House of Commons

Treasury Committee

Oral evidence: Spring Statement 2022, HC 1226

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Watch the meeting

Members present: Mel Stride (Chair); Harriett Baldwin; Anthony Browne; Gareth Davies; Dame Angela Eagle; Emma Hardy; Kevin Hollinrake; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 272 - 370

Witnesses

I: Dr Gemma Tetlow, Chief Economist, Institute for Government; Torsten Bell, Chief Executive, Resolution Foundation; Paul Johnson, Director, Institute for Fiscal Studies.

Examination of witnesses

Witnesses: Dr Gemma Tetlow, Torsten Bell and Paul Johnson.

Q272 **Chair:** Good afternoon. Welcome to the Treasury Select Committee hearing today on the Chancellor's spring statement. I am very pleased to be joined by some of our usual economists, it is fair to say. It is very good to see you again. You are very well known to us, but if you could just introduce yourselves to the Committee that would be great.

Paul Johnson: I am Paul Johnson. I am director of the Institute for Fiscal Studies.

Dr Tetlow: I am Gemma Tetlow, chief economist at the Institute for Government.

Torsten Bell: I am Torsten Bell. I am the chief exec of the Resolution Foundation.

Q273 **Chair:** Thank you very much for joining us. Can I start by looking at fiscal targets and headroom? The Chancellor found himself in a rather better position than was expected back in the autumn, principally because of the tax take and the fiscal drag around the income tax thresholds. Has he built enough in, given the huge uncertainties that lie ahead and the fact that the OBR has, rightly, pointed out the extraordinary sensitivities to interest rate movements, inflation, flatter growth than forecast and so on? Has he got that balance right between playing out some of that extra headroom and reserving a little bit more, as he has done?

Paul Johnson: It depends on how you see the fiscal rules. They are deliberately forward looking, so, in a sense, given that that is the OBR forecast, he has met them. Next year, it is another year into the future.

Q274 **Chair:** That brings into question how realistic that set of targets is. We tend not to meet them, historically.

Paul Johnson: Again, the Chancellor has, quite deliberately, set them out as forward looking, so that he has time to adjust. Clearly, if there are things in there that are unrealistic, which means that he is meeting them only because he is telling the OBR things that are not realistic—for example, that petrol taxes will go up by 5p plus RPI next year—the forecasts become somewhat unrealistic. If, next time he gets the chance, he creates a big increase in spending or a big cut in taxes that hits the fiscal target three years from today but not three years from next year, the whole thing begins to get undermined.

Whether he has given himself enough wiggle room against uncertainty is less of an issue, because, in a sense, if that uncertainty happens, he needs to adjust the fiscal policy in order to meet his targets one year further on. That is fine. The potential for games playing by, for example, saying, "I am going to increase petrol duty" when we all know he will not, or increasing spending on cutting taxes in a year before the point at which the fiscal target hits, is more of a concern with that forward-looking thing.

In terms of the actual level of headroom, as you say, if you wanted to be meeting the target in three years' time, not just meeting it in prospect, he has, as the OBR says, a 40% chance of not meeting those targets, but, precisely, the target is definitionally met, because that is what the forecast says.

Q275 **Chair:** Let me open it up to the full panel. What other elements like the fuel duty cut and reimposing that, which may be very difficult in the future, are looking pretty dubious at this stage but are factored into the forecast?

Torsten Bell: The super deduction comes to an end, but we all know we are going to put in place a replacement for it, so that is going to cost. That has always been the case since the Chancellor announced the super deduction, but, in the last month or so, he has been putting more weight on wanting to move to a more European-style corporation tax system, which means giving up some of the revenues from the higher rate in favour of exempting more areas of R&D and/or investment, and/or even human capital investment. The idea that there are not going to be some giveaways on the corporation tax side is unlikely, given stated policy.

Q276 **Chair:** What sort of size would you anticipate those giveaways might be?

Torsten Bell: That could be very variable. I do not think that the Chancellor has given us much steer in terms of how far he wants to go. At least he has not given it to me.

Dr Tetlow: The other area where there might be pressure for more spending is on public services, which we may want to come to later in questions. There was no increase in cash spending for Departments, despite the fact that the outlook for inflation has increased quite significantly since the October plans were set out, so that is another area where there may be pressure for higher spending.

Q277 **Chair:** Let us just go to that. We will come to public spending in a bit more detail in a minute, but as I understand it, back in the autumn, the Chancellor was able to say that, in real terms, departmental spending would be increasing by 3.7% across the forecast. That has dropped just a little to 3.6%, if I am right—there or thereabouts. Is that as it seems or has the way that the baseline for the GDP deflator has operated meant that that is statistically fudging what is really going on, which is a lot more pressure on the real-terms spending that the public sector has? I see Paul nodding, and maybe we could bring you in on that point.

Paul Johnson: That is right. The 3.7% to 3.6% is over the Parliament, rather than over the forecast period. Over the period, it is 3.1% to 3.3% or something of that order. That is dependent on how seriously you take the GDP deflator. In that, we see the price of Government consumption falling in the coming year, which just reflects the fact that, on the way that it is measured, we did a lot less teaching and a lot fewer operations last year, so it looks like the price of each child taught or each operation done is going down. Of course, that is not real in any real sense. The cost of running the NHS and schools will go up, so the GDP deflator is probably not the right number to use.

Equally, the CPI will not be the right number, because the public sector will face a different rate of inflation to that faced by households. The right number is probably somewhere in between, but it might well be closer to the CPI than will be comfortable for Government. Clearly, Government are going to have to pay for energy prices, and a lot of their supplies and contracts are going to become more expensive, but the big issue here is the quarter of a trillion that goes on public sector pay, which is going to be the biggest choice in terms of resources for public services and the biggest input into what their actual inflation is going to be.

Q278 **Chair:** If the GDP deflator and CPI are not the right measures, is there something out there that is a better measure to use than those?

Paul Johnson: I do not think that there is a single right measure. As ever, it partly depends on what you are trying to look at. Ex post, one would want to look at the impact of the actual increase in the price of medicines, operations, nurses and so on in the NHS. We do not tend to do that. We do not tend to have an NHS or education deflator. In most years, the GDP deflator is not so bad, but this time round it is not great.

The real cut will be bigger than that implied by the GDP deflator. It is very hard to put a clearer number on it than that.

Q279 **Chair:** That was going to be my next question. As a panel, what do you think is really going on if we think the GDP deflator is just giving us a nonsense number? What do you think is happening to public spending, given the level of inflation?

Dr Tetlow: I would agree with everything that Paul said and just add a couple more points to that. There is not a number for public service spending cost growth, but there are a few things that are relevant to thinking about that. First, the OBR's forecast for nominal wage growth this year has gone from 3.9% in October to 5.3% now, so it thinks that there is more pressure on nominal wage growth than there was when those spending review plans were set.

Secondly, those pressures vary across Departments and service areas, because different Departments spend a different fraction of their budgets on pay and energy costs. For example, about 70% of school spending is salary costs, so what happens there will make up a really big impact on the schools budget. It is about half for the NHS and a bit under half for the MoD, so it will vary across the services.

Torsten Bell: I agree with all of that. I would probably, on my balance of things to focus on, worry less about the short-term statistical shenanigans with the GDP deflator if you are looking across the Parliament as a whole. If you are looking at this year, that does matter. No one should use the GDP deflator for looking at the relative change from the financial year that is about to end to the next financial year.

If you are looking across the Parliament as a whole, a lot of the shenanigans have worked their way through over that period, so I would worry a bit less about that and a bit more about the GDP deflator telling you about something different. It is not giving you a deflator for Government consumption, and the main thing that that means is that it just does not include any imports. That is the main thing that it is missing.

There is then a separate question about the exact difference between Government consumption basket and household consumption basket, but the big thing is that we do not have imported costs of energy in there, which gives you the non-wage part of this package. What matters are wages plus the right deflator. The thing that is definitely wrong with the deflator that we tend to use—historically, the GDP deflator—is less the statistical shenanigans and more that it does not measure any import costs that are then borne by the public sector.

Q280 **Chair:** If things got really bad and if a lot of the uncertainties headed in the wrong direction, and if the Chancellor wanted to maintain his income tax cut in 2024 and the Prime Minister wanted to keep spending, what is your view of the fiscal targets themselves? Do you think there would ever be a point at which Treasury might reasonably say, "As we did under the covid crisis, we can step back from this for a bit and release ourselves from the strictures of the fiscal targets for a while"? I know that that begs the answer, "It depends on the circumstances," but I would value your views.

Torsten Bell: If we step back from the specifics of the fiscal rules and look at what we are doing fiscal policy-wise, big picture, it is worth us reflecting on how the defining feature of this post-crisis phase is the speed of the fiscal consolidation. It is incredibly quick, and quicker than any of us have ever seen. We are going from 15% of GDP borrowing in the depths of the crisis to 1.3% in 2024-25, which is three times the speed of the consolidation after the financial crisis. It is about 0.8% of GDP lower than it was predicted to be prior to the pandemic hitting, so the place where we are going to end up in terms of borrowing, on this forecast, is lower than we were predicting it was going to be at the same point when we did the forecast before the pandemic.

Q281 **Chair:** We are coming from a higher base.

Torsten Bell: We are coming from a very high base, but it is a very successful consolidation from the Treasury's perspective. One reading of that is that there is plenty of room, particularly given the point Paul is making about the fiscal rules being forward looking, for bad news to turn up and for that to be absorbed within both the time period you buy from those extra—so, are the fiscal rules a problem, given that we are about to be hit with a big energy shock? Broadly, the answer is no—first, because you have headroom, which is the point I am making about the pace of consolidation, and secondly because the rules will roll us forward.

What is underpinning the OBR's numbers is the idea that we do not have lasting damage from this energy shock, because it is assuming that energy prices get back, roughly, to where they were. The damage is all happening to GDP. In so far as higher energy costs that are imported mean lower GDP for the UK, none of that is permanent in these forecasts. It all works its way out of the system. That is why the Bank of England and the OBR have these different forecasts. That is the main thing that is going on in their different forecasts.

On that basis, on our list of concerns, do the Government have the wriggle room to stick broadly within their fiscal framework while dealing with quite a lot of uncertainty turning up? They probably have.

Q282 **Chair:** Even if, say—just wild speculation here—interest rates were a couple of per cent. above the central forecast, and growth was a per cent. lower, that would absorb almost 250% of the current headroom. Is that the kind of territory where your argument starts to look a little less certain?

Torsten Bell: If the last 10 years have taught us anything, it is that we should all be not too certain about anything in this world on the macro side. Broadly, it is fair. The kind of scenario that you are talking about is not impossible but hard to materialise. For that to happen, we need to maintain a very tight labour market and really strong wage pressure that the Bank of England does not get on top of, plus our productivity growth is a complete disaster. We have growth that we cannot afford and, therefore, rates have to stay high for quite a long time.

If that did happen, how much of that is permanent? If the growth is really bad, it probably means that you are not getting the interest rates. To have both those things happen is a concoction of pretty awful circumstances. I am not saying it is totally impossible. Really bad productivity growth and policy mistakes can get you in the place you are talking about, but it is definitely a tail risk, and you have to balance this out against the wider set of risks that we face.

Q283 **Dame Angela Eagle:** I want to talk about what the Chancellor did or did not do for those on low incomes. Were you shocked by the lack of any kind of support for those who are on low fixed incomes that they cannot increase?

Torsten Bell: Yes.

Dame Angela Eagle: I am glad you were shocked, but—

Torsten Bell: On the day, I was very surprised that the Chancellor had chosen the overall package that he had when it came to what was on offer for lower-income households. Given the source of the inflation pressure—largely, energy costs—and that, as a general point of consensus, those who bear that most are lower-income households, which spend a larger proportion of their income on that and have less ability to manage shock to their budget in general, it is an odd choice to have offered, basically, next to nothing to those households in this spring statement. I am not saying that there is nothing in the overall package, but, in this spring statement, there is nothing focused on that space. I did not think he would do that, and I was wrong.

Q284 **Dame Angela Eagle:** Are there any other observations on that point? The Resolution Foundation said that 1.3 million people are going to be plunged into absolute poverty, and 500,000 of those are children. Tell us what you mean by "absolute poverty".

Torsten Bell: The thing that is pushing 1.3 million people into absolute poverty, which is measured against a 2010 baseline, is the rising cost of living. The surprise is that he did not try to do anything about that in order to reduce the increase in absolute poverty. It is not him doing the absolute poverty rising; it is the world doing it and him choosing not to ameliorate it, to a very surprising extent. That means a couple seeing their income after housing costs falling below £14,000. It would be about £8,000 for a single person and more for people with children. Those are the kinds of numbers that we mean.

