because in essence there is no echo from that; there are no repercussions from that.

You can perhaps see that in some of the judgments he has made about the nature of the support he has provided, because the energy price support is an effect alone that is recouped from future energy bills. As I said, the cut to the fuel duty rate is recouped the following year by over-indexing fuel duty by the amount of the fuel duty cuts, so there is an attempt to repair the public finances over the medium term and to keep the damage to the public finances limited to just next year.

Q11 **Chair:** So what you are saying, just to recap, is an interesting point. If you do something that is temporary and you withdraw it before the effect on the three-year target, of course, it has all come out in the wash by the time that comes around.

Richard Hughes: Indeed, because the balance target is for the current balance, so long as you get the tax and spending back to where you need to be. Also, the debt target is to get debt falling, not to get debt below a certain level, so as long as it is falling from that level and is on a downward trajectory, it does not matter where it is falling from.

Q12 **Chair:** Just on that point, and this idea that he has to be able to withdraw these things in order for that situation to come into effect, along with fuel, what else is there in the announcement that is in that category of a short-term boost that is then being withdrawn?

Richard Hughes: The energy support is provided.

Q13 **Chair:** The loan element is a loan element, so that takes care of itself, but there is the council tax reduction of £150. Of the £9 billion-odd that goes towards all of that, how much of that is for the council tax rebate? Presumably about 40% of it. Would that be about right?

Andy King: Some £3 billion is for the council tax rebate and £6 billion is for the energy bills reduction. It is the £6 billion that is recouped over the subsequent five years.

Q14 **Dame Angela Eagle:** Richard, your latest economic and fiscal outlook notes that the rise in inflation to a 40-year high is expected to reduce real household disposable incomes on a per-person basis by 2.2% in the coming financial year, which is the biggest fall in living standards in any financial year since ONS records began in 1956-57. Can you set out for us what such falls in living standards mean in practical terms? Also, they are not evenly distributed, are they?

Richard Hughes: No, that is right. The hit to living standards comes in very large part from the fact that this is a terms of trade shock to the UK economy. We are a net importer of energy, and in particular we get about three-quarters of our energy from oil and gas. Oil and gas prices had already begun to rise over the course of the autumn, and this dates back to the supply bottlenecks that we have been talking about in our last forecast. They have been exacerbated now by this supply shock brought about by the Russian invasion of Ukraine and international sanctions, which has pushed both those prices up even further.

The cost of living squeeze comes in large part from the fact that inflation is outpacing growth in real earnings. You have 8.7% inflation, about 7.4% on an annual basis. We have actually revised up our forecast for nominal earnings growth because we have a tighter labour market than we thought. We think that there is going to be some reaction of wages to these cost of living pressures, but not enough to keep pace with inflation. That mismatch between inflation and earnings growth drives about two thirds of the fall in living standards in the coming financial year, but about another third is due to the tax and benefit changes that are coming in from 1 April as well.

Q15 **Dame Angela Eagle:** By that do you mean the freezing of the income tax threshold and the increase in national insurance contributions for the health and social care levy, albeit mitigated in part by the increase in thresholds? Some of that does not affect those at the lower level of earnings, does it?

Richard Hughes: That is right. Also, people on lower incomes tend to spend more of their household budgets on energy, so they get hit harder in percentage terms by the rise of energy costs. One should note that the support the Government are providing is flat rate; if you are in the council tax support or the support for energy bills, they get as much support as anybody higher up the income scale. As a share of their incomes they are also getting more support from the Government on that side.

Q16 **Dame Angela Eagle:** The original design prior to these extra price increases was meant to offset about half of the increase in energy costs. It is now expected to only offset about a fifth. Is that right?

Richard Hughes: Andy will correct me if I am wrong, but if you take the fuel duty change and the increase in the personal allowance, you are still offsetting around half of the total increase in energy costs.

Q17 **Dame Angela Eagle:** Not everyone has a car, and 55% of the bottom 10% of earners do not drive.

Richard Hughes: That is true, and not everybody is earning above the personal allowance either.

Q18 **Dame Angela Eagle:** Those who are on lower fixed incomes get less help than those who are earning enough to pay national insurance in the first place.

Richard Hughes: Yes, that is right.

Q19 **Dame Angela Eagle:** The analysis shows that the rise in living costs and the cost of living for those who are at the very lower end, on fixed incomes or on benefits, is as high as 6%, not the 2% fall in living standards. What sort of things might the Chancellor have done to target them?

Richard Hughes: It is not really for us to speculate about what the Government could have done in their forecast. We do point out that there are risks and pressures on the public finances from the nature of the way in which benefits are indexed. One of the reasons why living standards are falling in the coming year is the fact that benefits are indexed to September inflation.

Dame Angela Eagle: It is a retrospective indexation.

Richard Hughes: Indeed, which means that in April benefits can be uprated by what inflation was in September, which was around 3%. One of the things that is driving the fall in living standards from this April is the fact that it takes a while for benefits to then catch up with rising inflation. They do eventually, but it takes about 18 months for that whole process to run its course. The indexation regime works fine as long as inflation is running at a stable rate, because one year’s indexation is the same as last year’s. The issue at the moment is we have accelerating inflation, and so, for the next 18 months at least, the uprating of benefits is going to fall behind, in real terms, where inflation is actually going.

Q20 **Dame Angela Eagle:** In your forecast you state that there will be a 5% fall in the real value of social security benefits in 2022-23. Is that an unprecedented fall in their value?

Richard Hughes: I have been talking a lot. I might ask my colleague, Andy, if he could say any more about putting that number in context.

Andy King: I do not have a figure. I do not have a historical series in front of me. I cannot recall a 5% real-terms decline.

Q21 **Dame Angela Eagle:** Neither can I. What is the monetary value of the effective real-terms cut to benefits that we see with this 5%?

Andy King: I think it is around £12 billion in real terms in our forecast.

Q22 **Dame Angela Eagle:** The Chancellor has made available what equals a household support fund, which is going to have £500 million extra, which brings it to £1 billion. It is fair to say that he saved £12 billion by allowing the real value of benefits to be cut, and he has given £1 billion back.

Andy King: The real-terms fall in benefits is £12 billion in the forecast, yes. I recognise those figures for the household support fund as well.

Q23 **Dame Angela Eagle:** This is a pretty poorly designed and poorly targeted support for those who are the poorest, would you not agree?

Richard Hughes: One issue is that the Chancellor has used a combination of the council tax system, support with energy bills and then the tax system to deliver support and relief for people facing this cost of living squeeze, rather than the benefit system. One of the limitations of that is that you are limited by how many people you can reach through the tax system, income tax and the national insurance system. If people are not in work or they are not working the number of hours they need to get them beyond the personal allowances and thresholds, they are more difficult to reach through the tax system than they would be through something like universal credit, which reaches people lower down the income scale and also people who are out of work.

Q24 **Dame Angela Eagle:** In his speech, the Chancellor said that this was a tax-cutting fiscal event and that he was a tax-cutting Chancellor. Your analysis shows that the UK's tax burden has noticeably gone up. Can you explain what has been going on?

Richard Hughes: This was a tax-cutting fiscal event, but I suppose you have to put it into the context of all the decisions that this Chancellor has made about taxes since coming to office. It is true that he has raised the personal allowance for national insurance in the coming year. He is cutting 1p off the basic rate of income tax over the medium term, but since coming to office he has also announced significant tax rises, both in corporation tax and to personal taxes. If you put the 1p cut to the basic rate of income tax by the mid-2020s in context, that undoes about one sixth of the total tax rises that this Chancellor has introduced since coming into office.

Q25 **Dame Angela Eagle:** Another way of putting that is that for every £6 of tax increases he has given £1 back.

Richard Hughes: Yes.

Q26 **Dame Angela Eagle:** So that means that taxes have gone up £5.

Richard Hughes: Yes, and they are to pay for a larger state that he has also announced, both a state that is investing more, but also a state that is spending more on health and social care and on other things. It is paying for the state, which was announced back in the October spending review, which was spending about 2% of GDP more than we were before the pandemic.

Q27 **Dame Angela Eagle:** The Institute for Fiscal Studies has shown that because the income tax threshold is being frozen—something the Chancellor did not talk about a lot in his Spring Statement—the tax yield for income tax continues to rise, even in the year in which the income tax rate cut comes into effect. He is offsetting the 1p cut announced for 2024 because of the increases in income tax thresholds, because he has expressed those in cash terms. Even when the 1p cut comes in, the yield from income tax continues to rise. Can this, therefore, in any way be expressed as a tax cut?

