

Treasury Committee

Oral evidence: The cost of living, HC 343

Thursday 22 September 2022

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

Questions 302 - 394

Witnesses

I: Torsten Bell, Chief Executive, Resolution Foundation; Louise Hellem, Director of Economic Policy, CBI; Rebecca McDonald, Chief Economist, Joseph Rowntree Foundation; and Neil Shearing, Group Chief Economist, Capital Economics.

Examination of witnesses

Witnesses: Torsten Bell, Louise Hellem, Rebecca McDonald and Neil Shearing

Q302 Chair: Good afternoon, everybody. Welcome to the Treasury Committee and our hearing into the cost of living and the fiscal event that the Chancellor will be announcing by way of a statement in the House tomorrow morning. I am very pleased to be joined by four witnesses this afternoon. I will ask them to very briefly introduce themselves to the Committee.

Louise Hellem: Good afternoon, everybody. My name is Louise Hellem, and I am the director of economic policy at the Confederation of British Industry, which represents businesses of all sectors and sizes across the nations and regions.

Torsten Bell: I am Torsten Bell, chief executive of the Resolution Foundation.

Rebecca McDonald: I am Rebecca McDonald, chief economist at the Joseph Rowntree Foundation.

Neil Shearing: I am Neil Shearing, the group chief economist at Capital Economics.

Q303 Chair: Thank you, and welcome to you all. Could I start with you, Torsten? We have this huge fiscal intervention that has been announced to support domestic households with their fuel bills. They are big numbers, although we still do not know what they are or what the range of figures might be. Did it surprise you that when the announcement was originally made, no figures were provided? What are your speculations about why the Government did not come forward and just say, "Here's the announcement, and this is broadly what it might cost"?

Torsten Bell: It should not surprise us that a very, very large fiscal announcement has happened. I think that had basically become inevitable, given developments in wholesale gas prices by the end of July, and it was inevitable that it would look something like the package that has been announced, in terms of the support and the cap on household bills. As you say, the scale of it is very large, and yes, it would have been significantly better had there been estimates, because we should be clear that this bill is not only huge but hugely uncertain in terms of how much it costs. To give you an example, our own estimates on the day of the announcement were that this would cost in the region of £120 billion, given wholesale prices as they stood on that day, but even in the course of the last few weeks, or however many days it is now, it has fallen very significantly by tens of billions and then risen back up again by tens of billions of pounds. What is understandable is a reluctance to provide a point estimate. What is not a good idea is to provide no sense of scale or the uncertainty that is involved.



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Q304 **Chair:** The reason I ask you that question is that you have been in the Treasury and you had senior positions there. *[Interruption.]* Is it a flashback to the Treasury?

Torsten Bell: Yes, we were buying banks, but we knew how much they cost.

Q305 **Chair:** Why, therefore, might the Government not just have come forward with a number? They have worked up the basic policy, although it is going to swing around a bit, depending on the gas price.

Torsten Bell: That is a question definitely best answered by the people in the Treasury now rather than those who were there in the dawn of time. In general, people might be nervous to have a good news story about households having much lower energy bills being topped in the media coverage by the fact that it will cost well over £100 billion to implement. That would be an understandable concern for people's media management. It is obviously not a concern for those of us focused on the substance of the packages, but it is an important part of the big picture here. The Government are deciding that tomorrow's taxpayers, rather than today's bill payers, should pay for the country being poorer this year. That is the big choice we are making as a country. I think it is reasonable to some degree. Even if you disagree around the margins about how large that support is, that is a reasonable approach to take, but you only focus on half of that if you do not set out how much it costs.

Q306 **Chair:** No OBR forecast is to be presented tomorrow. Why do you think that is? What are the implications of that?

Torsten Bell: It is reasonable to have gone ahead and announced emergency energy support—temporary support in an economy facing a really significant crisis—without the full process of an OBR forecast. That is consistent with what was done during the pandemic and the other phases of economic crisis. It is not a good idea to announce large, permanent tax cuts without an underlying economic forecast. That is not because the economic forecast will definitely be right, but because the nature of those forecasts is to provide discipline to the internal decision taking, to make sure that within the Treasury and the discussions with No. 10 more broadly you are clear about the trade-offs, and the trade-offs are very real.

This week there has been a slightly weird discussion about these big tax cuts that are coming tomorrow. Will they or will they not lead to growth? That question is highly uncertain. Anyone who has a very strong view that it will lead to a big effect on growth is a bigger optimist than I am. But what you can confidently say is that it will definitely have a very big effect on the public finances and probably on public services in the longer run. That bit of the debate is completely missing. The danger is that it will also be missing tomorrow because you are not having the disciplining effect on the public debate that you also gain from an OBR forecast.

Why are we not publishing them? Again, that is definitely a question that the Chancellor is much better placed to answer than anybody in this room.