In general, we are all used to absolute poverty just falling year on year due to economic growth. The old political row was some not wanting to focus on relative poverty at all and what the right measure was. Everybody agrees that absolute poverty is something that should be going down, not up, so it is surprising, in the face of that very unusual and very big and bad outcome, that we have not done more. There is a reason why both the Prime Minister and, to a lesser extent, the Chancellor have suggested they might have to come back and do more, because we are, basically, stepping back and hoping it is okay.

There is a bigger question here. If you just step back and look at what we have done over the last year, in particular for those who are out of work, we are in quite a toxic combination. We have removed a decent level of support from those out of work—that is the £1,000 from universal credit that we have discussed with you several times before. Where we have tried to put more support in, the Chancellor has consistently gone out of his way to concentrate it on those in work. Sometimes, the higher end of the poorest group are in work, so up the earnings distribution. The combination is pretty toxic.

Overall, household incomes for the middle of the population, who are largely in work, fall by 4% next year after housing costs. For those in the poorest quarter, they fall by 6%. For out-of-work households, they fall by 8%. If anyone thinks that poor households who are out of work can afford an 8% fall in their income, I do not think that they have met very many people.

Q285 **Dame Angela Eagle:** In its forecast, the OBR states that there will be a 5% fall in the real value of welfare benefits—the social security benefits that people rely on. We are talking about people who perhaps cannot work because they are disabled, they are carers, or they are ill for some reason—perhaps temporarily, but they still cannot work. Is this 5% in real terms for benefits an unprecedented fall in value?

Torsten Bell: It is £11 billion in cash terms over the course of this year. In general, if we look back to the 1970s, when you had high inflation, we used to uprate benefits twice a year, so we did not have the system that we have now of automated uprating. It was more ad hoc. In the high inflation periods, you tended to get two upratings in a year in order to cope exactly with this problem that we are all now dealing with.

In terms of the timing of going from very low inflation to very high inflation, remember that we started with 0.7% or 0.5% inflation at the beginning of 2021, which feels like a long time ago. The speed of the coming up, so that you then end up with this timing problem being very acute year to year, probably does mean that it is. We have had inflation shocks in the recent past. If you look at 2011 or 2008, benefits were uprated pretty quickly, but some of that, to be fair, is not just policy; it is also about the timing of when the inflation came through.

Q286 **Dame Angela Eagle:** We do have a system now for uprating benefits. People have to bear the cost of inflation for up to 18 months before benefits finally catch up with the uprating. It is almost like they have to try to get through a very difficult period before benefits catch up, which must save the public purse an awful lot of money.

Torsten Bell: It is definitely true that, if you look at benefits in real terms, the pattern is rise in April, then slowly down, and then rise back up again the following April. In general, that is okay when you are talking about low levels of inflation, but is not okay when you are talking about 8% inflation.

Going back to your original question, what is so surprising is that everybody knows that. It is not like Treasury officials have not provided the Chancellor with lots of advice about the impact of that, and it is not like we are all not aware that it is in-work households that received most of the relative, quite generous topping up by the Chancellor of universal credit in the autumn.

It is a combination of the nature of the shock and an understanding of how that is affecting the benefits system, where the lag is particularly acute this year because of the way in which inflation has come through.

Q287 **Dame Angela Eagle:** If we had had a Chancellor who worried about that rather than one who had chosen not to address it, what, in your view, would have been the most effective way of addressing it for this period of shock, which we hope will not last too long? Would it have been uprating and restoring universal credit again for this period, or uprating benefits in April rather than September?

Torsten Bell: All of us probably agree that the blindingly obvious answer is that you need to uprate benefits in April by more than we are doing, so that the level of the real-terms cut over the course of this particularly difficult year is not huge. The exact number of that is 7%, 6% or 8%, and we should be clear that there are operational challenges with that, so I am not pretending that it is very easy, particularly for some of the other benefits. Universal credit is relatively straightforward, but some of the other benefits are harder to uprate at this short notice. That is the right policy answer and that is what we should have done.

Dr Tetlow: Can I just add one small thing to what Torsten said? Where to target support is a political choice. There is probably one extra thing that made this a circumstance where the Chancellor might particularly have chosen to target help on lower-income households. There is an unusual circumstance coming out of the pandemic, which is that, during the pandemic, it is typically middle and higher-income households that have built up quite substantial additional savings. That has not been the case for lower-income households, which are much more likely to have faced higher living costs or lower incomes during the pandemic. In a sense, we are in an unusual circumstance, where middle and higher-income households have more resilience than they would typically have to higher costs, while lower-income households do not.

Q288 **Dame Angela Eagle:** To sum up, the squeeze on those on fixed and low incomes is 8% rather than 4% in terms of the cost of living crisis, and £11 billion has been saved to go towards the fiscal consolidation by not uprating benefits.

Dr Tetlow: In terms of the £11 billion and how that relates to fiscal consolidation, it is purely a short-term saving. What Torsten was talking about in terms of doing a more generous uprating this year is that you increase benefits more this year but then do only a smaller increase next year, so you get back, in the medium term, to where you would have been. It would not affect the Chancellor's medium-term fiscal consolidation position.

Paul Johnson: That is what was so surprising. There is literally zero long-term cost from changing the basis on which you uprate benefits this year. The other thing that is worth saying in terms of the impact on a family on universal credit, for example, is that your income could be up to about 9% lower by next March than it was pre the pandemic, and about 17% lower than it was once you take account of the £20 uplift. Then it bounces back to its pre-pandemic level next April. These are really big falls in real living standards for households that are budgeting over relatively short periods of time.

Q289 **Chair:** Could I just pursue that for a moment? We are agreed that, if something was done that gave a bit more now but, in a sense, took it back later to smooth the effects that we are talking about, it would be fiscally neutral. Torsten, you have said—and, indeed, the Chancellor said when he appeared before us—that there are technical administration reasons why it is difficult to do that. Can we just explore for a second what options are feasible in this space? What might he be able to do that is not administratively too difficult to do?

Torsten Bell: To be clear, by "administratively too difficult", I do not mean that it cannot be done, but that you cannot flick a switch and it happens overnight. The more recently you built the system, the quicker it is to make the change happen. On universal credit, we saw that, in December, the Chancellor was able to make a change, admittedly with some prior warning within the system that they were going to do it, but it took a matter of weeks to move from announcing to introducing the taper change.

If you look back to the £20-a-week change at the beginning of the pandemic, similarly, it took a matter of weeks. That is definitely doable. That is the side effect of having built universal credit within the last decade and, after an initial traumatising phase, having got the IT okay, leaving aside the billions at the start of the phase. The outcome is that it is a better system, even if that is not why we built it in the first place. That is good news.

It is slower, but that probably means two months for the legacy benefits—JSA, ESA. That was our excuse for not uprating them during the pandemic—that it would take longer than universal credit. Given that it went on for two years, maybe we should have got on with it at some point. It is about two months, roughly, that we are talking about.

The other big one that I have not mentioned is the state pension system. I do not know the pace of updating a payment in that system.

Paul Johnson: I do not know, but it is worth asking officials at DWP, because they will say that it takes a long time and there is a remarkable amount of by-hand stuff that needs to be done, astonishingly.

Q290 **Chair:** So there is that approach, which is changing the indexation, if you like. Is there anything else, if you step away from that approach, that could be done—some other transfer payments of some sort that would go in and then come back out later in some form? What are the options there?

Torsten Bell: There are options in that ballpark. That is what, at one level, the Chancellor is trying to do with what are, basically, hardship payments administered by local authorities. In the olden days, that is something that you might well have administered via jobcentres, but we have moved away from that and, during the pandemic, relied on councils to dole out emergency grants. The take-up problems that that brings are severe, as is the overall constraint on the budget, and the scale: £1 billion for those hardship payments versus £11 billion lower benefits is not a great match-up.

Stepping back, why might the Chancellor not have wished to have gone through benefits? He gave you an answer earlier this week and he gave the same answer when he justified the energy package back in February, which is that he wants to provide support to 80% of the population, not 30%, and that is why he has put a lot of emphasis on the council tax system, using council tax rebates to do that.

The challenge that you have using those kinds of mechanisms is that, although we learned in the financial crisis that we did not have the means we needed to make payments to people when we wanted to, and we should have learned over the 10 years that we still needed them, we have come to another crisis and another time when we wanted to make direct payments, and are, again, trying to pick up the pieces.

Basically, the existing infrastructure outside of the benefits system is not going to easily allow you to suddenly recreate a benefits system that covers a slightly higher proportion. You are basically asking, "Can I introduce another means test to the world at very short notice?" and that is a very high bar to set. Maybe we will come on to this, but the attempt to use the council tax system to target support, where the thing that we are worried about is an energy bill increase, is deeply imperfect, even if it does get you to 80% of the population rather than to 30%.

It is benefits. Yes, you could look to direct payments of various forms, but we have not built the systems to do those easily, so the speed of getting that money out, doing it effectively and not missing people out will be very severe. Given that you have built a benefits system for targeting those on low incomes, you have to really not want to do that before you do not just do that.

Q291 **Chair:** Maybe the most practical approach that could work and land in the right place could be some kind of interim further uprating of benefits. Would that be a possibility that is fiscally neutral, gives the Treasury some time to build up towards that moment and takes the pressure off a bit earlier than would otherwise be the case?

Torsten Bell: That is what we should do.

Paul Johnson: I cannot see any reason not to. It might not be immediate, but it would be better than nothing.

Chair: I am so sorry, but I have to go to the Liaison Committee to grill the Prime Minister with other Chairs of Committees, so will you excuse me? I am going to hand over the Chair to Angela. Thanks very much for coming today. I appreciate it.

[Dame Angela Eagle took the Chair]

Q292 **Emma Hardy:** I want to ask about the fall in living standards and then go on to student loans, which seemed to confuse the Chancellor yesterday. Richard Hughes, the chair of the OBR, said the Government had "offset around one-third of the overall fall in living standards people would otherwise have faced over the next 12 months". Has the Chancellor gone far enough?

Paul Johnson: Refer to our previous answers. For those on the lowest incomes, I suspect there is consensus among us that he has probably not. For the rest of the population, through the energy rebate, the council tax rebate and the national insurance change that, when put together with income tax, help those under about £25,000, he has done a fair amount. It is a very qualitative judgment. Is that enough for the rest of the population? I think he is right to say that he cannot protect everyone entirely, but he has to make a judgment about who he is protecting and by how much.

What is interesting is that he has focused his resources on those on middle-ish incomes rather than really focusing them on those on the very lowest incomes, although even those on middle-ish incomes are still going to be several hundred pounds a year worse off in 2022 than they were in 2021. Whether that is enough is not a judgment I want to make, but someone on median earnings will still be something like £600 or £700 worse off in 2022-23 than they were in 2021-22, and it would have been a lot worse had he done nothing.

Q293 **Emma Hardy:** Angela was focusing on people on the lowest income and I am speaking more generally. Gemma, do you have any comments on whether households will be able to absorb the other two thirds that the

Chancellor chose not to offset? I suppose what I am trying to tease out is which households are going to be able to absorb the hit more than others.

Dr Tetlow: Paul is right. How much of that you want to absorb is a qualitative judgment. People perhaps have become unusually used to the Government stepping in and compensating them for all possible hits to living standards. The pandemic was a very unusual period of the Government stepping in, in a huge way, to support people's living standards, and that is not typically what the Government do when we have wider economic shocks, so you would be surprised if the Chancellor had tried to offset all of the hit to living standards this year from imported higher energy costs.

Who is going to be hit most by it? It is going to be a bigger rise in costs for people who spend more of their budget on energy costs, who are more reliant on their cars or who spend more on heating their homes. At the margins, people may be able to make some adjustments by turning down their thermostats or making some changes, but there is not a huge amount that you can do in a very short space of time to reduce your energy needs. It is those households that will be most severely hit by this.

Torsten Bell: To focus on your question on the overall scale of the support, the way the OBR has come at it with this one third/two thirds statistic is slightly obscuring what is going on. A large chunk of the income hit, particularly for the highest-income households, is the tax rises. It is not that the economy is giving us a hit to everyone's incomes and then how much we wish to borrow to help people through that. It is more complicated.