Richard Hughes: Looking at personal taxes alone and what has been announced, the 1p cut to the basic rate of income tax reduces the overall rise in personal taxes by about a quarter but, as you say, because of the 1.25% of the health and social care levy and the freezing of the personal allowances for income tax and national insurance, especially in the context of higher inflation, that is bringing millions of people more into the tax system.

Dame Angela Eagle: There is so-called fiscal drag.

Richard Hughes: There is fiscal drag and more people are brought into being higher-rate taxpayers. In net terms he has offset about a quarter of that overall rise in the personal tax burden with the 1p cut, but overall personal taxes are going up.

Professor Miles: I just have a point about disposable income, on average, going down by 2.2%. I suspect there will be very few people who will not feel a real cut in their standard of living. Inflation, which until recently we thought might be 3% or 3.5%, is going to be 7.5%. It could be 9% in the autumn.

Q28 **Dame Angela Eagle:** That is CPI, not RPI.

Professor Miles: That is CPI.

Q29 **Dame Angela Eagle:** The Retail Prices Index includes the cost of housing. Most people pay the cost of housing, so although we all go on about CPI, RPI is something that most people experience personally if they are paying for their housing costs. That is 11%.

Professor Miles: That will be 1.5% or so more, yes. It is very likely to be 10% or slightly more than 10% this year. Very few people will see their after-tax earnings rising by anything like the same amount. Across the board pretty much everybody will lose. You are right that some people will be relatively better protected than others.

Just on the tax changes in themselves, I think I am right in saying that the national insurance changes—both the increase in the rate that was announced before and then the higher allowance—are, in themselves, redistributive. I recall the IFS analysis just after the Budget, which said something like that anybody who is earning £25,000 or more this year will end up paying more, and anybody who is earning less than £25,000 will pay either less or be unaffected by it.

The tax changes in themselves are redistributive, although you are right that it is highly likely that energy costs, which are the biggest reason why inflation is going up, are a higher proportion of the incomes of people who are less well off. It is quite a complicated picture, in a sense, on the redistributive element of this, but one thing I am very confident of is that pretty much everybody is going to take a significant hit to their real standard of living this year.

Q30 **Dame Angela Eagle:** The Resolution Foundation said that 1.3 million extra people would be put into absolute poverty by the cumulative effect of these changes, including 500,000 children. That surely implies that those on lower and fixed incomes are going to feel this pain a lot more than those who are earning. Everyone will feel their cost of living squeezed, but the effects are going to be particularly concentrated on those who really cannot increase their income because they cannot work, or they are on fixed benefits. That is pensioners and those who perhaps have disabilities or caring responsibilities.

Richard Hughes: That is correct. We have increased our forecast for nominal earnings, so we do expect people who are working to be able to offset at least some of the inflationary pressure compared to what they have seen in the past. The issue is with people on benefits. We have earnings of 5.3% and benefits being updated by just 3.1%, so they are feeling more of a squeeze than people who are managing to get some of their income from earnings.

Q31 **Dame Angela Eagle:** Did the changes in student loans, which are the single largest revenue-raiser in the scorecard—I think about £11 billion, off the top of my head—score as an increase in the tax burden?

Andy King: No, that is a reduction in the amount of spending that is recorded for the portion of student loans that is not expected to be repaid. It is one for the accounting enthusiasts.

Q32 **Dame Angela Eagle:** That is rather convenient for the Treasury though. It rather implies that any time they want to gather in more income without affecting the so-called tax burden then they just hit poor old graduates again.

Andy King: "Convenient" is not a word that you would want from the OBR, but it is a genuine fiscal saving. In terms of the accounting treatment for student loans previously, measures like this would not have touched the sides in the numbers that you could see in our forecast, because the effects are 30 years down the line.

Q33 **Dame Angela Eagle:** By its nature, these numbers are going to get bigger and bigger as more people take out loans. Are we treating them correctly in the way that we are measuring things as this gets to be a bigger and bigger, more significant number?

Andy King: It is a complicated treatment, but it is certainly better than the previous treatment, which was just to look at the cashflows and to say, "Look, this loan has been issued. It is called a loan; therefore, it does not affect the accrued measure of borrowing at all because it is going to be repaid." Of course, when the loan was issued, everyone knew that a large proportion of it would not be repaid. Those costs are now recorded up front, and when reforms come in that reduce those costs it shows as a saving.

The accounting is complicated but it is better. It might not be a coincidence that the system got more and more expensive before the costs were recognised up front and that has been reformed to make it less expensive once the costs are recorded up front.

Q34 **Dame Angela Eagle:** Finally, Richard, the fact that the Chancellor expressed the departmental spending totals in his October statement in cash terms and the fact that we might be looking at inflation of 9% or 11% implies a real-terms reduction in the spending power of Departments. It also implies, does it not, a virtual standstill for public sector pay?

Richard Hughes: It does erode the real value of those budgets compared with what was anticipated when they were set back in October. Depending on the index of inflation you use to measure the real value of that spending, the erosion is anywhere between £5 billion and £17 billion. If you use the GDP deflator it is a lower number. If you use CPI it is a higher number.

In terms of what it means for public sector pay, we have not yet seen much out of Government about their plans for public sector pay within those budgets. What we have seen so far suggests that they are getting below inflation pay rises for some key workers. We have seen that in education, and we will have to see what comes out of other pay settlements set by the other pay review bodies.

Q35 **Chair:** Can I very quickly go back to tax and the points that David was beginning to move into? Overall, over his two years, the Chancellor has raised the tax burden, but in this particular fiscal event he started on a downward trajectory. That is basically what has happened. In terms of who has paid the costs in terms of the distributional analysis of the tax rises and who has had the benefits of the tax reductions—proportionally, at least—what would your comments be? Would it be right to say that those with the broadest shoulders have borne proportionally more of the cost of the rises, and those with the narrow shoulders have borne more of the benefit of the tax reductions, or is that not the case?

Richard Hughes: I should say at some point that we are not experts in distributional analysis and it is not something that we feature as a regular part of our forecast, partly because we have some very good institutions, which I know you are going to see, that do this very well, such as the IFS and the Resolution Foundation. Because of the nature of the tax rises, it is the case that more of the tax is raised from those better off, because there are increases in the rates, because they go all the way up the income distribution and because so much of our tax take comes from the higher end of the income distribution. The tax changes are progressive in that sense.

Because the support that is being provided for energy costs in the near term is being provided in flat rate cash terms, it does provide proportionately more benefit to people at the lower end of the income scale than it does to people at the top end of the income scale, because everybody gets £150 regardless of their level of income.

Q36 **Emma Hardy:** Good afternoon, everyone. I want to ask a bit about the support for households with energy bills. First, would you class the energy bill rebate as a rebate or a loan?

Andy King: For those who are energy bill payers for all of the six years that the rebate and the clawback are in place, it will feel a lot like a loan, because you receive the money and you pay it back in instalments. In statistical terms, we do not know yet what the ONS will say, but I would expect it to be treated as spending in tax rather than loan and repayment, because it is levied on all energy bills. If you move out of home in two years' time and set up, you will pay the £40 a year clawback. It will not feel like a loan to you because you did not get the rebate. I guess it will feel like a loan to most, and not to some.

Q37 **Emma Hardy:** Within your forecast you said there were classification issues around both the council tax rebate and the energy rebate, and that the ONS is still working through as to whether they are rebates or loans. Can you explain what the implications are for public finances for those different classifications?

Andy King: The council tax rebate has been classified as public spending because it does not change someone's council tax liability. It is not a tax cut; it is a public spending measure. The energy bill discount looks similar, but the ONS needs to work that through. As it says, the subsequent clawback looks like a tax in statistical terms. None of these has any implications for the public finances, other than whether something is recorded as positive spending. The borrowing effects are all the same.

Perhaps the bigger issue is how the energy bills elements are going to be treated for inflation. You can make a case either way for these being things that do affect inflation or do not. The distinction is typically whether the money that is given to households is treated as being income for the households or changes their energy bills. Because measured inflation has lots of impacts on the public finances, from debt interest to all the things we have been talking about with indexation, that would have knock-on implications. We have assumed for this forecast that neither part of the energy bill measure will affect inflation. If the ONS decides otherwise, we will update that in the autumn.