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All I would say is that it is almost inconceivable that any reasonable forecast from the OBR would not show debt rising throughout the forecast period. Fiscal rules are being blown not just slightly but hugely by what will be announced tomorrow.

Q307 Chair: Do you feel that the IFS forecast that we received yesterday is broadly in the ballpark?

Torsten Bell: We will set out our own forecast tomorrow. We are waiting to see what the Government actually announce. The unusual thing is not that borrowing will go up hugely in the face of a big economic crisis. That is normal. What is not normal is that in response to the economy deteriorating and borrowing therefore rising, the Government are choosing to permanently increase borrowing at the back end of the forecast period. That is what is unusual about the policy choices being made tomorrow.

I cannot off the top of my head remember a Chancellor responding to higher borrowing in the short term driven by an economic deterioration by loosening fiscal policy at the back end of the forecast period. That is unusual, and that's the polite way of putting it; "risky" or "a gamble" would be the less polite way. It is almost unimaginable that we will be on track for debt falling by anything like the middle of this decade.

Q308 Chair: So the IFS's forecast from yesterday shows that, at the end of the forecast period, all the targets will not be met.

Torsten Bell: What the Chancellor is choosing to do is to say, "I am far less fussed about having debt falling than the previous incumbent, or about ensuring I've definitely got the cash for public services to hand." That is a big political choice.

Q309 Chair: Just a general question: you are in the field of forecasting, and you interact with the IFS and all sorts of other think-tanks and people out there who try to forecast the economy. On "Newsnight" last night, when pressed on the issue of the OBR forecast, the Business Secretary—I am kind of paraphrasing, which may be a little unfair—basically seemed to question whether the output of the OBR was worth having anyway, because it was inaccurate or had been shown to be inaccurate in the past.

It is pointless to say whether forecasts are accurate or not; no forecast can ever be accurate, but that is not the same thing as saying that they are not useful. What is your assessment? What do you think the generality of economists' assessments would be of the OBR's performance in terms of producing useful output and forecasts?

Torsten Bell: A Conservative Chancellor in a Conservative Government brought in the Office for Budget Responsibility. It was a main plank of their economic programme at the 2010 election. I can't remember whether the now Business Secretary voted for it. At the time, I would have thought he did.

Chair: I think he said he felt it was a good idea initially but has subsequently become less enamoured with it.



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Torsten Bell: Okay. Well, he was right the first time and wrong the second time because it was a big improvement. I was in the Treasury when we were doing the forecasts without that independent scrutiny. This system is definitely better than the one being put in place then. Is it always exactly what Government want to hear? No. Is it always absolutely right? No, because these things are incredibly uncertain. But is it a good idea to have that kind of disciplining on your fiscal macro decision taking? Very much indeed.

Q310 **Chair:** Is it the view among those who carry out lots of forecasting, such as the Resolution Foundation, that the OBR is as good as any or better than most? Where would you put them?

Torsten Bell: The OBR adds a lot to the quality of British economic policymaking on not just the forecast, but the analysis of some of the big fiscal decisions that are being taken. The country is making better economic policy decisions because the OBR exists. Does it get everything right? No. When we disagree with it, we say so, and when it disagrees with us, we say so. That is what good old-fashioned liberal debate involves, and that is what I thought people would be placing value on. It does not mean people should agree with everything it says—that is the nature of the beast. Obviously, the Government have the ability to choose the leadership of the OBR, as they have done in the recent past.

Q311 **Chair:** Okay. That is helpful; thank you very much. I will go to Neil now and switch to the actual support the Government have announced for households. This two-year deal is universal, which has the advantage of avoiding hard edges and stopping people falling through the gaps, but it does bring in the issues of deadweight and the sheer cost of the support. What other approaches could have been taken that might have been more targeted and perhaps better value for money?

Neil Shearing: You are right: the advantage is that it is universal and pretty easy to implement. There are at least two drawbacks. One is the huge cost. It is also a pretty inefficient way to spend, because of the distribution of who consumes energy and who benefits. You could take that money and better target it at the households that are really struggling. To an economist, the price mechanism is almost everything, and you have basically taken that signalling away. What you are losing by freezing prices is any diminution in demand for energy because the price has gone up, and that's the type of thing you want to try to incentivise. You want to try to cushion and protect those who are really struggling with the cost of energy, but you also want to try to adjust behaviour. The price of this good has gone up, so you want to try to consume less of it.

Chair: The alternative would be to let the price go where it is going, but transfer payments.

Neil Shearing: Exactly. So if you run that forward—

Q312 **Chair:** How big an impact is that? What is your assessment of that? Does this mean we are going to be using a lot more energy than we should be, or is it a more marginal effect?