We have the economy hitting everybody, broadly, which is harder felt by those on lower incomes when we are particularly focused on the energy bill part of this package. Among the highest-income households, that is not the issue. It is the national insurance rise that is doing the work at the top of the earnings distribution. The overall impact of policy this year—not the spring statement package—is progressive, in the sense that it is giving everybody, more or less, a flat amount, particularly for the middle and the top. The poor get less because of the national insurance threshold rise not benefiting them.

There are big takeaways that get bigger as you move through the top half of the income distribution, which gives you these very large numbers of more than £2,000 worse off for the top 10% of households, because of the national insurance rise and the income tax threshold freeze.

The unusual thing that is going on is that he has not done enough for the poorest households and is taking a lot away from richer households at the same time as they are being hit by a high inflation rate. That is the unusual feature of what is going on: big tax rises mainly taking cash away from the top half, and doing that when they are dealing with the cost of living squeeze, while not doing enough to protect the poorest households from that.

Overall, it probably would lead you to conclude that it is an unusual thing to be doing, given how the world has panned out, but when lots of that package was set out back in September we did not think we would be facing 8% inflation in 2022.

Paul Johnson: When you ask what is unusual, if you look at the record of Chancellors over the last decade in terms of their policy changes, over the period from 2010 to 2017, there were big takeaways from the very poorest. That is not happening in terms of policy this time. There are some small giveaways there, but they are small. If you look over that period, there were big takeaways from the top 2% or 3%, and we are getting that again.

What is different this time round is that there also significant takeaways from people in the middle and upper middle of the distribution, from the national insurance and income tax changes. Quite remarkably, over the austerity period that group was almost completely protected, but Mr Sunak is choosing to push some of the pain on to them from his policy changes.

Q294 **Emma Hardy:** Gemma, earlier you mentioned mid and higher-income households having higher savings. To what extent could they be protected or shielded from some of these costs?

Dr Tetlow: In the OBR forecasts, they are assuming that those groups will draw down on their savings or build up their savings less rapidly than they were previously expecting, cushioning part of this rise in living costs and the hit to their incomes. The other thing that will be important for people is that part of the reason why people are seeing their real-terms living standards falling is that wage growth is not expected to keep up with price growth this year. That will differ across different groups of the workforce. If you are lucky enough to be in a relative shortage occupation, where they are struggling to get workers, you may be more likely to see faster wage rises this year than some others will.

Q295 **Emma Hardy:** Paul, you mentioned inflation. Will the policies that the Chancellor announced in the spring statement protect households from rising inflation?

Paul Johnson: No—on average and, indeed, right across the piece. As we have discussed, households will, on average, be significantly worse off. It is a big loss in living standards, largely associated with what is happening to inflation.

Again, to repeat, I do not think there was any world in which he was going to protect everyone from that, but he has chosen, as we said earlier, not to do more than he could have done for those on the lowest incomes. It would have been a much bigger thing to protect those on middle and higher incomes. That is more difficult and more expensive, but as Gemma was saying, people got used to it over covid, and that is part of the shock of not doing it this time.

Q296 **Emma Hardy:** Torsten, could you outline which households these policies are going to protect and whether any income groups are better off than others as a result of the measures that the Chancellor has introduced, taking into account, of course, the higher cost of living?

Torsten Bell: The package in the spring statement benefits the middle and top half of the income distribution more in terms of overall pounds spent, which is largely driven by the fact that they are more likely to have earnings that would benefit from the national insurance threshold rise. That is the main driver of why £2 in every £3 of the spend from this package goes to the top half and £1 in every £3 to the bottom half.

Fuel duty will also have a bit of that effect, because it is well targeted at those facing higher fuel costs, but not well targeted across the income distribution, because about 55% of the bottom decile do not drive. You need to see both halves of that, because if the policy objective was to get the cost of driving down, it is not surprising that non-drivers did not benefit. Non-drivers are also not being hit by the higher petrol prices, so we need to be a bit careful about saying it is a complete disaster.

Overall, if you look at what the Chancellor is doing this year, he is providing a flattish package but slightly more generous support to middle-income households, but then having big takeaways from richer households. That is the big picture, and that is just not enough to protect the poorer households that are then getting hit. It is also upsetting the *Telegraph*, because it is taking away thousands of pounds from higher-income households when, as people point out, they have not had to deal with that in the last few years.

Within that, there are other things to think about. Gemma mentioned differences in wages and how much wages can protect people from those things. If we look at that, we would probably say you are better off being in the private sector in terms of your level of protection over the next year. There is quite a big public/private split going on right now. We will wait to see how sustainable that is at that scale, but as Gemma pointed out earlier it is probably not sustainable at the current level that the Chancellor envisages.

If you look at what is happening on wage growth, you have the minimum wage going up by 6.6% this week, so that is good news at the bottom. It still falls in real terms, but it will be an above-average wage growth. Overall, if you look at the pay distribution, one thing that is going on underneath the OBR's revenue forecasts—everyone keeps saying it is about higher inflation giving us higher tax revenues; that is not really what is going on in their forecasts—is to do with the tax richness, even leaving aside whether you have lots of inflation going on. A lot of that is about higher earners having higher pay growth right now.

We did not see that in the autumn, but the data is now showing us that, particularly right at the top. You can see it in the bonuses data and in the wider PAYE data that HMRC provides on a monthly basis. If the current pattern of earnings growth continues, higher earners will be better protected from rising inflation by their wage packets going up.

Q297 **Emma Hardy:** So the biggest losers in terms of this are those on fixed incomes and on benefits.

Torsten Bell: The biggest losers in cash terms will be those on the very highest incomes, because the national insurance rise and the income tax threshold is such a big takeaway. The biggest losers in terms of the lived experience of how difficult the next year is going to be are those on the very lowest incomes, particularly those out of work.

Q298 **Emma Hardy:** Who are the biggest winners? Are there any?

Torsten Bell: The big picture is that we are all losers. In technical terms, if you earn exactly between £49,000 and £50,000 in 2024, you are the only sweet spot who will see your income tax lower than if the Chancellor had not bothered fiddling around with the system. There are some winners out there. If you manage to find them, you have done very well.

Q299 **Emma Hardy:** Talking about some of the losers, I want to ask about student loans and how they are going to impact people’s incomes and how much they take home. I questioned the Chancellor on it yesterday, and it was a bit disappointing that he did not seem to be aware of what I was talking about, considering that he is the Chancellor, but I will write and point out where he may have got himself mixed up.

The changes made to the student loan system save £34 billion over the forecast period. The impact analysis published by the DfE—I have brought it as a prop to show you, because this was a document that he was unaware of—shows that eight of the 10 income deciles of graduates will be adversely affected by these changes. The two income deciles who actually make savings from the changes are the two highest income groups. Is it fair to impose higher lifetime repayments on the lowest-earning 80% of graduates, while at the same time reducing them for the two highest income groups?

Paul Johnson: We have done similar analysis to what you have seen in the DfE publication and we come to similar conclusions. Given where we started, that result was not surprising. The reason that the highest-earning graduates win is that the interest rate has been cut significantly. Lots of people were asking for that, but it was always the case that the only possible winners from that were the highest-earning graduates, because they were the only ones who were paying back all of their loans and, therefore, the only ones who could benefit from paying less over their lifetime. If you are going to cut the interest rate, you are going to benefit the highest-earning graduates. That is what is going on there.

The reason that lower earners are paying more is, at least in the short run, that the threshold at which you start to pay is being brought down, which will look like a significant tax rise, effectively, for that group. To be honest, I would just ignore the stuff about what happens after 30 years. The system has changed three times in the last decade, so the idea that we now have a system where people will be paying back under this current set of rules for 40 years instead of 30, and that it will be the same in the 2060s, as has just been announced, is for the birds.

As a result of these changes, we have something that looks a bit more like a loan system and a bit less like a tax system. Although it goes on for 40 years—so that is, in a sense, more like a tax—you are much more likely to end up paying it off. Something like 60% of graduates will now be able to see a point at which it will stop, because they have paid it back, and there will not be the same degree of redistribution.

The high interest rate did make the thing redistributive, a bit like a tax. If you were a high earner, you would end up paying back quite a lot more as a result of that. Technically, at least, it is a continuum between a loan system and a tax system. We were very close to a tax system and we have moved a little closer to a loan system. Given where we started, the set of options, what Augar recommended and all those sorts of things, I am not terribly surprised—let me put it that way—that that is where the policy has ended up. For sure, the losers are the middle-earning graduates.

Q300 **Emma Hardy:** When I was questioning the Chancellor, I pointed out that the average salary is £26,000 in Hull and £40,000 in London. The Department for Education's own analysis shows that, understandably, the higher-earning graduates tend to live in London and the south-east, and lower-earning graduates in areas like Hull. Is reducing the student loan repayment for the highest earners levelling up by region in reverse?

Paul Johnson: It is benefiting the high earners, for exactly the reasons discussed. You are right that London and south-east graduates earn a lot more than they do elsewhere, so it will have that regional distribution.

Q301 **Emma Hardy:** Torsten, taking into account everything we were just talking about—the winners and the losers—how tough is it going to be for a lower-earning graduate living in Hull, with all of these changes taken into account?

Torsten Bell: We should probably think about the next year separately from the long-term effects of this change to student loans. I agree with the big picture of the average graduate and that it does have the effect that you are talking about. There is a separate issue, which is that London has more of the graduates and, overall, this is an increase in how much graduates are paying. I do not know where the average hit per person would be highest. I do not know if you have looked at that, Paul, but there are more graduates in London, so it could go either way. I do not know the answer to that question.

To give you a more useful and less ambiguous answer, I would focus a bit more on the gender split of what this effect means. This is really bad news for women and much better news for men. That is what this package is really doing. The chart that you are talking about looks at lifetime earnings, and we know that lifetime earnings of male graduates are much higher. There is not an equal split of men and women among those lifetime earnings deciles. I cannot remember the exact numbers but you are going to be a lot more likely to be a loser from this package as a female graduate than a male graduate, partly because of the years out of the workforce. It will not be just that, but also the profile of average earnings of male and female graduates, even in the years they are in work.

Q302 **Emma Hardy:** The DfE's own assessment says: "Graduates who are more likely than average to be among the lowest earners 10 years after graduation…are likely to share the characteristics of: female, any ethnicity other than white, started studying after age 45, from a disadvantaged background, or who reside outside of London". They are the ones who are going to be hit the most, according to their own statement. It was a shame that the Chancellor had not read it.

Going back to the point that you made, Paul, the OBR told us that the increases in student loan repayments do not count as a tax, which is interesting if you are saying that it is moving more to a loan system. Do you think that, given the changes to the student loan system and moving it closer and closer to a graduate tax, an increase in student loan repayments should be seen as an increase in tax, or should it not, now we are moving more towards a loan system?

Paul Johnson: There is a good case for moving it towards a tax system. It has a lot of those characteristics. It will be more redistributive. It is extraordinary that we call it a loan system and yet fiddle around with all the parameters such as interest rates, the point that you have to pay and so on, well after people have graduated and taken out the so-called loan. Committees like yours would be having a bit of a go at a private sector organisation that was doing the same thing to people who had taken out loans, so it does not look like a loan in the normal sense.

That is good, because we want something that is income contingent. Overall, the package remains redistributive to the lowest earners, because they still do not pay it all back and, therefore, higher earners will pay back more than the lowest earners, so that has a lot of the characteristics of what you get from the welfare state through taxes and benefits. It is a hybrid system. A significant part of the reason that it is a hybrid system is that it looks better, frankly, in the public finances for a long time when you do it that way, because it is not all spending up front, given the expectation of it being repaid as a loan.

There are some advantages in having something as a loan. Certainly, universities prefer that, because it ringfences income for them, although they are also suffering from the fact that that ringfenced income has been frozen for a very long time.

Q303 **Emma Hardy:** If we looked at this loan system as being a form of tax or of taking away income from graduates, have any calculations been done on what sort of percentages they would be paying?

Torsten Bell: Do you mean the marginal tax rates for graduates?

Emma Hardy: Yes.

Torsten Bell: That is a good question in terms of the lived experience of the coming decades. The Chancellor is talking about wanting to reduce income tax and being a lower tax Britain, but, overall, income taxes for everyone are going up because of the national insurance rise.

If you are a younger graduate who is now looking at a significantly higher marginal tax rate for possibly up to 40 years—depending on, as Paul says, what on earth happens in the 2060s, which I do not have strong views about—you are living in a world of higher marginal tax rates than some people thought was the norm if you went back 15 years. One penny off income tax when you have large student loan repayments and higher national insurance is not going to look like a lower tax Britain when it comes to income taxes generally, but that is for one part of the population.