Q38 **Emma Hardy:** Earlier you highlighted the issue that some people who were not in receipt of this energy rebate will end up paying for it in the future. You mentioned if you are someone living at home and you move out, you will end up having to pay for this. You will be aware that Martin Lewis has called for this to be scrapped, because he said, "If rates do not drop or do not drop a lot, people will be left in a lose-lose situation, with far higher bills now and an additional levy on top." Do you agree that the Government should be offering some kind of opt-out for this loan or not loan?

Andy King: I am afraid that is not one for the OBR to comment on. The thing that I can say is that within our forecast, and therefore the forecast that underpins the policy decisions, energy prices fall back very sharply. That is based on what the futures markets think. Now, if that proves not to be the case when we come to produce our next forecast, or indeed whenever the Chancellor next comes to think about these policy settings, the world will have changed. You can imagine that that will be factored into any decisions that are taken, but within this forecast the fuel duty super-indexation and the energy bills recouping measure happen when energy prices are falling back sharply.

Q39 **Emma Hardy:** Do you think the assumption that prices are expected to come down in 2023 is a realistic one? Were these assumptions made before the war in Ukraine, for example? How realistic is it that prices are going to drop a lot?

Andy King: These assumptions are drawn on what financial markets thought one week into the invasion. They are post-invasion, but essentially an initial view. Energy prices today are not dissimilar to those. They have been very volatile, but they are currently in a similar place. What is priced into markets is that this is a period of disruption that lasts this year and falls away next year. I have not looked at options prices, but I imagine the uncertainty around this is pretty great.

Q40 **Emma Hardy:** I have read some evidence that there could be a situation where the Chancellor recoups more in terms of payments than he has actually put out in terms of rebate. Is that accurate, and under what circumstances could that happen?

Andy King: That was my initial impression, but that is not the case. The policy is designed to recoup precisely what goes out the door; it is a £200 rebate and then it is up to £40 a year in recouping. The number of households and therefore the number of electricity meters in the country is growing steadily. If you did precisely £40 for five years, you would recoup more money than was paid out, but my understanding is that is not the design of the policy. The rate will either be a little bit less than £40, or in the fifth year it will be less than, but these things are being consulted on this year.

Q41 **Emma Hardy:** Would you be expecting the Chancellor to be announcing each year exactly what level of clawback he would be taking? Would you expect him to take into account other issues related to the cost of living when he makes that decision, or do you expect it to be purely based on how many more households there are so he gets back the exact same amount that he put in?

Andy King: These are the details that are being consulted on. The numbers that are in our forecast are based on recouping the precise amount of the outlay in October, but whether it is part of the energy cap announcement each year or whether it is something else are the details that are being consulted on.

Q42 **Emma Hardy:** When would you expect the Chancellor to make an announcement on exactly how much people can be expecting to pay in the future?

Andy King: I am afraid I do not know that.

Q43 **Emma Hardy:** Do you know when the consultation is going to end?

Andy King: No. The consultation is coming soon but I do not know the end date, I am afraid.

Q44 **Emma Hardy:** Two weeks ago we heard from oil and gas experts who told us that high prices are "going to last for a while. This is not just for this year…This is going to be a cost of living crisis for people for a long time to come". Would anyone else like to comment on that?

Richard Hughes: As Andy said, our forecasts are premised on what the financial markets think about the future price of oil and gas, which are our main energy imports. The price of gas does fall back from its current level of around £2.50 to £3 per therm down to about £1.20, but that is considerably above where gas prices were before the pandemic and before we saw this surge in energy prices, starting with the recovery from the pandemic and then being supercharged by the Russian invasion of Ukraine. They do not fall back to the levels of gas prices that we saw in 2019. They are still seemingly elevated.

The same is true of oil. It falls back from over $100 a barrel to around $80 a barrel on the futures markets, but that is still well above the relatively low prices we saw before the pandemic. At the moment markets are pricing this in as a permanent increase in the cost of the UK economy doing business if it continues to use energy the way it does now.

One thing to bear in mind, however, is that there is a risk premium in there that is being priced in. There is a lot of uncertainty about the future. If the war in Ukraine resolves itself more quickly, and if the sanctions regime is eased and supply comes onstream, that uncertainty starts to ease, and maybe prices fall back by more. For the moment we take what the markets think is going to happen.

Professor Miles: The volatility in the last few weeks since the invasion is really extraordinary. There was a moment intraday where the price of short-term futures contracts for gas were up at 800p a therm. We used a date where the average over the last five days has been about 300. This morning it is 240. Today's price is meaningfully lower than the projection that we used, but in the intervening period it went up to 800. It is very hard to be confident about where it will be even a month ahead, let alone two or three years down the road.

Q45 **Emma Hardy:** What do you think the overall impact on the cost of living will be with prices being as volatile, taken into account the loan or not loan that the Chancellor has introduced?

Professor Miles: As I am sure you know, the way the Ofgem price cap is set basically relies on looking at average prices over quite a long period leading up to when they set the cap. They take an average over six months. That number is much less volatile than the month to month, even, let alone the day to day, but you cannot get around the fact that the futures prices that we use do imply, as Richard said, quite a significant fallback, at least a couple of years down the road. If that is not true, energy prices will be very substantially higher for longer. That will have a very significant impact on disposable incomes if it turns out to be the case.

Q46 **Emma Hardy:** As we have mentioned, the Chancellor has the ability to set this £40 limit wherever he sees fit. Would you expect at that point that to be taken into account when looking at how much money he wants to take back off people?

Professor Miles: I am sure future Government decisions will be sensitive to the position at the time. It comes back to the questions about headroom, why it is there and whether it is enough. The headroom has gone up by a meaningful amount, but in an environment where the amount of uncertainty is even higher than one might have expected a couple of years ago when we were beginning to see how bad Covid was.

Just to take a slightly longer-term perspective, in the last 14 years, three things have happened that most economists would have said in the past were once in 40 or 50-year events. We have had three of them in 14 years: the global financial crisis; Covid; and now war in eastern Europe. That is why the stock of Government debt is just so much higher than anybody thought conceivable in 2007 or 2008, which sounds like 100 years ago, but was just before the financial crisis.

Emma Hardy: We are cursed to live in interesting times.

Q47 **Chair:** That is certainly one description for it. Can I just quickly come back to this issue of the uprating of benefits pegged to the 3.1% in September, but rising, and therefore this very large impact, particularly on those who are not benefiting from being in work and on benefits? What are the options around smoothing that in some way, so that you could provide a higher rate now, but maybe some mechanism where it is lowered further on as inflation comes down. Was that something that you were asked to look at at all?

Richard Hughes: We cannot really comment on what we were asked to look at in terms of potential policies. Andy, do you want to say something about what has been done in the past?

Andy King: The most recent example is what happened in 2020 as the pandemic struck. You saw that the Government were able to put the £20 a week uplift into all universal credit awards. Last autumn the universal credit taper and work allowances were changed, which affects in-work universal credit households but not out-of-work ones. There are a couple of recent examples of what has been done.

Richard Hughes: The operating by September RPI is the default; that can obviously be overridden if the Government choose to do so. I think that is through secondary legislation, but I could be wrong.

Q48 **Chair:** Twelve billion was the figure that would be required had the uprating been in line with inflation through the year. What proportion of that do you think relates to those who are out of work and in benefits, and not benefiting from the taper, for example?

Andy King: I do not have a precise figure. Roughly half is pension and benefits, and roughly half is working age. I am afraid I do not have the precise figure for in work versus out of work of the working age, but, again, it will not be a million miles away from half and half.

Q49 **Chair:** So it is about a quarter, possibly, or in that ballpark.

Andy King: Yes, possibly.

Q50 **Kevin Hollinrake:** Looking at the two national insurance changes—the health and social care levy and then the threshold changes—the levy was going to raise about £14 billion, and £1 billion was then set aside to offset public sector wages to compensate for that rise, so a net of £13 billion. With the changes to the threshold, has that figure been cut?

Andy King: Yes. The national insurance threshold change cost about £500 million to £600 million a year in terms of the health and social care levy itself.

Q51 **Kevin Hollinrake:** It is probably £12.5 billion now, net, rather than the £13 billion that was suggested at the start. Is that right?

Andy King: There are other changes as well, as we have been talking about earlier. We have revised up our tax forecasts in general. One of the reasons for that is a somewhat higher outlook for wages and salaries in cash terms. Obviously they are being hit quite hard in real terms, but in cash terms they are higher. The forecast revenue from the health and social care levy prior to the national insurance measure had been revised up around £700 million to £800 million a year. Actually, in net terms, we have revised it up.

Q52 **Kevin Hollinrake:** Looking at the health and social care levy, the overall take, despite the increase in threshold, is actually positive. You get more money off that based on higher wages.

Andy King: Yes.

Q53 **Kevin Hollinrake:** That is by about £200 million a year.

Andy King: Yes, £100 million to £200 million.

Q54 **Kevin Hollinrake:** Obviously that is hypothecated. We do not have a great track record when it comes to hypothecation and things staying hypothecated. Is it going to work this time?

Andy King: The Chancellor’s words were that every penny will be spent on health and social care. The health and social care levy obviously raises much less money than is spent on the NHS in total. The hypothecation is not in legislation. It does not flow from one's tax payment to the NHS. It goes via the general fund like everything else. The NHS budgets were not changed in the Spring Statement. In effect, other sources of funding are modestly lower.

Q55 **Kevin Hollinrake:** Are you saying the health and social care levy will be the vehicle for increases in health spending in the future? Is that what you understand from the Chancellor?

Andy King: No. I am simply saying that, for all of the health and social care levy to be spent on the NHS, the proportion of NHS spending that is financed via other means—other taxes—will vary.

Q56 **Kevin Hollinrake:** Of course, initially it is going to be spent primarily on healthcare and then move towards social care. Is that your understanding of how that levy is going to work in the medium to longer term?

Andy King: Yes, that is my understanding.

Q57 **Kevin Hollinrake:** Of the £13 billion that has been raised, what proportion is going to go to healthcare versus social care?

Andy King: I do not recall these figures. These are from the autumn, are they not? They are initially focused on catch-up spending in healthcare and then moving progressively towards social care.

Q58 **Kevin Hollinrake:** Was it needed? Some people will say that we needed the spending on the health service and social care but we should not have raised anything at all; we should have just borrowed. Is that something that would have been a problem for the UK in terms of market confidence?

Richard Hughes: The issue with the tax rises was that, when the Government set out their spending plans back in October for the next three years, they did plan for a bigger state—about 2% of GDP more. Much of that was a rise in healthcare spending, which has continued to grow faster than the growth rate of the economy. If that was to be paid for by not borrowing in perpetuity and therefore also continuing to accumulate more and more debt in normal times—we are forecasting at some point a return to normal times—and if the Government do not want to just keep accumulating debt to pay for a larger health service, there was going to need to be some rise in the tax burden to deal with that.

Also bear in mind the fact that there are fewer and fewer people in work for every person in retirement, and those people are more likely to be consuming healthcare services. If the country wants the health service that it is being promised by this Government, it has to pay for it somehow in the long run.

Q59 **Kevin Hollinrake:** Is that through tax rises?

Richard Hughes: To allow debt to accumulate forever to pay for a health service that you are not funding out of annual tax revenue is going to get you into trouble at some point.

Q60 **Kevin Hollinrake:** What kind of trouble?

Richard Hughes: At some point markets take a look at your debt as an investable proposition and worry at some point about whether you are going to be able to pay it back.

Q61 **Kevin Hollinrake:** Could you not borrow more? It would be more expensive to borrow more.

Richard Hughes: These things tend to get worse slowly and then they get worse more quickly. You saw in the eurozone fiscal crises that there were countries whose borrowing costs were very low for very long periods of time, and then suddenly they were reappraised by markets and their borrowing costs shot up, because it looked as though they were going to struggle to service their debts.

I should stress that, where we are now, in the 80% to 90% of GDP debt levels, those are eminently affordable for an advanced economy with a broad tax base, a growing economy and access to the global pool of savings, but you do not take that for granted. Interest rates have risen even since our October forecast. One of the things that was consuming the Chancellor's headroom in this forecast was £9 billion more in debt interest over the medium term from the fact that interest rates are starting to rise. Previous Chancellors benefited from falling interest rates, giving them more and more wiggle room to spend. That is no longer the case. Increasingly, public spending is being eaten up by the rising cost of servicing debt.

Q62 **Kevin Hollinrake:** Which countries were you referring to in terms of their debt becoming more expensive?

Richard Hughes: Greece’s interest payments went up into double digits in the run up to the eurozone financial crisis. The same was true of Portugal, Ireland and other countries.

Professor Miles: Italy as well.

Richard Hughes: Had the international community not stepped in with a loan, they probably would not have been able to service their debt.

Q63 **Kevin Hollinrake:** The health and social care levy is a broad-based taxation in terms of the fact that everybody is contributing towards that, and it affects people's real wages as a result. The Government are taking some of that to give to public sector workers. Is that what will happen to private sector workers? Not necessarily, but employers might decide to do it. Is it fair that part of their taxes are going to compensate public sector workers for the rise in tax rates?

Richard Hughes: It is not for us to comment on whether it is fair or not.

Kevin Hollinrake: That is what is happening.

Richard Hughes: It is the case. I do not know whether Andy could say more about what it means for the public finances.

Andy King: All of the money could have been allocated to health, and then other public sector employers, if they were not compensated, could have reduced the volume of public services they provided. They could have cut real wages with whatever effects. It was a choice within the public sector of how you want this tax rise to affect health and non-health public services. You are quite right that within the private sector our forecast assumes that the employer component of this tax rise will eventually be passed back in lower real wages, partly through prices and partly through lower pay settlements, than would otherwise have been the case.

Q64 **Kevin Hollinrake:** It is a double whammy for private sector workers then, because they are going to lose 1.25% off their wages and they are probably going to lose the employer contribution because it comes off pay settlements.

Andy King: That is right. The incidence of a payroll tax like national insurance or the health and social care levy is ultimately on employees.

Kevin Hollinrake: Not public sector employees—they are being compensated for that.

Andy King: Yes, that is how I understand the policy to have been implemented.

Q65 **Alison Thewliss:** I have some questions around economic growth. The Chancellor made a lot of play of the UK economy having the highest rate of growth in the G7 in the Autumn Budget. Your growth figures for this year are down from 6% to 3.8%. Could you tell us a wee bit more about that?

Professor Miles: It is a big reduction in the growth of the economy. It is what we have been talking about. It is a hit to disposable income. It is the fact that things that we import and we need and cannot substitute away from have gone up in price so very much. That hits disposable income and then it hits consumption. That is the biggest part of the downgrade in the growth.

In an ordinary year, in a sense, if you had seen the level of growth fall relative to where we thought it would be, by 2.5%, we would be in a recession, but since we are in a recovery phase and we thought GDP was going to grow so rapidly anyway, it merely goes from 6% to 3.8%. Of course, 3.8% historically is a big number, but it is nonetheless a big hit to GDP this year. The biggest part of it is weaker consumption spending. We are having to spend more on things we import and less on stuff that is produced in the UK. That is the big story.

There is another slight effect. After the October EFO of last year there were some revisions to back data. The Blue Book changed its assessment of how big the UK economy was. That would have made the growth rate slightly lower than 6% anyway, so that is nothing to do with energy prices or a hit to disposable income. In a sense that was just a statistical artifact of some changes, but the bigger story is just the hit to disposable income.

Q66 **Alison Thewliss:** In previous sessions when you have been here, you have talked about the impact that Covid would have in terms of scarring and the impact that Brexit would have. Is it possible to pull that out from the figures here?

Professor Miles: In terms of the longer-term scarring effect of Covid, we looked at the numbers again. The overall hit is still the same order of magnitude. It is around about 2% in the medium term. It has changed a bit in its composition. It now looks like a bit more of it is a result of the size of the labour force in the UK. The number of people working is likely to be lower. That is partly to do with illnesses, the long-term effects of Covid and slightly lower net migration into the UK. That looks like it is a bigger part of the 2% hit. The good news is that our assessment—"best guess" is probably a better phrase—of the productivity hit is a bit lower, but you are still left with a 2% number for how much smaller the UK economy will be in the long term than had there not been Covid.

On the Brexit work, I think I am right in saying—I only joined the OBR at the beginning of this year—that we have not revisited the assessment made in the past in any great detail this time around. It looked to me as though one part of that assessment, which is the size of the reduction in the amount of net trade the UK does, seems broadly consistent with how things are playing out.

The big unknown there, which to my mind gives more uncertainty about Brexit effects than about Covid effects, is the impact on productivity of the UK economy doing somewhat less trade than it otherwise would. There is enormous uncertainty in that area. My own view would be that the Covid judgment is one that you can have somewhat more confidence about than the Brexit one.