Q304 **Kevin Hollinrake:** I have some questions around council tax and the rebate, some of which you covered before, in terms of how fair it is. The Chancellor said to us a couple of days ago that council tax banding was a good proxy for household income. Is that true?

Torsten Bell: No.

Q305 **Kevin Hollinrake:** Why do you think not?

Torsten Bell: Because it is not. Is it vaguely correlated? Yes. Are property values in the early 1990s perfectly correlated with incomes today or with increasing energy bills today? No.

Q306 **Kevin Hollinrake:** He did not say it was perfectly correlated. He said that it was not perfect but it was the best one we have.

Torsten Bell: That is a different question. It is not the best one that we have in terms of targeting poorer households, because, as we have discussed, that is the benefits system. He is totally right to say that we do not have a good way of targeting 80% of the population by income. What does that mean in practice? Targeting bands A to D means that, if you are a low-income household that happens not to be in those bands, of which there are over half a million, you will not get the council tax rebate in the autumn when it is paid.

It has a very extreme geographical spread to it. There are 10 local authorities where more than half the properties will not receive this payment. They are focused in London, but the Isles of Scilly will be included. I do not know why the Isles of Scilly has that council tax band, but whoever their MP is should go and sort it out. There are 19 local authorities where over 95% of the properties will get the money.

A lot of that is income—that is London versus the north-east—but it is not all income. If you look within London, one in five low-income households—the bottom third or three deciles of this population—will not get this. That is a lot. One in five will not receive this. If we are aiming to target low-income households, we will not have succeeded in higher property value areas.

Q307 **Kevin Hollinrake:** I will have a chat with Derek Thomas, who is the MP for the Isles of Scilly. Do any of you think we should have a better proxy, or should we just use universal credit? About 6 million households are on universal credit versus 20 million households that will benefit from this. Would it have been better to focus more or the same amount of money on fewer households? Is that something you would have done if you had been in his hotseat?

Torsten Bell: It is a totally legitimate position to say, "I want to go broader. That is why I have done national insurance thresholds. That is why I have used the council tax rebate." What you cannot do is do those things and not do the thing that helps the poor. The first thing you need to do is uprate benefits, and then you can decide, on top of that, what you want to provide in a more universalist approach. Once you get to that situation, your limited range of options takes you to the kinds of things he has done.

The issue is not that it is bad that he has used these other, more universalist levers. The issue is that he has not used the well-targeted lever, because it really matters if the lower-income ones slip through the net. As we were discussing earlier, you have some people whose income is going to be 15% lower this September compared to last September, who are on the lowest incomes. That is such a bad situation.

You have to do the well-targeted thing first and then, depending on how much, as Paul was saying earlier, you decide you want to protect the population as a whole, you have these other levers. The fact that they are not perfect is not the Chancellor's fault and should not be his responsibility, except in the longer term, but it does not mean it is okay to have forgotten this problem.

Dr Tetlow: Just to give a sense of scale, if you had spent the same amount of money as you are spending on the council tax rebate just on increasing payments to UC households, you could have given them £600 each versus £150 each in the council tax rebate. That is a sense of the scale.

Q308 **Kevin Hollinrake:** Is that what you would have done?

Dr Tetlow: As I said earlier, it is ultimately a political choice, but I can see several reasons why, in these particular circumstances, there is a case for targeting it at lower incomes.

Paul Johnson: If you wanted to provide broad-based protection to the population, with a little bit of targeting through the council tax rebate, the February package was probably not a bad way of doing it. But, first, that has become less adequate for everyone in the last month, given that prices look like they are going to rise more quickly.

Secondly, as we have said many times, it does not do "enough" for those on the very lowest incomes who are the ones who are going to be struggling most. If your target was those on low to moderate incomes, it is quite difficult, as Torsten was saying, within our current system, to design something an enormous amount better than what he did in February.

Q309 **Kevin Hollinrake:** It does potentially give rise to fraud, in that, for people who are on direct debits, it is quite easy to get the money out, but people who are not have to self-certify. There are some checks and balances there, but, on that basis, is this a robust way to deliver this payment?

Paul Johnson: I do not know. Councils ought to have a reasonable idea of who is paying council tax, you would hope. How good their systems are at preventing fraud, I am afraid I am not the right person to ask.

Q310 **Kevin Hollinrake:** Is anybody unduly worried about that element of it?

Torsten Bell: I would probably go both ways. The fact that we are relying on people to phone up their council definitely introduces the aspect of people providing bank details. You are right to raise the issue and I am sure that councils will now be wrestling with how to prevent that. I am sure that fraudsters will also be thinking about how they can use this system to ring people up and ask them for their bank details. There is lots of fraud available. That is one of the big challenges facing how we deal with crime in the 2020s, which we have not managed to get a grip of, and this is just another aspect of it.

It will go the other way, in that take-up will also be an issue, because you need to ring your council to do it. The OBR said that a third of us do not pay our council tax by direct debit, and that 20% of those probably would not claim. That is about £200 million and 1.3 million people missing out on the £150, so you have a targeting problem as well as a fraud problem.

Q311 **Kevin Hollinrake:** Gemma, on fuel duty, Germany's package was more generous, with 30 cents off petrol duty and 14 cents off diesel duty. Did we go far enough on that? You have to look at these things in the round, but is their package more generous generally?

Dr Tetlow: Yes, Germany's package is more generous generally in several ways, not only on fuel duty, but Germany and other countries have done something to target support at businesses facing higher energy costs as well, which was notably absent from the Chancellor's package altogether in the spring statement.

Q312 **Kevin Hollinrake:** Can you set out what they did for businesses? I was not aware of that.

Dr Tetlow: I am more familiar with the French package. I cannot remember off the top of my head what the German package did.

Q313 **Kevin Hollinrake:** The French also gave something to businesses, did they?

Dr Tetlow: Yes. The French have explicitly rebated half of businesses' higher energy costs for those that spend more than 30% of their budgets on energy costs. There is very targeted support, particularly for fishermen and truckers, in France.

Torsten Bell: Obviously.

Dr Tetlow: Have we gone far enough on fuel duties? There are difficult choices. There are clearly groups of people who are very reliant on their cars and have faced very big increases in fuel costs. They may be struggling for both business and personal reasons.

On the other hand, as Torsten said, if you look across the population as a whole, the people who spend most on petrol tend to be higher-income households who drive more gas-guzzling cars more miles, so there may be scope within that group to drive less or they may have flex in their budget to meet those costs, and therefore there is perhaps not such a demand for the Chancellor to step in to target support there.

The other context in the Chancellor's decision around what to do with fuel duties is whether anything that he does—we have already touched on this—is plausibly temporary. That may well have been one good reason not to go further in a temporary cut in fuel duties: the difficulty there is likely to be in reversing that cut next year. The assumption is that it goes straight back up again, but we have not seen an inflationary increase in fuel duty for more than 12 years.

Q314 **Kevin Hollinrake:** In terms of the overall package of support, if you look at the energy stuff, national insurance and fuel duty, it adds up to about 20 billion quid. Are you saying that Germany's package per capita is more than £20 billion overall or is it just spread differently?

Dr Tetlow: I am afraid that I do not know the total, but looking at the types of policies I would be surprised if it is not bigger.

Torsten Bell: The German package is definitely bigger, once you take off the fact that there are big tax rises happening at the same time. You are talking about the gross giveaway, but there is a takeaway going on at the same time. Overall, if you just look at how much we are giving on average to the whole population, I would say that our level of support is pretty low. It is only about £110 per household net everything this year. That is then heavily skewed by these big losses among the richest households.

Overall, to the population as a whole, the state is not making a huge effort compared with what some other states are doing. France has a much bigger package on capping energy cost increases to households too, so we are at the less aggressive end of the market, but to be fair, we were at the more aggressive end of the market during the pandemic.

Q315 **Kevin Hollinrake:** If we are at £110 per household, what is Germany?

Torsten Bell: I have no idea off the top of my head.

Q316 **Kevin Hollinrake:** But you think it is more.

Torsten Bell: It is definitely more, yes.

Q317 **Kevin Hollinrake:** I would be interested to know how much more. Gemma made the point about fuel duty going back up again. Paul, you were sceptical about this in your review of what the Chancellor had done. Do you think that will happen?

Paul Johnson: I would be extremely surprised if what happens in a year's time is that it goes up by 5p plus RPI, which is what is in all the public finance numbers, because that is official policy. As Gemma said, we have not even managed RPI for more than a decade. There is perhaps more chance of it going up by 5p, but that is going to be very dependent on where fuel prices are at that stage.

In the past, George Osborne introduced what he called the fair fuel stabiliser and promised to put duties down when prices went up, and up went they went down, but they never went up. Whether this happens is entirely up to Members of this House, and the pressure that goes on the Chancellor, but history would suggest that it has been quite difficult for at least 12 years or longer, given that Gordon Brown spent several years not doing inflationary increases following the petrol drivers' dispute in about 2000. Clearly, history shows us that it is politically difficult to move these things up.

Chair: When is an escalator not an escalator?

Paul Johnson: We fell off that a long time ago.

Dr Tetlow: Paul is right to distinguish between the 5p and the assumed inflationary increase next year, because the 5p has been done through a statutory instrument that has a fixed term and will just run out next April, whereas the RPI increase will need to be legislated for and voted on through the Finance Act next year. Different politics may play out. Despite that, the Chancellor may well come under pressure outside, even if the statutory instrument is due to run out, to do something about it, but there is a bit of a difference in how they will be voted on.

Q318 **Kevin Hollinrake:** The other thing he did in the statement was to scrap VAT on solar panels, heat pumps and that kind of stuff, which most people would probably welcome, but that does not help poorer households, because they cannot afford them in the first place. Should we have something else, like a green homes grant that actually works and makes it easier for these households to make these energy modifications?

Torsten Bell: Yes.

Q319 **Kevin Hollinrake:** I thought you might say that. Are there any other views? Is it good politics or good economics to do that?

Dr Tetlow: The thing that might help with energy costs in the short term is quite easy, small energy improvements like loft insulation, which we moved away from subsidising some years ago. As a result, the numbers of those improvements have gone through the floor, so there is scope to do something to encourage those kinds of investments, which are smaller, cheaper and quicker to get off the ground.

Q320 **Kevin Hollinrake:** The energy companies do some of that, like the ECO or whatever it is.

Dr Tetlow: Yes, but the subsidy is not as generous as it was.

Paul Johnson: It is on a very small scale. We do know how to make this work, because it worked up until 2010, and then the system was changed and it stopped working.

Kevin Hollinrake: The energy thingy obligation or whatever it is.

Torsten Bell: When we cut the "green crap", what we cut were the levels of insulation being put into people's homes. I think we cut it by almost 80% or 90%. The fall was overnight and has now been running for a decade. It was in a Resolution Foundation report a few weeks back. The fall is very large and is directly a policy choice.

That happened because the world is telling us that lower-income homeowners in particular will not invest to save on insulation. Higher-income households will, as you pointed out, put on solar panels. When they do their posh extension to their kitchen, they tend to improve the insulation, I am told. I have never done insulation myself, but, if you look at the data on whose houses have become more fuel efficient over the last 10 years, it is disproportionately higher-income households. That is because they are all staying put and doing renovation work, and then doing energy insulation measures.

On average, we need to spend £8,000 to £10,000 to make some of our homes more energy efficient. Poorer households do not have that amount of money lying around, and it is a big gap in our net zero plans at present.

Q321 **Siobhain McDonagh:** Would the panel like to divulge what cars they own and how much it costs to fill the tanks? I am taking that as a no.

Paul Johnson: A 21-year-old Golf, if you want to know.

Chair: Ah, another Golf!

Torsten Bell: Paul has only got one car.

Paul Johnson: That's for sure.

Q322 **Siobhain McDonagh:** Paul, the IFS dubbed the Chancellor a "fiscal illusionist" in your post-statement analysis. Mr Sunak categorically denied this when I put it to him on Monday. Do you stand by your characterisation?

Paul Johnson: Yes. The reason for saying that is that he presented this as a tax-cutting Budget as a result of the increase in the national insurance floor and the cut in the income tax rate in 2024, yet the projected tax burden went up relative to the tax burden projected before. In a sense, what he did was to take advantage of the fact that a huge amount of additional fiscal drag, plus possibly, as Torsten was saying, some tax-rich growth, gave him a large amount of extra tax revenue, and he took advantage of that to cut a rate and to increase a threshold.

Nevertheless, he did not take full advantage of it in terms of cutting taxes. I am not saying that he should have done, but the net impact is that the tax burden, as projected last week, is higher than the tax burden as projected last October. While he cut some elements of the tax system, overall he left a tax rise in place.

Q323 **Siobhain McDonagh:** The IFS said that a median earner on around £27,500 a year will be about £360 worse off in the next financial year than in the current year. Could you explain why?

Paul Johnson: There is a combination of things going on. One is that their real level of earnings will be going down. Someone on that salary will be being made better off, net-net, by the two national insurance changes, but worse off by the freezing of the income tax threshold. They are, I think, just above the point where they would be better off as a result of those tax changes; they are slightly worse off as a result of the national insurance and income tax change together. They are benefiting from the council tax and energy rebate.

If you put all of that into the mix—it will be different in different households—that group will, net-net, still be significantly worse off in the coming year than in the last year, despite what we have seen since February. The three policies that the Chancellor has announced since February—the energy rebate, the council tax rebate and the national insurance threshold increase—have been pretty well targeted at exactly that household, in a sense, and deliberately so, but that is still not enough to offset a lot of other things that are going on.

It is worth saying that, once you take account of the income tax and national insurance changes, it is only people right down at £13,000 or £14,000 who are, in the medium term, going to be better off net-net. It is still going to be that nearly everybody is losing when you put all of that together, not next year but further on. You have to be only about £1,000 or £2,000 above the income threshold to be losing as a result of the income tax and national insurance changes altogether in the medium run.

Q324 **Siobhain McDonagh:** Torsten, in his statement, the Chancellor pledged to cut income tax tomorrow while raising national insurance today. I am concerned that this is simply a tax trick that will widen the gap between the taxation of earned and unearned income. I understand from the Resolution Foundation analysis that the net result is that anyone earning below £34,000 will be worse off, while all those earning more will benefit. Could you expand on the winners and losers and why you think the changes have been made this way?

Torsten Bell: If we are talking about changes to income taxes generally, almost everybody is a loser—as I say, 27 million out of 31 million are losers. If we are focusing on the combined income tax and national insurance rises, the only group that wins is the one that Paul mentioned, which is a narrow band of those with earnings in the low teens.

It is worth stepping back and saying that what is going on in the overall spend is that the freezes in thresholds—the income tax freeze from now and the national insurance freeze after the big hike that happens in April—are paying for the income tax cut. The last two years of the freeze are raising almost exactly the same revenue as the income tax cut is costing, so we are increasing everyone's taxes via the freeze so that we can cut their taxes via the rate, which is a silly thing to do just in general terms. In particular, it is a silly thing to do because that change in isolation, leaving aside what has happened on the national insurance rate, means that we are freezing everyone's taxes so that we can cut taxes and, overall, only the top quarter of the population by income will be better off as a result of that change. That is the back end of this tax package.

The front end of the tax package is really bad for the rich. The back end—keeping the freezes but going ahead with the income tax rate—is better for the better off, but it does not undo the damage to the rich from what is happening next year. That does not make any sense, for a whole host of reasons. That is what is going on on the overall revenue side of it.

On the marginal tax rates side of it—national insurance up, income tax down—what you said is completely right, which is that we are choosing to have higher marginal tax rates on earned income, and lower marginal tax rates on most other kinds of income. That is what you would call bananas.

Siobhain McDonagh: Is that the technical term?

Torsten Bell: The technical term is that this is the opposite of what everybody thinks we should be doing, and we are doing it only because "focus groups tell us people will understand the national insurance rate going up to pay for the health service and I've got to prove that I'm tax-cutting Chancellor".

It is really depressing. It was forgivable to make mistakes on the relative roles of income tax and national insurance 20 years ago—I do not want to be too kind, so I will say "more forgivable"—because we did not know we had as big a self-employment problem in terms of our tax base. We had not made this mistake repeatedly at that point, so everyone should be damned, but making the same mistake again is really bad and we just should not be doing it.

Q325 **Siobhain McDonagh:** Gemma, on Monday I asked the Chancellor about the timing of his so-called income tax cut, and put it to him that he was determining his fiscal policy decisions around the general election cycle. Do you agree with my concerns or are the pre-election tax cut headlines just a fortunate coincidence for him?

Dr Tetlow: I have not seen any rationale for why 2024 was chosen as the date for the income tax cut. Back to the discussion we were having earlier, we face a lot of uncertainty about what is going to happen over the next few years. We always face uncertainties, but we are facing particularly high levels of uncertainty at the moment about how things are going to play out, which makes it a particularly odd time to pre-announce a tax cut, even though he has kept back some of his headroom. The first thing that came to my mind when I heard the date of that tax announcement was the date of the next election, but I could not possibly impart any motivation to Rishi Sunak.

Q326 **Siobhain McDonagh:** Finally, Torsten, I want to ask more about the impact of the combination of the national insurance rise, the income tax fall, and the freezing of thresholds for those on universal credit.

Torsten Bell: Yes, that is a great question.

Siobhain McDonagh: I remember reading in some of your commentary that, because universal credit is based on post-tax income and you lose 45p in every pound above the taper, it is another bad impact on universal credit claimants.

Torsten Bell: We are talking here about the short-term increase in the national insurance threshold in terms of what it means for the extra help for the year that is just coming. Overall, it is better anyway in terms of the tax cut for the middle and the top, because there are more earners, and those earners are more likely to be over the national insurance threshold and, therefore, benefit in full from the change to the threshold. You have more tax cut in cash terms going to the middle and the top.

Even among those who are on lower incomes who do get the tax cut, if they are on universal credit, the overall benefit to their overall incomes from that tax cut is lower, because the taper, after the Chancellor reduced it in the autumn, will take away 55p of every pound gained from that tax cut. They get less in the first place in terms of tax cuts and, if they are on universal credit, they will keep less of that tax cut. In the end, we care about their disposable incomes, not about what benefits are what, so that is completely right.

Q327 **Anthony Browne:** Good afternoon, everyone. I have two sets of questions, first about national insurance specifically, and secondly about Government interest payments. On national insurance, I realise that you have touched on some angles of this, but I want to ask first about what you thought about the decision to raise the threshold rate of national insurance to the personal income tax threshold rather than delaying or cancelling it overall. Do the benefits of equalising those two thresholds make a significant economic difference to work behaviour and so on?

Paul Johnson: If you are going to make a tax change that is going to help relatively low earners, an increase in the national insurance threshold is probably the best change that you can make. In terms of how that sits against a temporary reduction in the rate, first, the increase in the threshold is more helpful to lower earners, if that is what you want to achieve. Secondly, for very good reason, the Chancellor would worry about the credibility of a delay, in the sense of, "If you cannot do it this year, can you really do it next year?" This is all ignoring the fact—I agree with Torsten—that, if you want to raise tax, national insurance is not the obvious place to go.

On balance, if you want to do something with the national insurance system going forward, that is a pretty sensible thing to do.

Q328 **Anthony Browne:** What are the benefits or otherwise of equalising the rate?

Paul Johnson: It tidies it up. If we go back to 2010, we had the lower earnings limit and the personal tax allowance at the same level. If I thought this was a step towards a broader bringing together of the two systems, I would be cheering more loudly. The reality is that it probably does not make too much difference to anything very much, not least because they remain two completely separate systems and national insurance will still be charged on a weekly basis and income tax on an annual basis, and so on. It will not be that helpful to employers, because the employer national insurance threshold has not gone up.

As a tidy-minded tax analyst, it looks a little better. In reality, the alignment maybe adds a little bit of simplicity to people understanding at what point they start paying tax on their earnings. That is probably not a bad thing, but, until I see something more substantive about a desire to bring the two systems closer together as a whole, I am not going to get ever so excited about it.

Q329 **Anthony Browne:** Gemma, do you think it was better to raise the threshold than to delay or cancel the rise in the rate? What do you think about equalising the thresholds?

Dr Tetlow: I am going to be terribly boring and say that my answer would have been pretty much the same as Paul's.

Anthony Browne: We are all in favour of consensus.

Dr Tetlow: Whether it was better to raise the threshold rather than cut the rate depends on whom you are trying to benefit with the tax change. Doing what the Chancellor did gives the largest benefit to lower earners through the confines of the national insurance system rather than cutting the rate. I would agree with Paul's concern that a delay to the NICs rise may have meant the cancellation of it altogether, but the whole nature of changes that were made to NICs shows the lie that there was in the hypothecation of the NICs increase to NHS and social care spending. We have not cut NHS and social care spending because we raised the NICs threshold.

Q330 **Anthony Browne:** I was going to ask about that, but you have raised it now, so, before I come to Torsten, I will just pick up on that point. When we had the Chancellor here on Monday, I asked him about exactly that point. He is going to lose £600 million from the NICs rise by raising the threshold. I asked if he was cutting NHS spending by £600 million, and he said no, because the budget has already been allocated. Is there any sense that this is a hypothecation or is it purely political hypothecation?

Dr Tetlow: It is purely political hypothecation. We would not want the Chancellor to have come here and, at the very last minute, tried to cut—

Anthony Browne: He would have had a lot of criticism for doing it.

Dr Tetlow: There is no real sense in which this tax is used for the NHS or social care.

Q331 **Anthony Browne:** It is unlike the TV licence fee, which does go to the BBC. Torsten, the same question to you—raising the threshold versus delaying the increase in the rates.

Torsten Bell: Within that package, he definitely did the right thing. Everything we have said about the overall package announced last week not doing enough for the bottom—

Anthony Browne: I totally take that point, and we have discussed that quite a bit.

Torsten Bell: I was going to say that that would have been true on steroids if he had changed the rate. You would have been spending almost of all your money on the top fifth of the population, if he had scrapped the rate cut and not raised the threshold. He has broadly done the right thing in terms of targeting the middle.

Q332 **Anthony Browne:** Scrapping the rate cut would have been really regressive compared to what—

Torsten Bell: Because the rise in the national insurance rate is very progressive among earners, if you scrap it, the giveaway is to those at the very top. It would have been hugely regressive, so that would not have been a good idea.

I broadly agree with what the others have said about the desirability of aligning the national insurance and income tax thresholds. You need to be abolishing the weekly calculation rate and the per-job-ness of national insurance, and then you are within a ballpark of being able to get to the systems being vaguely similar.

Both George Osborne and Gordon Brown at times flirted with the long-term objective of merging the systems. I am enough of a cynic to think that that is probably not what we are going to be doing in the foreseeable future, but that would be a better idea because you would be able to treat all kinds of income on a similar basis, which would remove a lot of the problems with our tax system, particularly in terms of how it interacts with how people report their income.

Q333 **Anthony Browne:** The challenge with merging the two systems is that, from where we are now, apart from the complexity of system changes, there are just too many losers politically, so you need to have a 10-year plan.

Torsten Bell: You would know better than me.

Q334 **Anthony Browne:** I want to ask you about hypothecation as well. The Chancellor did not cut NHS spending.

Torsten Bell: I was going to be slightly fair to the Chancellor and say that it turns out that it was a two-hit hypothecation. It was vaguely true as a statement of intent in September, and then, because he thought he should try hard, he made it slightly true in the Budget, where he slightly increased the rate of increase. Because, even then, national insurance was bringing in more than expected, in the autumn, he did actually change the total spending for the Department of Health to match what was coming in, but we are now done, so it is now dead.

Q335 **Anthony Browne:** I want to ask about increasing national insurance rates and cutting income tax rates. Paul, you issued a statement saying that that increases the wedge between higher taxes on earnings and lower taxes on pensions and unearned incomes. Torsten described that as "bananas". Could you elucidate why that is a particular concern?

Paul Johnson: There are two issues there. One is that you might feel that there is an equity concern about treating different types of income differently, but there is also an efficiency concern.

Q336 **Anthony Browne:** But there is no economic rationale for treating them differently.

Paul Johnson: There is a potential economic rationale for treating incomes that result from investment differently, because you do not want to put people off investing. The problem is that, if you have different rates, it is possible for people to take income in different forms. An awful lot of self-employment looks remarkably like employment and does not involve any investment, and the same is true of one-person companies and so on. Indeed, the receipt of lots of dividends can look very much like the returns to work. There are lots of reasons for having the same rate of tax.

For some kinds of income, where there has been an investment that is resulting in that income, you do not necessarily want to tax that at the same rate as employment income, because you do not want to provide disincentives to investment. The ideal way around that is to change the tax base, so that you give full relief on the investment that is made.