Q67 **Alison Thewliss:** Your forecast included charts that show a clearly observable deviation between the UK's trade intensity and export volumes compared to similar economies since it left the EU, suggesting that leaving the EU is leading to a significant reduction in UK trade. Can you tell me a bit more about those as well? These are the graphs on page 63 and 64.

Professor Miles: There is a chart on page 64, yes, which shows trade intensity of GDP for the UK and then a swathe of numbers for other G7 countries. As you say, the UK has fallen outside that range for most other countries. I would say that is consistent with the judgment the OBR made in the past, which was that the long-term effect of Brexit might mean that the amount of exports and imports from the UK in and out will be of the order of 15% lower than it might have been without Brexit.

Although there is lots of noise in the data, given the Covid effects, bottlenecks around the world and all that, what we are seeing so far is at least consistent with the judgment that was made in the past—I do not say that it strongly proves the 15% number. As I said, the area of greater uncertainty is around the implication of that for real incomes and productivity in the UK. That is a foggier picture.

Q68 **Alison Thewliss:** The graph on page 63 highlights the difference between goods trade and services trade. Services trade would appear to be pretty much on the floor. It is suggested in your analysis that this may have something to do with tourism and that kind of thing. How much would you apportion to that? How much of that would be apportioned to the lack of a trade in services agreement?

Professor Miles: Tourism was hit enormously hard in 2021. I doubt whether it has recovered very much in this year either. That is a pretty big factor. I suspect that this big fall in services trade will be true for a lot of European countries as well. That is probably the biggest single factor on that one.

Q69 **Alison Thewliss:** You mentioned that there are around 400,000 fewer people in the labour market than forecast. How much of that is to do with migration? How much of that is to do with other factors? Will things like the Nationality and Borders Bill making it more difficult for people to come and work here make that worse?

Professor Miles: Relative to pre-pandemic, the labour force in the UK is down by a lot. It is down by something like 600,000 or 650,000 or so. The bigger part of that is people who were in the UK and who have left the labour force. Some of them are students—people who decided not to join the labour force but go to university or stay in higher education. There are then people who have left the labour force, predominantly people aged over 50. It is a bit difficult to know how much of that is permanent and how many of those people might come back. Then, finally, it is not so much about immigrants in the UK who have left, but more about the migrants who you thought would be coming but who did not.

The longer-term assessment that we have made, this time around, is that, of that 650,000-odd, there is a permanent negative impact from the migrants who did not come. We do not think they are now going to come. In terms of the labour force, that might lose you something like a third of that amount, so 200,000 or so. In terms of the participation rate being lower and people having left the labour force or stayed in higher education, half of them will not come back either. You lose another 200,000-odd there. The labour force in the longer term could be something like 400,000 lower than it would have been without the pandemic.

Q70 **Alison Thewliss:** Is there any analysis that you have seen about how that is distributed across the country? There is some suggestion that perhaps rural places have lost out because of migration and people not coming from the EU.

Professor Miles: We certainly have not done that analysis. I suspect it is quite different across different bits of the UK. There may be some rural areas where you rely very highly on temporary migrant labour where they have seen very few people coming in. That is a very big impact. There, again, you might see more of a recovery in that quite quickly. To be honest, we have not done the regional analysis in any detail.

Q71 **Gareth Davies:** I want to focus on inflation, if that is all right. I will start with you, Richard. A lot has changed since October. You had GDP growth at 6%. You did not see household incomes falling. In fact, in your forecast in October, you did not mention the words "cost of living". Since then we have had £10 billion of tax cuts announced and £9 billion of rebates announced. These are not measures that would necessarily negatively impact growth or the cost of living. Would you say that inflation is possibly the primary concern and issue that we have in the economy today?

Richard Hughes: It is certainly the biggest shock that we are now having to cope with. Last year and the year before, I would have said that the pandemic is the biggest shock we are having to cope with, which was a shock to output; it would have been a shock to employment had the furlough scheme not helped keep people attached to the labour force.

We are now facing a different kind of shock. To some extent, it was a product of the pandemic. Even before the Russian invasion of Ukraine, there were these big supply and demand mismatches, with a recovering economy in Europe and North America putting pressure on the supply of goods coming out of Asia. You were already seeing goods price inflation going up, and that was also feeding a rise in energy costs to manufacture those goods. That demand squeeze on the price of energy was then compounded by the Russian invasion, which has put a supply shock into energy markets.

There was both rising inflation coming out of the pandemic, because of that demand/supply mismatch, and now also a supply shock, which is the thing that has driven the big downgrade in growth for us and two thirds of the big squeeze on living standards that you are seeing on households. Yes, it is the big challenge of the coming 12 months, if not beyond.

Q72 **Gareth Davies:** I hear what you are saying, but it is a massive change for the forecast to go from 5.4% to 8.7% inflation. You have touched on Ukraine and the situation there. Is that differential entirely down to Ukraine and the situation that we are seeing with the Russian invasion?

Richard Hughes: It is not. We did our last forecast in October, which meant that we closed it to market data a bit before then. At that point these global supply bottlenecks and pressures on goods markets were only really starting to emerge. The forecasters that went after us, like the Bank of England, ended up having slightly higher forecasts for inflation, but I cannot remember anybody forecasting inflation getting up to 9%, which only really happened once the Russian invasion of Ukraine had become clear. As I said, we have seen an inflation outturn of 6% already. That is above what we were forecasting in October. We have been consistently surprised on the upside by the strength of inflation.

Q73 **Gareth Davies:** How much can a Chancellor control inflation? How much can the Chancellor do about the inflationary pressure that we have in our economy—the shock that you are describing?

Richard Hughes: Most of this particular shock is imported from the rest of the world. We have a chart in the EFO that breaks down what is driving the composition of inflation over time. Much of it is being driven by rises in petrol prices, then rises in energy prices being driven by the rise in oil and gas prices.

I should say that there are choices to be made about energy regulation. Other countries are taking steps to stop the pass-through of higher wholesale energy costs into the retail sector. That needs to be compensated for. The Government have to step in to cover the operating losses of businesses. You do have choices around the regulatory regime for household energy costs but, in the long run, economy-wide you are facing a higher cost of energy if you are a net energy importer, like the UK.

You can have some influence over domestic inflation expectations and what kind of response you get from wages. That is the kind of thing that monetary policy setters can take into account. It can also be affected by decisions made by Government. Over the long long term, you have decisions about where you get your energy from. Countries like us, which rely on gas and oil for three-quarters of their energy supply, are very exposed to global energy shocks. Countries that rely more on nuclear and renewables do not have to worry about those as much, but they have made decades of investment in building up that capacity. If we want to change our energy mix, it would take that period of time to shift things.

For the near term, we are stuck with the way we produce energy. We can make some changes to the way in which costs get fed through to households, if we want to, but much of this is determined by international energy markets.

Professor Miles: On the question of what the Government can do, the Government have done something about offsetting the impact of higher energy prices. There is the £150 and the £200 of—

Q74 **Gareth Davies:** I am talking specifically about tackling inflation, not the effects of it.

Professor Miles: I know; I was coming to that. As I understand it, the way it is going to be treated in the statistics in the UK is that it will not reduce the rate of inflation. It will count as more income that people have rather than lower prices they pay. Of course, in a sense, it does not matter. If you are a household, what matters is, "How am I able to pay this bill?" Had the statistical authorities treated it in a different way—they might do in other countries—the inflation rate would not look quite as grisly as it does. In a sense, that does not make any difference to households.

The bigger question is about what you can do about a big shock that reflects events overseas on commodities that we pretty much have to have. Somebody is going to have to take it somewhere. It is a hit to the standard of living of this country; it is a terms of trade shock. It is very difficult to avoid the impact of that.

Q75 **Gareth Davies:** You mentioned the dilemma, if you are the Chancellor, in terms of intervention. There is a risk of those interventions being inflationary. In your March update you said that the Chancellor's Spring Statement will add just 0.1% to inflation with the measures he has announced. Have you looked at the other proposed interventions that are doing the rounds in the public policy arena? Can you say which would be the most inflationary of those?

Professor Miles: The honest answer is that we have been working pretty hard on trying to understand how the economic situation has changed given the measures that are going to be introduced. We have not devoted too much time to alternative policies. I am not probably in a good position—

Q76 **Gareth Davies:** For example, if we were to cut VAT, would that be inflationary? Would that cause, in effect, even more problems with inflation?