Given the system that we have at the moment and how much of this income does not look very much like the result of that kind of investment, my view is that, ideally, you change the base and move the rates to the same level. In a second-best world, it will be better to have the rates closer together than they are now, not further apart.

Q337 **Anthony Browne:** I am going to move on to my second set of questions, which are about interest payments, which we have not touched on yet. As the Chancellor highlighted in his statement, central Government debt interest, net of the asset purchase facility, is going to rise to £83 billion in 2022-23, which is quite an extraordinary amount of money. I realise that you do not have to pay it all up front now, because some of it is just when you pay off the Government bonds. How concerned should we be at rising interest payments, and how real a constraint are they on the Government fiscally?

Torsten Bell: In brief, we should worry a bit but we should worry about the right thing. I do not think we should worry overly about the spike in debt interest costs that is coming next year.

Anthony Browne: Because we are not paying it next year.

Torsten Bell: We are paying it for 30 years, and we pay back the gilts. I do not think that the way in which we classify that is unreasonable. I know that some people are horrified at the idea that accruals exist, but if you start undoing that you are going to be taking apart a lot of our public finance system, not to mention the accounting of every firm in the country.

I am not too fussed about the accountancy problem, but the real-world problem is that we do not need loads of cash to pay it next year, so we do not have a problem. Much more substantively importantly, so long as the inflation spike is temporary, it does not have any permanent effect on our debt interest costs and the fiscal position. Do not panic about that. Be a bit annoyed, maybe, but on the grand list of problems that inflation is causing this is way down.

Do worry about uncertainty about the longer-term path of interest rates, and make sure that that is baked into your thinking—do not just assume that they will always be as low as they are. We always used to think that they were going to be significantly higher than they currently are and, if that world did turn up, higher levels of debt would interact with that to give you high debt interest payments. That does not mean that we should be remotely worried right now, not least because, hopefully, that would happen in a context of higher growth and we would have time to adjust to that world, but we should pay attention to it. Do worry a bit, but worry about the right thing.

Q338 **Anthony Browne:** With these potential increases in interest debt payments, presumably the Chancellor has the choice of raising taxes to pay for it; borrowing more, which seems a bit short-sighted; or cutting spending. It will have an impact on future fiscal rounds.

Torsten Bell: One of the ways in which we have managed to increase some areas of public spending over the last 30 or 40 years, particularly on the NHS and, in the longer term, education, is because our debt interest payments have been on a long-term declining trajectory, mainly but not only because of the long-term decline in interest rates, and also because the level of debt came down until the financial crisis. Those two things gave us some headroom that could be spent on other things without raising taxes.

The overall amount of that is small. What we have done in running down our defence is a much bigger part of the savings we have made. Running down investment spending from the 1980s through to the late 2000s was also a large part of that. You are right that it is all fungible in the end.

The reason why we should think about debt interest slightly differently is that, when you are thinking about the tail risks that face countries, some of that probably does materialise through an out-of-control debt interest bill, and then it comes down, basically, to the political ability to raise sufficient taxes to choose not to default. I do not mean actually defaulting—you can default via inflation or via financial repression, which we already do a bit of.

In the UK, none of this is remotely plausible as a risk in the short term, but for countries in general the exam question is, "Do you have the political and economic space to raise taxes sufficiently to deal with a very fast-rising debt interest burden or is the political choice to default?", whether that is actual default or default in practice. We should think about that a bit, in the same way that you worry about whether the big tree at the back end of the garden could, one day, if the wind blew in a particular direction, take out one part of your roof. You are probably not going to do anything about it in the short term, but it is good to be aware of the risks.

Q339 **Anthony Browne:** Gemma, how worried should we be about increased debt interest payments? As a follow-up question, inflation is now hitting 8%. Not all of our debt is index-linked, so a lot of it will be going down in value, presumably, which is quite beneficial to the Government.

Dr Tetlow: I would probably agree with Torsten's answer that you shouldn't be not worried at all—

Anthony Browne: I can't believe all you economists are agreeing with each other. You're meant to disagree with each other!

Torsten Bell: That's because there are some facts, and we look at the facts and tell you what the facts say. They may be consistent.

Chair: That's probably one of the most controversial comments—

Torsten Bell: We can have a row about that instead, if you want.

Anthony Browne: Carry on—sorry.

Dr Tetlow: We do need to think about long-term fiscal sustainability, and the amount that we have to devote to debt interest costs is part of that. At the moment, the Chancellor's fiscal plans are such that he has debt falling at some rate in the future, so you could spend a bit more on debt interest costs without cutting other spending or raising taxes and still have debt on that broadly sustainable path, but there comes a point at which you would then be on an unsustainable path, where your higher debt interest costs are leading to more borrowing and to yet higher debt year on year, so you do need to be concerned about that. As Torsten said, the thing that you want to reassure markets of is that you are a Government that can cut spending or increase taxes, if needed, in that kind of scenario.

You are right on inflation and the public finance position. Although we have more of our debt stock that is now index-linked, so inflation does not do as much to reduce the burden as quickly as it did in the 1970s—

Anthony Browne: It is only a quarter, from memory.

Dr Tetlow: Yes, exactly. Still quite a lot of it is not index-linked and, therefore, overall, inflation is good for the public finances, because it erodes the debt stock and tends to feed through into higher revenues in the way that we were talking about before.

Interest rates do matter, but, as Torsten said, there are two worlds of future interest rate rises. One is a good world, where growth is picking up and that is what is resulting in normalisation of interest rates, so your ability to meet those debt interest costs is rising at the same time as the cash cost of them is. The really difficult world for the Government is where you just have runaway inflation without any economic growth.

Anthony Browne: Stagflation.

Dr Tetlow: Yes, exactly.

Q340 **Anthony Browne:** Paul, I assume you agree with the others, but how worried are you about increased interest payments in a world where interest rates are expected to go up a bit more and inflation is rising, with negative real interest rates?

Paul Johnson: I am slightly more worried than I was, given Torsten's analogy with trees falling down and how many trees fell down last month.

There are various reasons for worrying, as ever. One is if inflation stays high, and it seems to be not impossible that it will stay higher than is currently forecast. By the bye, why are we still linking it to the RPI as opposed to the CPI?

The thing that continues to worry me and has done for the last decade is this. Why can the Government sell their debt for nothing and massively negative returns? In the end, it is because people are scared to put their money anywhere else or because they do not see any returns that they can be comfortable with elsewhere. It really is a signal of how much uncertainty and concern there is about the rest of the economy. For the economy as a whole, people demanding a higher return on Government debt, assuming it is not associated with fear of default, which it is highly unlikely to be in the UK context, would be a reflection of the fact that people are more confident that they can put their money in the stock market or wherever and get a decent return on it, because there are good enough things to invest their money in. That is really what is going on, not just in the UK but internationally.

In terms of broader interest rates, it is easy to come up with all of the problems that having higher interest rates would create, but having interest rates somewhat higher than they are at the moment, and inflation somewhat lower, so that you have real interest rates that are closer to zero than minus seven or whatever they are at the moment, would be a much better world for all sorts of reasons, including distributional ones and people making choices around borrowing, saving and so on.

Given where we are at the moment and the likely sets of directions, I am more worried about interest rates not going up than I am about them going up.

Anthony Browne: Because of the impact on inflation.

Paul Johnson: Just because of the general impact on the economy, because we have been living for 12 years with negative real interest rates that have had these fairly damaging distributional consequences and because they are a signal of the underlying weakness of the economy.

Q341 **Anthony Browne:** There has been no indication that the Government are struggling to raise cash in the markets yet.

Torsten Bell: We are awash with cash. We have too much cash. We have accidentally raised too much money.

Anthony Browne: So there is no symptom at all of default being anywhere near.

Q342 **Alison Thewliss:** I have some questions around the energy bill rebate/loan/not-loan, whatever it might be called. I just wondered how each of you would describe it. The Chancellor was quite insistent that it was not a loan, despite it being money being given that has to be paid back on a schedule.

Paul Johnson: I do not really mind how you describe it. It is not a loan in the sense that people who have not received it will have to pay it back. My sons are likely to move out of home. They have not been paying an energy bill and will have to pay an energy bill. Equally, there will be people who move back into a house where they are not responsible for the energy bill and they will have got the benefit and not paid the cost.

It is not a loan in that formal sense, but it is clearly what it says on the tin. It is £200 this year and, for most people, it will be an additional £40 each year into the future, although it feels to me that this is highly dependent on what happens to energy bills. If energy bills are at the same level as we go into the next financial year, it is extremely unlikely that that £40 will be levied on top. Indeed, there will be pressure to have another £200 rebate.

We were having a discussion about student loans. You can decide how to describe it, but whatever the word is, we know exactly how it is going to work. It looks quite like a loan, but not completely.

Dr Tetlow: Yes, it does look quite like a loan, aside from people moving in and out of the system. Broadly, it is smoothing out the cost of energy to households in the UK by somewhat reducing energy bills this year and increasing them in the future. It gives people more options. If you are worried about your ability to make those payments in the future, you can put the money aside this year and pay it back out of your savings next year. I suppose, as a hard-headed economist, it is giving people more choices and, in that sense, cannot be a bad thing, apart from the people who are not benefiting from it this year and will be expected to pay next year.

Q343 **Alison Thewliss:** But you cannot choose whether to take it. You have to take it.

Dr Tetlow: You cannot, and so there might be a concern about people who do not understand that this is a temporary cut and that they will be expected to pay it back later on. If people understand, they have more options than they had before.

Torsten Bell: Luckily, I do not work for the ONS, so this is their problem. What would they call it? Their answer is a grant followed by a tax. That is the official answer and you can take it up with them. In the real world, it is a loan to us as a collective, which we then pay back as a collective. As Paul said, if you move in and out of the collective during that phase, it is a bad year for you. Collectively, it is a loan to bill payers. At an individual level, it will not always be the case, which is what the Chancellor is picking on.

Our general worry should be more around some of the issues that Gemma is raising and then how this fits together in a broader package. This has the advantage over the council tax rebate of at least being targeted at people's energy bills this year. It has the disadvantage, as Paul said, that we may still be facing big energy bills next year, and that this will be increasing the size of our energy bills rather than reducing them. That seems implausible to me.

Q344 **Alison Thewliss:** We heard from experts on energy prices about the way in which those are going. It does not seem realistic to expect it to go back down next year.

Torsten Bell: There are a number of things there. We should have a good dose of humility that we do not have a good handle on what could happen. It is plausible that one of the upsides to these awful living standards forecasts that we are all looking at is that energy bills fall more quickly than we anticipate, although they could also go the other way; real wages do better than we are anticipating; and productivity growth picks up to allow those wages to happen without the Bank of England having to whack up interest rates.

There is a better-world scenario about how the next two years play out. I do not have a strong view on what is going to happen to energy prices. As I said before, the difference between what is in the Bank of England's forecast, which uses the full forward projection of market energy prices, and the OBR, which chops it off after six months and has a flatlining level, is doing a lot. If you thought that energy prices were not going to come back down, you could end up with a bigger unemployment spike that the OBR does not have—it has perfect, immaculate disinflation happening—and you would end up with a hit to GDP that lasts, if that was the case.

One thing in the Chancellor's defence in saying that it is not a loan is that the financial effect of it will not be the same in terms of people's credit ratings or balance sheets. It is not like normal debt. That is how I would put it. It does not lead to the acute kinds of distress. It is analogous to a student loan system, to a degree. It is not going to be the thing that the collection of affects you personally in the same way as a credit card debt, for example. It is still going to be bad, because it is a higher energy bill, but it is not a debt in the normal sense.

Q345 **Alison Thewliss:** I was going to ask about the implications for people on prepayment meters, which is quite a different scenario from people who are on direct debits. Some of those people are put on prepayment meters because of debt that they have. The Chancellor was not really able to explain—he punted it on to BEIS—how exactly this payment would affect the debt that people had accrued on those meters. I do not suppose any of you guys have any better idea as to how that might work, because that is then a debt problem.

Torsten Bell: There are a number of challenges about implementing this policy for prepayment meters. I am not sure I know enough about the specific issue you are raising, but generally the issue about having to use multiple methods to make sure that you can get the cash to those on prepayment meters is going to be more complicated. It may end up being different for different suppliers. As someone who has been on a prepayment meter, the whole system is a turkey, so that is a problem. The danger is that we are not 100% confident that we will get the discount to people, but we may be much more confident that we can claw the money back through higher bills in future years. That is worth pursuing, but I have not seen any more detail from BEIS on how that will interact with wider debt challenges in the energy system.