Professor Miles: A cut in VAT would reduce, during the period in which you cut it, particularly in the year in which a cut came into effect. It would have a material impact on the inflation rate. It is expensive.

The question is what else you would change if you were to cut the VAT rate. One answer is, "Let's not change anything and just borrow some more money." As you well know, there is a problem there—it is the old joke: you would not want to start from here—because the stock of debt is 95% of GDP. Two years ago, just before Covid hit, really, the OBR was forecasting that today the stock of Government debt relative to GDP would be 75% of GDP. Today it is 20% of GDP higher than what was already a very high number relative to where we thought we would be years before that.

I do not doubt that, if you cut the VAT rate significantly, it would change the measured inflation rate quite a lot. The question is about what else is going to change.

Q77 **Gareth Davies:** Richard, your forecast this month does not include broader commodity prices. We have seen massive volatility in nickel, palladium and wheat. Does that mean this forecast for inflation could be vastly optimistic?

Richard Hughes: There is a huge amount of uncertainty about the inflation outlook for all the reasons you have heard from us already. Just from the energy price component, these prices have been all over the place. We had to take a read at some point. It has turned out that the gas price is a bit lower and the oil price is a bit higher. For the moment, it is still a reasonable outlook for the energy market.

You are right that we did not look into the inflationary impact of other commodities of which Russia is a major exporter, such as nickel and wheat. We augmented the energy price hit to inflation by 25% to take account of the wider effects that having higher energy prices could have on the cost of other goods and services in the economy. You do not just get the direct hit from energy prices to inflation. Anything that uses energy as an input also becomes more expensive to produce. Just keeping the lights on in this place, in a restaurant or in a factory also becomes more expensive.

In that we have also, in essence, wrapped up the wider commodity price effects. That is because we are macroeconomists and not microeconomists. If you asked me what would happen to the UK economy if we took nickel out of it, the short answer would be that I have no idea. In order to capture those wider spill-overs, we have augmented that effect by 25%. If that turns out to be wrong and there is some crucial bit of the British economy that depends on nickel to function—

Q78 **Gareth Davies:** There are. Palladium is a massive part of car production.

Richard Hughes: It is used in car production and batteries, yes.

Q79 **Gareth Davies:** It is used in our food supplies. It is surprising that you did not include or try to predict that within your estimates. It is potentially a massive impact to our inflation.

Richard Hughes: As I say, we have augmented the overall impact by about 25%. That is what we have extrapolated from previous energy shocks to the UK economy in terms of their spill-over effects, where you also saw rises in other commodity prices that we are a net importer of in production.

There would not be a lot of value for us to try to chase down every single supply chain all the way back to Russia for every single company in the country to try to figure out what effect it would have.

Q80 **Gareth Davies:** It is clearly uncertain. It is a very uncertain situation. Therefore, would you not agree that it is right to be cautious, particularly on things like the headroom?

Richard Hughes: Certainly, yes, and not just for that reason. You have a lot of uncertainty about the energy price outlook. We know how much oil and gas we use to produce what we do today and also to heat homes in the country. Just the uncertainty around the energy outlook calls for caution about what you would do in response.

Q81 **Harriett Baldwin:** I am going to try to mop up some of the topics that have already been touched on, starting with Government interest payments. This Committee has been worried for a while about how vulnerable the public finances are to increases in interest rates. It is quite sobering to see that the interest bill doubled this year; it is going up to £83 billion in the next financial year. I think I am right in saying that is the highest cash level ever. It is certainly a big spike in terms of the percentage of the economy. It makes it the fourth-biggest spending Department after the NHS, the state pension and education. The spike next year is partly to do with the rate of inflation, index-linking and its accrual against that. How worried should we be about that as a Committee?

Andy King: As we have discussed a number of times when we have been here, the sensitivity of public spending to inflation and interest rate via the debt stock has increased dramatically since before the financial crisis, because the debt is higher, the proportion of debt that is index-linked is higher, and the proportion of debt that is very short-term interest rates, because of quantitative easing, is much higher.

We looked at the sensitivity of a percentage-point change in inflation or interest rates. It would cost £23 billion. That was the number we had in the autumn. It is greater than that in the forecast revision this time, because the spike in inflation is so high. That is why you get the huge spike in spending next year. The upward revision of almost £10 billion a year in the medium term is an interest rate effect. If it were not for the £40 billion revision in 2022, those £10 billion numbers would look very large. Interest rates and inflation have hit relatively hard in the space of a few months.

Q82 **Harriett Baldwin:** We should be very worried. That is what I am hearing you say in OBR speak.

Andy King: The debt interest to revenue ratio in the medium term is still historically low, because interest rates are still historically low. Changes in interest rates cost a lot very quickly, so, yes, that is something to worry about.

Q83 **Harriett Baldwin:** Realistically, that is the way they are going, is it not?

Andy King: I have certainly thought that for a decade and have always been wrong, but now they have moved up. With high inflation and a tight labour market, you would expect the direction to be up. The markets expect the direction to be up.

Q84 **Harriett Baldwin:** As I understand it, the £83 billion next year is more an accrual on the amount at which the index-linked gilts will be redeemed rather than a cash outflow. Is that correct?

Andy King: That is correct. The cash outflow is tiny because the coupon on an index-linked gilt is typically one eighth of 1%.

Q85 **Harriett Baldwin:** Yes, sometimes it is negative, is it not? I do not mean a negative coupon but a negative yield.

Andy King: The yields are negative in real terms by a long way, yes. The coupon is low. It is almost entirely an accrual of something. The cash outlay could be years or even be decades ahead, because index-linked debt is of long duration.

Q86 **Harriett Baldwin:** It is the fourth-biggest Department. In your numbers, do you detect any current expenditure that is being affected by the higher debt interest? In other words, is the Chancellor requiring reductions in day-to-day Government spending as a result of that higher interest bill at the moment?

Andy King: No. This pushes up the accrued measure of borrowing in the year that it spikes.

Q87 **Harriett Baldwin:** Turning to departmental spending itself, if you look at your projections, what is in your budget numbers in terms of the increase in public sector pay?

Andy King: In terms of public sector pay policy, there is no hard and fast pay policy over the next year. The Pay Review Body will be making recommendations soon. Departments will make their choices. Implicit in the departmental spending plans were pay rises in the order of 3%.

Q88 **Harriett Baldwin:** Were you given indications by the Treasury that you should work with 3%?

Andy King: We make assumptions for our public sector pensions forecast. We make assumptions where there are specific pay policies, and at the moment there are not. We make assumptions based on the amount that has been allocated to pay bills and—

Q89 **Harriett Baldwin:** You put about 3% in your assumptions, did you?

Andy King: I do not have the figures. I do not want to tell you a wrong number.

Q90 **Harriett Baldwin:** If you could follow up with the Committee afterwards in terms of what that assumption was, it would be helpful. Can you tell us what the triple-lock assumption is in your numbers?

Andy King: Yes, for the triple lock for the state pension, for this April coming, is 3.1%, because it became a double lock.

Q91 **Harriett Baldwin:** Have you put it in your numbers for next year? Is that in there?

Andy King: The triple lock for the following year is 7.5%.

Harriett Baldwin: You have put 7.5% in there.

Andy King: That is essentially our forecast for inflation in September.

Q92 **Harriett Baldwin:** In terms of the exposure of Government Departments to this increase in energy costs, they are pretty exposed, are they not? As we were hearing from Richard, the cost of keeping the lights on across Government is going to go up sharply. You have not factored that in at all, have you? You have just put in the normal settlements for Government Departments.

Andy King: The cash settlements for Departments are as they were set in the spending review in the autumn. In order to forecast what will actually be spent, we take a judgment about the degree to which Departments will underspend their settlements. They always do underspend, because of the way the incentives work. We have reduced the extent to which we think they will underspend. We think more will be spent from within the settlement because of the pressures of inflation. Our forecast revision is much smaller than the pressure on Departments from inflation and wage inflation.

Q93 **Harriett Baldwin:** Departments are seeing the equivalent of multiple years of real-terms deductions in their spending power, effectively, are they not?

Andy King: The real-terms rise in budgets is smaller than it looked when the budgets were set in the autumn. The degree of the squeeze depends hugely on which measure of inflation you look at. Typically, real departmental spending is something people think of in terms of the GDP deflator, the widest measure of inflation. That is much less affected by import prices, because of the nature of what it is trying to measure. It is probably the case that neither CPI inflation nor the GDP deflator is a perfect representation of the pressures that Departments will face.

Of course, in exactly the same way as every household experiences inflation in a different way, depending on what they spend their money on, every Department will experience it differently depending on whether they have a very large procurement budget, whether they have a very large pay budget or whether they are exposed to energy costs.

Q94 **Harriett Baldwin:** Which Departments are the most exposed to the price rises we have seen across the economy?

Andy King: I am afraid we have not looked Department by Department.

Q95 **Harriett Baldwin:** I have in front of me that using CPI inflation would mean a real-terms cut to Departments' spending power of about £5 billion; using the GDP deflator would mean a £17 billion cut. Is that the right way around?

Andy King: It is the other way around. The CPI measure is much higher, because it is driven by import prices. The GDP deflator is trying to measure the price of things we produce at home. By definition, it does not have those import prices in. If you are a Department that spends a lot procuring imported goods or that has a very high energy bill, you will be more exposed.

Q96 **Harriett Baldwin:** Is it fair to conclude this morning's session, before we meet the Chancellor this afternoon, by saying that the OBR's numbers for the two biggest vulnerabilities—inflation and interest rates—probably understate the risks to both those big variables?

Andy King: I am sorry. In what sense do you mean?

Q97 **Harriett Baldwin:** The OBR's numbers make certain assumptions about interest rates and inflation. Is it fair to say that the risks to those numbers being wrong in both cases are more significant in terms of the upside for both of those affecting the Chancellor adversely? Your risks are not skewed in terms of a nice even distribution, are they? Those big numbers, the numbers for inflation and interest rates, are skewed to the upside, and therefore adversely for the Chancellor's numbers.

Andy King: There are certainly a lot of downside risks around, and it is true to say that there is much more scope for interest rates to rise rather than to fall, because they are very low already. Richard mentioned a couple of the big near-term risks around, or pressures from inflation on the social security side and on departmental spending. There is a lot of uncertainty in both directions around the inflation forecast. The energy prices that we have based our inflation forecast on fall back, but they fall back to a level that is considerably higher than people expected in the medium term back in the autumn.

If the geopolitical situation resolves itself and the uncertainty in risk premia falls away, there is scope for inflation to fall further. In the near term, it is easier to list a lot of downside risks than upside risks.

Q98 **Alison Thewliss:** I have a few further questions on oil and gas and the impact there. I suppose the first thing I would be interested in finding out about is where any of your assessments changed over the past month or so with the way things have unfolded with Russia and Ukraine, particularly the impact of sanctions on oil and gas.

Richard Hughes: The main way in which the Russian invasion of Ukraine and the sanctions announced in response have fallen into our forecast has been on the oil and gas price. We get three quarters of our energy from those two sources. That is the biggest impact that we have factored in macroeconomically. We have not factored in explicitly any economic impact from the wider financial sanctions that the Government have introduced on oligarchs and on banks. We have not seen any evidence from the financial stability side that those things might pose a risk to the UK financial system.

We have, however, taken into account the impact of the war and the sanctions regime on equity prices. They fell in the immediate aftermath of the invasion and the announcements of sanctions here in the UK, mostly for energy companies and for a few companies that were exposed to Russian business. That has a modest effect on capital gains tax receipts in future, if and when those shares get sold. It is mostly through international energy prices that we factored in the effect of the invasion.

Q99 **Alison Thewliss:** Your energy market downside scenario assumes that high global energy prices will be short term and that they will fall back—perhaps above where they were before but they will fall back. What are the economic consequences if they do not fall back to where you expect, if they persist at that higher level?

Richard Hughes: We looked at what would happen if they peaked higher. What we have not looked at—it is work for us to consider, depending on how the war unfolds—is the impact if energy prices remained much higher for much longer. If you have a higher peak energy price, you face more of a near-term hit to growth. That raises the cost to the public finances by around £9 billion, if memory serves. It is set out in a scenario in the chapter.

Coming back to this question about long-term productivity and the scarring effect of the various shocks we have faced in the UK economy, we have not, for the moment, assumed any long-term impact on productivity or potential output for the UK from this energy price shock, because we are assuming, as the markets do, that it will resolve itself and we can absorb the higher long-term cost of energy prices through domestic adjustments ourselves. If that is not the case, what we have seen since 24 February in terms of economic impacts could turn out to be a lot more lingering and have long-term effects on potential output for the UK, because it is just more expensive to produce everything that we produce here in the UK given the way in which we get energy.

We have not taken that judgment for the moment. We do not usually take those judgments until the summer, when we have more time to reflect on all of these things that affect potential output: the pandemic itself; as David alluded to, the consequences of Brexit and being a less open economy; and, potentially, what kind of energy mix we are using and how expensive it is to use it.

Q100 **Alison Thewliss:** In terms of increased production, someone suggested that increased domestic production might have a positive impact. Would that have any significant effect?

Richard Hughes: In the near term it is very difficult to bring more on stream. You have seen in the past quite modest supply responses from the North Sea because they have such long lead times in investment. Nuclear power plants take decades to build. You can do more on renewables. You can build more windmills, but you are building them one at a time and each one only adds a marginal amount to the overall supply of energy. There is a limit to what can be done.

The problem with energy is that it is one of the hardest things to substitute away from. If the price of wheat goes up, sometimes you can find alternatives in the shops. We get our energy from where we get our energy from at the moment. Substituting away takes a much longer time.

Q101 **Alison Thewliss:** Connected to some of this is the dramatic increase in oil and gas prices and the tax receipts that have come into the Treasury. You have also talked about that falling back as well within the forecast. Can you tell me a bit more about the impact of that?

Richard Hughes: We get a boost to North Sea oil receipts. Andy, I do not know whether you know the figures offhand.

Alison Thewliss: It goes from £3.1 billion to £7.8 billion, according to your figures here.

Richard Hughes: Yes. That is because in essence it is a profits tax. North Sea oil companies are making more profits as a result of the higher oil and gas prices.

Q102 **Alison Thewliss:** How quickly would you expect that to fall back?

Andy King: We have it falling back to about £5 billion the year after and then it is between £2.5 billion and £3 billion in the medium term.

Q103 **Alison Thewliss:** I have a couple of final questions on this. One of the economists we spoke to on the Committee a few weeks ago talked about the rationing of diesel in Germany. Would you see that happening here? What impact might something like that have?

Richard Hughes: It is not something we are forecasting. The impact of energy prices on output that we have in our forecast is transmitted through the consumption side. It is not interrupting either people's ability to consume or companies' ability to access diesel for transport, distribution and production. We are not assuming disruptive supply bottlenecks in the UK from a scarcity of diesel. The way it impacts our forecast is just by being more expensive.

Q104 **Alison Thewliss:** Finally, if I were a small business and my energy costs were increasing, and other costs were increasing in terms of employment such as employers' national insurance payments, it would seem to me that the only thing left to me to tackle this would be on the number of employees I have or the wages that they have. Would you expect to see any impact from these increased costs on the number of people in employment?

Richard Hughes: We have not assumed an employment effect over the long term. We have been consistently surprised on the upside, in fact, by how well the UK labour market has performance in terms of its ability to find jobs for the people who are looking for work. There has been an impact, as David was talking about, on the level of participation. A lot of people have left the workforce during the pandemic and not come back, either because they do not think they can find work or they are not able to because of long-term sickness, caring responsibilities or other things.

For the moment, we are assuming that the labour market is fairly tight over the medium term. That is not the case for other forecasters. The Bank of England has a higher unemployment forecast than we do; it has it going up, in its last forecast, around 5%. That is not something we have factored into ours, partly because we have had a series of forecasts that assumed worse labour market outcomes on the back of major shocks to the UK economy. We seem to have a remarkably resilient labour market in terms of its ability to match people who want jobs with jobs. It is less successful in making sure people are in the labour market looking for work.

Q105 **Kevin Hollinrake:** Just looking at business investment, the Chancellor has been pretty clear that how he sees the future of the economy is to increase private sector investment in capital, people and ideas, which he talks about in the Mais lecture and also the Spring Statement. Is what he has done so far—the super-deduction, for example—working in terms of bringing forward business investment?

Professor Miles: Our prediction for this year is that investment will grow pretty strongly. It will grow about 10.5% or so. That is less than we thought back in October. There are a couple of forces at work there. In an absolute sense, investment looks strong. Relative to where we thought it would be, it is a bit weaker. There are a couple of things there. First, after the October EFO, it become clear that there were quite a lot of bottlenecks that were holding back certain kinds of spending. Capital spending seems to have been held back quite a bit by that. That is one thing.