Q346 **Alison Thewliss:** Some people are worried that any payment that they get just goes against debt and does not mean that they can pay for the extra electricity when it comes in. The notion is that it comes in five £40 chunks rather than £200 all together.

Torsten Bell: You know more than I do.

Q347 **Alison Thewliss:** How confident are you that the Chancellor will get the money back in if energy prices increase?

Torsten Bell: It would be mad to try to collect the money back next year if energy bills have not fallen. The exam question come the autumn is not going to be, "Can we get the money back in next year?" but "What else are we doing to support households that are going through an absolute nightmare?"

Paul Johnson: That sounds about right. As I said just now, if energy bills are still at the same level as they are now, not only does it look very unlikely that he would charge the extra £40, but there would be pressure to have another grant or rebate of some kind to keep them down. Given the policy in place, that is going to be another tricky position for the Chancellor to be in, but that is the sort of position he has put himself in by creating this loan-type thing, in which he has tied his hands to, in a sense, stopping giving people £200 and then taking another £40 off them. That is fine if energy bills go down by £240, but, if they do not, that is going to look really hard.

Q348 **Chair:** Just before we move away from that point, could you clarify whether you are talking about this autumn or next autumn? We are expecting potentially a 40% increase in the energy price cap this autumn, so, with those comments, are you talking about this year or next year?

Paul Johnson: I am really talking about next spring and the next fiscal year, and it is over the year that this policy is in place for. The Chancellor could fiddle around with the exact timing. If there was a very good reason to think that, in September 2023, energy bills were really going to start falling, that might be the point at which he starts clawing back.

Q349 **Chair:** He has talked about potentially doing more in the autumn.

Torsten Bell: There are a number of different chunks here. Just on energy, the energy price cap that will apply in April 2023 will be set on the basis of the wholesale energy prices for the six months before February. The energy prices that we see in the markets this autumn, even though they have not been borne by consumers this autumn, will matter for him taking his decision in the Budget for what happens, as Paul rightly says, in April, leaving aside that Ofgem has reweighted slightly which months count towards the energy price cap. That is broadly what is going on, so it will matter for that.

The exam question for the Prime Minister at the Liaison Committee, and for others who area saying, "If it stays bad, we will do more," is, "What is it that you are waiting to get worse, and how is that going to show up in time for you to act?" These energy prices are now baked in. These energy companies have been making losses. They are going to be charging this cap. It is not like they are going to be coming in well under the cap over the course of the next few months, so it is not clear to me what we are waiting to see. Further damage to households via rising energy bills will come in October, which may call for an early Budget, and it will be the wholesale energy prices over the coming months that will tell us where that is.

I do not yet feel confident saying what the level of the energy price cap will be in October. It is definitely plausible that it is a significant further increase of, say, 40% on current levels, but that is very uncertain. You saw large movements yesterday in energy markets just because of the Russians promising less action in one area of the Ukraine conflict, without any evidence that anything was happening on the ground, so who knows?

Dr Tetlow: Torsten is absolutely right that we really do not know what is going to happen to energy prices, but, if you take the OBR's forecasts at face value, they suggest that the dual fuel bill will go from about £2,000 this April to £2,800 in October, and then back down to about £2,000 next April. Their forecast is that we would have bills about the same as they are this April and the Chancellor will be raising them by £240.

Alison Thewliss: So still quite high.

Dr Tetlow: Yes.

Q350 **Alison Thewliss:** Money Saving Expert has carried out some research showing that more than half of people polled would prefer not to receive the rebate, because they would not want to get into that debt or have it added to their bills later, when prices might be higher. The Chancellor told us this week that it would not be possible to set up a system that allows people to opt out of this loan. Should the Government be trying to achieve that rather than forcing this on people?

Dr Tetlow: For the reasons that Paul set out, I would really worry about the mis-selling of that. How do we keep track of the people who did not take this and then make sure that they are not paying it back later on? The whole system is not set up to be an individual transaction of that nature, so I would very much worry about that.

Paul Johnson: As we have discussed, there is a good chance that this £40 a year will never be repayable, so you would be very poorly advised not to take the £200 upfront.

Q351 **Alison Thewliss:** It is still a bit of a risk though. There was nothing in what the Chancellor was saying about people who use heating oil or LPG, and who have to fill up by the tank and are seeing really significant increases in costs. Are there any measures that you would think of putting in place that could support that group of people? The Chancellor said they were being prioritised for insulation payments, but that does not seem to be quite enough.

Torsten Bell: They are generally being prioritised within some of the energy efficiency packages that the Government have announced, separate from all of this, so there is an element of that going on, but you are completely right that, if those are your sources of home heating, this system is not doing anything for you. The absolute number of people is substantive, but the majority of people have more traditional heating mechanisms. You could move to a more manual mechanism with a similar approach, but you do not have very large companies largely operating via direct debits, because you are paying by the tank, and so it is difficult.

If you look at what is happening in France, for example, the system that they have used to do the equivalent of the fuel duty cut is a rebate at the pump when you go and pay. The equivalent of that scheme for, for example, heating oil would be that the Government just give 15% off the bill this year and pay that to the supplier directly. It would be a hassle to implement, but that is what the French Government are doing for their petrol prices. You would have to do something like that. This mechanism does not work for those sectors.

Dr Tetlow: As someone who heats with oil, I have personal experience of this. I think I am right in saying that these rebates are going on electricity bills as well, so most households will use electricity, even if they are using oil for heating and not gas. I do not know what fraction would fall through the cracks of not having electricity as well.

Q352 **Alison Thewliss:** Moving to a slightly different subject, around economic growth and forecasts, the OBR has reduced its economic growth forecast this year from 6% down to 3.8%. How concerned should we be about this? To what extent do the ongoing war in Ukraine, Brexit and covid feed into that narrative of growth?

Torsten Bell: We should start with the good news, although there is not much of it. The economy is slightly bigger than we thought it was going to be, by about 0.5%, and unemployment is lower, so the short-term recent history is good news. I do not think we should completely forget that as we look ahead at the trauma to come—lower unemployment and a bigger economy.

In so far as the slowdown in GDP growth next year is because the past is slightly better, that is not a problem at all. That is the minority of the slowdown, so we should worry about all of the rest, which is being driven in the short term by everything we have been discussing today.

What is happening to GDP is quite decoupled from what is happening to households, and that is the most important thing for the next year ahead. Looking at GDP growth across the whole of the forecast, we should conclude that it is awful but could be worse. That is because it is really bad. The underlying British period of relative decline that we have got ourselves into is the reason why we have public services, as the IFG tracker shows, suffering lots of delivery problems, despite taxes going up. It lies behind most of our national traumas.

The GDP forecast that the OBR has broadly continues that, but it does show GDP growth being significantly higher in the future than it has been in the 10 years since the financial crisis, so if we ended up just getting back to where we were pre-pandemic it would be worse than these OBR forecasts are showing.

We have all had a tax row on the back of this spring statement in focusing on the benefits system, but the big problem that is underpinning the fact that we are going into this inflation-driven cost of living crisis is a productivity stagnation/living standards crisis, which means that we are ill prepared to be hit by this one. In the end, unless we get this country growing again and stop it falling behind other countries, all the rest of this is for the birds, because it does not matter whether you want to be a tax-raising or a tax-cutting Chancellor; whatever you want, you are not going to be able to get it.

Dr Tetlow: Broadly speaking, the OBR's forecast, as Torsten said, is, "We have had better growth than we expected. We definitely have worse growth than we expected for the next year, and then things pick up." Overall, they are getting back to a similar real size of the economy to what they expected before, which is bad in the short term. It is not as bad as it could be in the longer term. As Torsten alluded to before, the OBR is, essentially, assuming that this is a temporary shock to energy costs and, therefore, does not have a permanent impact on the UK's supply potential. If that is not true and if we have longer-standing rises in energy costs, that would be more depressing and worse for the UK economy than it being a purely temporary shock.

Paul Johnson: Broadly speaking, if we get away with what the OBR is forecasting—in other words, a very small long-term hit from covid and no long-term hit from this—it could be a lot worse.

Q353 **Alison Thewliss:** The OBR's forecast included charts showing a clearly observable deviation between the UK's trade intensity and export volumes compared with other similar economies since the UK left the EU. Are these lower export volumes a result of Brexit or, like the Chancellor was trying to say, is it too early to attribute them to that directly?

Paul Johnson: They almost certainly are, given the difference in what has happened between us and the EU and us and other countries, and between our performance and other countries' performance. If you dig into the figures, it is really associated with a lot of smaller companies just giving up on exporting, even before some of the problems arose. Could I prove that causally? No. Does that seem much the most likely explanation for at least a large part of it? Yes.

Dr Tetlow: The OBR figures show that the UK's trade intensity is behind where other countries have gone since the Brexit vote. There are two reasons to think that perhaps this does not suggest that Brexit has been the causal factor, or at least that the forecasts that were made about what Brexit would do pre Brexit have not played out. The first is timing. A lot of this divergence in trade performance happened before we implemented the new trade relationship with the EU.

Secondly, the thing that has really been hit is UK imports from the EU rather than exports to the EU. That is not really what the standard economic models would have said; they would have said the reverse. Those are two reasons to think that maybe it is not totally Brexit and could be something else.

Q354 **Alison Thewliss:** Is there something else you would attribute it to?

Dr Tetlow: One is that the timing mismatch could be explained by people anticipating what was going to happen when the trade rules changed, and it is very likely that businesses did that. The second is that the pandemic may have brought forward things that would otherwise have taken a longer time to manifest. What we had been expecting in the absence of the pandemic was that, gradually, it would be harder to find new customers in the EU, and vice versa, and that we would no longer have that growth in trade relationships that we would have had. The pandemic severed that ability to trade and, therefore, may have meant that, after that happened quite rapidly, businesses then thought, "There is not much point in trying to get this started again, because we know it is not going to be profitable in the longer term."

The other possible reason that I have heard people talking about in terms of why it might have impacted more on imports from the EU than vice versa is that, if you are an EU company, the UK is a relatively small part of your customer base. Because you really do not know what the new rules are going to be, if there is a bit of a mental barrier to have to get over to figure out what they are, EU companies may just have said, "That is a small part of our customer base. We can focus our efforts on finding customers elsewhere." For UK firms, EU customers are a very big part of their market and, therefore, it is much more worthwhile for them to try to figure out how this new system works.

Q355 **Harriett Baldwin:** I am interested to get to the bottom of something that the OBR was not able to answer and the Chancellor did not have the answer to either. Which departmental spending lines are going to be hit most severely by the rise in inflation? We know about this difference between the GDP deflator, RPI, measures of inflation and so on, but, with the headline rate of 8% coming mainly from energy prices, some Departments will suffer much worse from that than others and will be seeing significant real-terms reductions in their spending power. I just wondered if any of you had done a departmental analysis.

Paul Johnson: We have looked a bit at which Departments spend how much on energy. MoD spends an awful lot and hospitals spend a fair bit, but these are relatively small amounts compared with, for example, how much they spend on pay: 50% of NHS spending is on pay, and a very small fraction is on energy; 70% of school spending is on pay. All of these things are going to matter and, particularly at an individual school or hospital level, they are going to see increases in their bills, but it will be wiped out by each 0.5% on the pay bill, one way or the other.

This does, for example, tip MoD spending, at least on the current basis, from positive to negative over the next three years in real terms, just taking account of the energy prices. It is quite big for some of those Departments.

Q356 **Harriett Baldwin:** That is really helpful. That is the first time we have had that level of granular analysis. Can I drill down a bit further and ask how much of the MoD budget is fuel?

Paul Johnson: I have that somewhere if you could give me a couple of minutes to google it off the IFS website.

Q357 **Harriett Baldwin:** Are they hedged? They may have hedged it.

Paul Johnson: That I do not know.

Torsten Bell: On the MoD, the shift from a slight increase to a slight decrease is also hiding what is really going on. All of these cost pressures are on current spending, so they are all putting pressure on the current side of the MoD budget, and it is that bit that was already getting squeezed very significantly. The fact that it is not falling overall is only because the MoD is seeing increases in capital spending, in large part to pay for the nuclear deterrent.

If what you care about is the rest of what the military can do day to day—the size of the Army and that side of things—paying for heating bills is coming out of the current budget, which was previously falling by 4.3% and, by 2024-25, will be falling by 5.7%, even if we use the GDP deflator. If we then take into account rising import costs, you are talking about a more than 6% fall in the MoD’s spending power on day-to-day defence.