The other is that, of course, as you get nearer to the end of the super-deduction, companies' ability to bring stuff forward is eroded in some sense. It is not that long now until the super-deduction goes away. The window that you have—just over a year—is a period when companies look at what is going on right now. Uncertainty for them is certainly a lot higher than we thought back in October. What we have done in this forecast is reduce a bit the investment that we thought was going to be brought forward. You do not lose that forever, because you get slightly stronger investment in the years after the super-deduction finishes, because we assume that it did not get brought forward. We have weaker investment this year, but it is actually a bit stronger in 2024 and 2025.

The overall input on the capital stock of the UK is what really matters for long-term standards of living. The impact of there being a bit less investment brought forward is pretty marginal.

Q106 **Kevin Hollinrake:** That was in your report. Only 26% of CFOs expected the super-deduction to have a positive effect on investment plans. Does that indicate that that lever is not working and that other interventions might not either?

Professor Miles: It is a bit difficult to know how to interpret that, but my guess is that it is just that companies are saying, "Our planning horizons are quite long, and right now it is really uncertain. Therefore, are we going to bring forward a load of investment that we might do in 18 months' time to now? Now probably is not quite the right time to do that." That is why the numbers are lower on the bringing forward thing.

Q107 **Kevin Hollinrake:** The CBI said something similar. Tony Danker at the CBI said that business confidence is seeing a bit of a downturn. Is that factored into your current forecast or not?

Professor Miles: They were influenced by those survey things. We quote a couple of them. That was what lay behind the judgment that, relative to where we thought we would be back in October, we would reduce investment this year. You get quite a lot of it back a bit down the road.

Q108 **Kevin Hollinrake:** What will the increase in corporation tax from 19% to 25% do to investment?

Professor Miles: There will probably be a net increase in the rate of return you would need to get, because you are paying that much more corporation tax. Having said that, it depends a bit on the mix of funding that companies use for investments. Since you can deduct interest payments on debt against corporation tax, that cushions the impact of a higher corporation tax rate on your incentive to invest. My guess is that having higher corporation tax is a marginal negative.

Q109 **Kevin Hollinrake:** Why is it that we invest less in the UK? It is about 40% less, according to the figures.

Professor Miles: Forty per cent. less than what?

Kevin Hollinrake: We invest 40% less than other countries. It is in the tax plan: "Our companies invest just 10% of GDP each year, compared with 14% in our competitor countries". Why is that?

Professor Miles: I can think of a few reasons. I do not have a very scientifically based answer to it. Investment tends to be heavier in the manufacturing sector than in the service sector. We have one of the lowest manufacturing sectors. It is not unique, but it is one of the lowest amongst industrialised economies. I suspect that is a pretty big factor. There are probably quite a lot of things that you and I might consider investment that some companies do, particularly in the service sector, that just do not get measured as investment in the statistics.

Kevin Hollinrake: You mean intangibles.

Professor Miles: Yes, I mean intangibles—training the workforce and things like that, which might not count as investment. There are probably more of those in the service sector than in the manufacturing sector, and we have an unusually big service sector. I can think of a few things, but I do not have a strong empirically based answer to the question.

Q110 **Kevin Hollinrake:** This is all about productivity, is it not? Our productivity levels are pretty poor as well. It is much more difficult to drive productivity in the service sector, is it not?

Professor Miles: That is right. Productivity performance in the UK has not been good for a depressingly long time. This goes back to right before the financial crisis. We have had very low productivity. Having said that, just to finish my line of thought, we have been relatively successful on employment. In some sense, you could think that there is a bit of a trade-off there. We have been more successful than most richer countries in terms of the unemployment rate.

Q111 **Kevin Hollinrake:** Are the opportunities for investment going to be reduced in the future? Premises is an investment, and so is IT equipment. If businesses are automating more and they are probably taking less office space, will it mean that the opportunities for business investment are reduced?

Professor Miles: It may well be the case that companies need less space, particularly if you rely on office space. In some sense, that is a boost. You could view that partly as a boost to productivity in the sense that you need less of something that is a cost. It is not as if the buildings that you need less of go to waste. Some of it is quite amenable to conversion into residential. To some extent, it might reflect a greater ability of people to work from home. That is something that people seem very keen to do. In terms of overall quality of life in the UK, there is definitely a plus side to what might show up as less demand for office space.

Q112 **Kevin Hollinrake:** Are there any other levers, such as cutting taxes, reforming taxes or incentives for businesses to invest, that would make a difference? The super-deduction was supposed to do this, but the indication is that it has not been massively successful for various reasons, not least because of the pandemic and other things. Are there levers that we should be reaching for?

Professor Miles: I am sure there are levers that could be used. They all come at some cost and quite what impact they would have in the longer term on the capital stock is not quite so clear. Allowing a 100% deduction of investment costs against the corporate tax bill is pretty clearly a positive. In terms of quite how positive it is, my impression is that empirical studies say it is somewhat helpful but not transformational. Going back to what we were talking about earlier, productivity is probably much more important than things like that.

Richard Hughes: It is about the skills of the population and the workers who are being asked to use the equipment you are investing in. If you unleash a new piece of equipment on an unsuspecting workforce, they will struggle to make good use of it. Empirical evidence shows that investment is higher in countries that have higher workforce skill levels, because they are able to use it productively. One of the things we have also suffered from in the UK is having relatively lower levels of workforce skills, which means you do not get the return from big investments in complex kit, because they do not know how to use it.

Q113 **Kevin Hollinrake:** If the super-deduction had a greater lifespan, if it was a less generous super-deduction, say there were a 100% tax break on it but it was over 10 years, would that bring forward business investment or stimulate business investment over that cycle and over that period?

Richard Hughes: The real challenge with business investment at the moment is the uncertainty created by other factors. Even coming out of the pandemic we had Omicron and we had supply bottlenecks making it harder for businesses to get the inputs they needed even if they were investing to expand production.

It may have been the case that, if you gave a longer window, you would have had a longer period to bring forward investment into it, but, given the uncertainty and shocks we have faced since that policy was introduced, I am not sure it necessarily would have implied that in practice you would have seen more investment now. Businesses are dealing with so much uncertainty about their cost of operating and their ability to get hold of inputs. My suspicion is that those things would have outweighed any benefit from having a longer window for the policy, at least for the moment. If there is more certainty in future than there is now, you might see more of a benefit.

Q114 **Kevin Hollinrake:** What about the employment allowance? That is about £1,000 for a typical SME of the right qualifying type. Will that help investment? Will those businesses invest that money?

Andy King: The employment allowance is capped at pay bills of £100,000. Very small companies account for a very small share of whole-economy investment.

On your previous question, one thing that is true is that the capital allowances regime has changed very frequently, particularly annual investment allowance, where the limit has moved dramatically up and down and been extended and so on. In recent years, it has been the case that there is a degree of an uncertainty over the tax system itself.

I have spent a decade at the OBR and before that a decade at the Treasury. The thing I am always struck by is the fact that the UK's low investment rate has been near the top of the to-do list all of that time. There are some things that I remember looking at 20 years ago that are still true now: the skills challenge in the country is about a long tail. The highest skill levels are comparable with the rest of the world. The lower skill levels lag the rest of the world. The same is true for management skills in businesses.

The low investment rate is common to business investment, residential investment and, until very recently, public investment. There is something that affects all forms of public investment in the UK relative to other countries. My personal prejudice is that the planning system is something that affects all three types of investment in the UK but not other countries. We revised down our public investment forecast in this forecast a long way. Bottlenecks are part of that, but the time it takes to get through the planning system is another factor that was at play. It is a long-term problem. Therefore, it is not an easy nut to crack.

Q115 **Kevin Hollinrake:** We have tried to crack that nut quite recently without great success. In terms of what you are saying initially about the variations in the level of annual investment allowance, for example, are you arguing that it should be at a consistent level for longer? Would that be helpful for businesses?

Andy King: I am not arguing for anything. The CBI has put the case for more stability. I am conscious that, in my job signing off the cost of new policy measures, the annual investment allowance crosses my desk very frequently.

Chair: That brings us to the end. Thank you very much for appearing before us today. As ever, it has been very insightful, interesting and helpful to the Committee to hear from you. There is great uncertainty for everybody. It makes your job very difficult. There is a gentleman who is appearing before us in just over an hour, and it has made his job very difficult too. We will be asking him some questions a little bit later this afternoon. Thank you very much indeed for coming.