Chair: Just to make it clear, the Government do not hedge against prices. There is no hedging.

Harriett Baldwin: You never know; they may have done.

Chair: They do not do it.

Q358 **Harriett Baldwin:** We assume they have not—I agree, Chair. In terms of hospitals, they presumably have a pretty big energy bill as well.

Torsten Bell: They do publish that.

Harriett Baldwin: You mentioned school buildings.

Torsten Bell: The Treasury does publish the breakdown of its spend, including on energy. I do not have it off the top of my head, but I have seen it.

Q359 **Harriett Baldwin:** Could it be so significant that you would find hospitals worried about whether they could perform the operations that they had scheduled?

Torsten Bell: It will not have anything like the effect. It will not have the same interesting talking point about moving to negative spending for the NHS, because the rise is big enough that it will not be doing that. The bigger picture is that we were already worried about how on earth the NHS was going to cope with the ongoing impacts of covid, plus trying to deal with the backlog, and higher energy bills are not going to make that any easier, but I would add it to the long list of pressures rather than saying that this is the one that will definitely push Hospital X over the edge.

Q360 **Harriett Baldwin:** What percentage of schools' budget is energy?

Torsten Bell: School spending is overwhelmingly staff costs, but among the biggest non-staff costs will be energy. Again, we should be clear that public services require a lot of people.

Q361 **Harriett Baldwin:** In terms of public sector pay, we could not get a precise answer out of any of our previous witnesses. Would it sound about right if about 3% in terms of public sector pay has been baked into the forecast numbers?

Dr Tetlow: I think the OBR told you that that was what was implicit in the spending review plans.

Harriett Baldwin: They sort of implied it was, yes, but they did not really want to confirm that the Treasury had said that.

Dr Tetlow: I have not seen that from another source. If that is right, that was an assumption being made at the time when the OBR was projecting that, economy-wide, wages this year would go up by 3.9%, and it is now expecting 5.3% wage growth this year. If 3% was doable in terms of attracting and retaining the quality of staff that you want in the public sector when the rest of the economy was getting 3.9%, it may be harder to retain and recruit the staff you want when there is a bigger gap.

Q362 **Harriett Baldwin:** Paul, did you find out the answer?

Paul Johnson: What I have here is that schools and hospitals spend between £1 billion and £1.5 billion on electricity and gas, and the Ministry of Defence spends about £0.6 billion on energy and fuel. The figure that I have here is that a 50% price rise would cost the public sector at least £1.5 billion a year.

Harriett Baldwin: That does not sound massive in the great scheme of things.

Torsten Bell: It is tiny compared with what Gemma is talking about.

Paul Johnson: It is not vast relative to pay; that is for sure.

Harriett Baldwin: It is not, in any way, similar to what households are going to experience.

Torsten Bell: No, because most households do not employ people.

Harriett Baldwin: I mean in terms of the proportion of their outgoings.

Torsten Bell: Absolutely, yes, it is much bigger.

Q363 **Chair:** On public sector pay, this real-terms decline in the increases that the Chancellor thought he was announcing last October does imply a very tight public sector pay settlement, possibly with zero or very small increases, and a fall in real wages for public sector workers, does it not?

Paul Johnson: I do not think we are looking at zero nominal increases. As Gemma was saying, the OBR has significantly more than that pencilled in, but they will, on current trends, be well below not just inflation but the private sector. The Government's evidence to the School Teachers' Review Body was asking for a 3% pay rise for experienced teachers, which will be something like a 5% real-terms cut, after something like an 8% real-terms cut over the last decade. While private sector pay has done badly over the last decade, it has not gone down. It has gone up a little bit, so the public sector has already fallen quite a long way behind the private sector relative to 2010-type levels.

With no extra money at all for public services, it seems to me almost certain that we will have bigger than intended real-terms pay cuts in the public sector, and almost certainly a bigger differential between public and private sector pay increases than was intended back in October, unless Departments decide that they are going to employ fewer nurses or teachers and pay the ones they have a bit more. What we saw in the evidence to the School Teachers' Review Body is that that is not what they are planning.

Q364 **Gareth Davies:** I have three pretty quick questions on business investment. Gemma, I want to talk about the fallout from the pandemic.

I read in the OBR forecast, "Overall, the pandemic appears less likely to weigh on firms' ability to invest than we feared a year ago." It expected that business investment will return to pre-pandemic levels this year. Why do you think that is?

Dr Tetlow: I am afraid this is not an area of deep expertise for me, but the concern, certainly earlier in the pandemic—I think this is what the OBR was factoring in—was that there would be a debt overhang from the pandemic for firms that would weigh on their ability to invest more in the longer term. Firms are coming out of this with a better financial position than was expected and, looking back with hindsight at the package of support that was offered to firms through things like the furlough scheme and the loan schemes, this perhaps went further to cushioning the blow on firms than had been intended.

Therefore, they are coming out of this in a slightly better financial position than was feared originally. Things like changes to the ability of landlords to kick firms out of their premises or for them to become insolvent during the pandemic also helped firms to survive some of those pressures that they otherwise might not have done.

Q365 **Gareth Davies:** You said it was "perhaps" the economic package of support. What could it be, if not that?

Dr Tetlow: The pandemic probably played out a bit differently than we expected. If you think back to March 2020, when we went into the first lockdown, the entire economy shut down across all sectors. As the pandemic went on, we learned that some sectors had an ability to return to more of their normal operation, even in the presence of public health restrictions.

Compared with where the OBR might have feared things would be right at the start of the pandemic, vaccines came along more quickly than we might have expected, so the pandemic was less long lasting than it could have been and, therefore, less damaging to firms. Also, firms managed to adapt and continue some kind of operation, even while reducing the spread of the disease.

Q366 **Gareth Davies:** Paul, the Treasury has committed to reviewing the tax incentive offering for stimulating business investment. What is your specific assessment of R&D tax credits as a way of boosting business investment?

Paul Johnson: I do not have a detailed knowledge of them, I am afraid. There are a range of things that the Treasury could be looking at in terms of investment, including continuing the way the super deduction works, or some version of it, so that you get full deductibility against any investment that you make, which would be very helpful.

There is a very strong case in principle for the R&D tax credit, and early evaluations of it suggest that it was quite effective in increasing R&D. Gemma or Torsten may know more about whether there is better evidence on it more recently and how well targeted it is, because I am afraid that I do not know.

Q367 **Gareth Davies:** The curiosity that I have is that it is, apparently, one of the most generous R&D tax credits in the world, yet we have pretty low amounts of R&D investment.

Torsten Bell: We do. The Chancellor is reviewing all of these at the moment, and that is a very sensible thing for him to be doing. I do slightly worry about the particular talking point—I have heard it used a few times—that British firms invest less in everything, so the fact that we have a more generous R&D tax credit and get less R&D partly reflects that they invest less in human capital and in buildings. So R&D is on the list of our disaster, but—

Gareth Davies: This has been the case for decades.

Torsten Bell: That is my point, exactly.

Q368 **Gareth Davies:** We had a member of the OBR who said that he has worked there for 10 years, and at the Treasury for 10 years before that. For 20 years, this has been top of the Government's agenda, and nobody has really tackled it to the extent that they perhaps should.

I am asking about R&D. I was really struck that—I mentioned this to the Chancellor—page 40 of the spring statement showed that Israel and South Korea have three or four times the level of R&D investment that we do, yet we have one of the most generous R&D tax credits in the world. I am trying to square that circle.

Torsten Bell: You should conclude that, when it comes to asking the big, right question, which the Chancellor has started asking since his Mais lecture, about how the problem is a lack of private sector investment—that is appearing across these different ranges and types of investment—thinking that tax is the most important answer is giving too much agency to the tax system. The Chancellor, to be fair to him, is focusing on tax because that is the thing that he has as a lever to talk about, but if you read his lecture he rightly says that there is some other stuff going on here. I would say that, yes, there is.

We have a broader challenge around why we invest so little. People always say it is because we have smaller manufacturing and a larger service economy, but all of that is nonsense. If you adjust for our industrial mix, we invest less right across the board. We do less R&D, and that, in the end, has to be sorted, but do not think that, in the end, the tax system is the big driver of that.

I will give you an example. We saw no investment growth after 2016 for four years, while the rest of the world was having its version of the post-financial crisis boom. It was not our tax regime but Brexit. These big macro things are what matter for the levels of investment in an economy. Your tax system can make things better or worse around the edges, but it is not the tax system that differentiates us from Israel and South Korea, I am afraid.

Q369 **Gareth Davies:** If you are asked to contribute to the consultation that is going to happen before the next Budget, what will each of you suggest? I know you are saying that there are lots of different things you need to do and lots of different levers to pull, but what do you think would have the greatest impact as a single policy area that you would suggest in order to boost business investment?

Torsten Bell: I am going to cop out on the tax system, because we have some work starting that is going to try to answer that question and I do not want to prejudge where that comes out. I will throw something else into the mix from the academic literature. Theresa May, in the dawn of time, was in favour of workers on boards—do you remember that?—and we did not do it. The left is generally in favour of workers on boards, because they think it will push up the amount of wages that goes into the company.

There is now quite a bit of academic evidence from Germany and a Scandinavian country—I want to say Finland—looking at the introduction of workers on boards as a policy. It does not do what the left would generally want it to do, which is to boost wages relative to profits in the firms. It does not have that effect at all. What it does is to boost investment by those firms, because it changes the dynamic in the decision-making process.

I would start focusing on other areas. We will contribute to the right design of tax policies, but I would start thinking about other policy areas as well as that, if you want to make a long-term change to the fact that Britain does not deliver private sector investment. The Chancellor is doing public sector investment, which is now very high by UK historical standards.

Gareth Davies: Yes, he made that point.

Dr Tetlow: I do not know the evidence well enough on what works, but I would second Torsten's call for the Chancellor to approach this with a clear objective for what he is trying to achieve, to think about the full policy mix that might contribute to this, and to look at the evidence on which of these policy levers are going to be most effective, rather than not being clear about where you are trying to go and just thinking, "What we want to do is to tweak R&D tax credits, so let us just tweak that," or thinking very narrowly just about tax because that is the lever that the Treasury has directly under its control. Something else might be more effective.

Paul Johnson: I agree with all of that. As a meta point, Torsten's initial point about institutional design and stability is probably the most important thing, and it would be fair to say that we have not done that terribly well for the last decade. That is particularly important for international inward investment.

As a second point, I agree that it is the whole slew of policies that matter. A third one that I might draw specific attention to is the way that our competition regime works in the context of high-tech companies, where, internationally, it does not always work brilliantly. For example, do we want to do more to protect those start-ups that get gobbled up? The whole competition regime has not really been given enough focus in the context of its impact both on the division between labour and capital in terms of profits and inequality, and on investment.

All of those things really matter, and that is a really important part of the overall institutional framework. The wrong outcome from this review that we are talking about would be a few tweaks to the tax system that no one expected, which come in next year and get changed again the year after. That is historically rather how we have gone about it.

Torsten Bell: In one of these sessions, which may have been with you, asking us about the super deduction, I remember saying, "The OBR has some very punchy numbers in for the impact of this tax policy. It is going to lead to a complete transformation of business investment." Now, that is true for BT, but is it really true? The OBR itself is now back saying, "It is not going to have as big as an effect on investment." It is still having a sizeable one, but it is only half the effect.

Gareth Davies: I think if the Chancellor was here, he would point out that the figures are still pretty good, but perhaps—

Torsten Bell: They are, but all I am saying is that economists who have spent a long time in their career working in the Treasury look at tax levers. The tax levers are not what is doing this. It is other stuff.

Q370 **Chair:** To be fair, the super deduction almost pays companies more than 100%, does it not?

Torsten Bell: We should be a bit cautious on that, because that is how it is presented. Mechanistically, it does do that, but when the corporation tax rate is about to go through the roof, that is what you have to do; otherwise, no one will invest a penny. We are doing the super deduction not because we wanted a super deduction, but because we are whacking up corporation tax. That is what is going on. Everything else is fluff.

Gareth Davies: I am not sure that everybody would agree with that, but I will leave it there.

Chair: That brings us to the end of our fascinating session today. I would like to thank our witnesses for enlightening us about some of these complex and interrelated issues, but the thing that we all understand is that the year ahead is going to be a really tough one for everybody, particularly for those who do not have an option to increase their earnings or their income. I would like to thank all our witnesses very much.