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Neil Shearing: That's an incredibly difficult question to answer, but you can look at international comparisons. For example, in Japan after the Fukushima disaster, there was energy rationing and they quite successfully managed to cut electricity consumption by about 10%. There wasn't much effect on the economy. They did things such as turn off the lights in office buildings in the evenings, and so on and so forth. People had to use the stairs rather than elevators in office blocks. There is quite a lot you can do to reduce your consumption of energy without necessarily having a detrimental effect on GDP.

I don't think you can quite say, "If we had done X, the impact on energy consumption would have been Y." However, I think you can frame it the other way by saying there are things we could have done to preserve the message from prices and reduce some energy consumption, without having an enormous effect on economic output.

Chair: Sorry, I interrupted your flow. You were about to go on to tell us what alternatives there are.

Neil Shearing: I think you answered my question far more succinctly than I did, actually. That is the point: the cost when you take away the price signalling effect. So you let the price go up—

Q313 **Chair:** So we have what the Government have done, which is a universal approach. What more targeted approaches might there be? Torsten, you might want to come in on this, because you have also commented on clawing back through taxes and social tariffs and things. Anything to add on that, Neil?

Neil Shearing: Yes, I think that's exactly how you would do it. You would let prices go up, but you would adjust things such as universal credit and make additional payments through other bits of the welfare system. Other people on the panel are better able to speak to the effectiveness of those, but in principle—at a macro level—I think that's how you would do it.

Q314 **Chair:** Torsten, using the benefit system is fine but then you get beyond that into individuals who are not picked up.

Torsten Bell: The problem is just too big. That is the problem. Economics textbooks definitely say that the best way to deal with this is to let the price rise and provide income to the poorest households. The price rise is now too large for that to work because our benefit system does not give us routes to provide cash to middle-income households—unless you think middle-income households can pay a bill of £5,000, which I would suggest they cannot. The textbooks are not much use to you because you do not have the levers. The broad ways around that are if you had got on with the work early enough, you could have put in place a mechanism to try to deliver a social tariff targeted at the lower and middle-income part of the income distribution. We should definitely be planning for that for future years, but it is not available to us this winter in anything other than a messy way. We set out how you could try to do it in a messy way in a paper in the middle of August, but it was definitely messy.



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The simpler way to get to the same broad—and it is only broad—distributional outcome is to combine the kind of universal support that the Government have set in place with solidarity taxes that remove the benefits of that. So you provide universal support via the energy bills. I think that is really important. I am not really with the people who say it is a massive problem that this provides support to people with larger energy bills, because people with larger energy bills are the ones seeing larger energy bill rises right now. It is true that richer households consume more energy than poorer households. Roughly, £1,300 is the gain from this policy for richer households, and it is £1,100 for poorer households, so it is true that it is regressive in that sense. However, within each income decile, the variation is much bigger than across the income deciles. The gap between someone with a low energy efficiency house who is on the same income as someone with a high energy efficiency house is much bigger than the gap between poorer households and richer households.

I think it is important that we are targeting support on that basis, because you would have to be very optimistic to believe that low-income households have the spare cash lying around to suddenly provide massive insulation. Remember, the amount you need to spend to improve the average below band C energy efficiency property exceeds the annual disposable income of a low-income homeowner. This is not like 500 quid and the problem goes away; it's like £10,000. I think we should be realistic about that incentive structure.

Given that, you should look to solidarity taxes to reduce the pressure on future taxpayers. That is generally what countries have done when geopolitics is the thing driving a terms of trade shock that makes the country as a whole poorer: we share the pain. Richer households contribute and therefore you do not need to use borrowing to the same extent, although you would still need to do it to a significant extent. That also, to some extent, takes the pressure off the Bank of England to raise rates. Windfall taxes should also be used to do that, which the Government are doing. I know the Government now say they do not like windfall taxes, but they are implementing a windfall tax, albeit not as big a tax as it perhaps should be. Solidarity taxes and windfall taxes—that is how you have better targeting but also remove some of the downside risk of a package this big.

Chair: Okay. We will come to some of those things specifically in a minute. Now, we go to Rushanara Ali.

Q315 Rushanara Ali: I want to ask a few follow-up questions about what you have said so far, then go on to the impact of inflation on households. Would each of you talk us through the implications of the tax cut that is likely to be announced tomorrow, alongside the £150 billion package? According to the IFS, the added permanent tax cuts could amount to about 1% of GDP. Where do you think inflation will go with that tax cut, along with the removal of restrictions on bankers' bonuses and so on?

Neil Shearing: Inflation or borrowing, or both?

Rushanara Ali: Both, but briefly, if you can.

Neil Shearing: We have crunched the numbers on the things that have been announced and some of the measures that have been trailed. We think that adds about £100 billion to borrowing this fiscal year, about another £70 billion to borrowing the following fiscal year, and about another £50 billion the year after that—2024-25. That is about 5% of GDP, 3% of GDP and 2.5% of GDP. These are big numbers.

In terms of what that does to the path of public debt, which was another part of your question, it depends a bit on how this is financed and structured, but it is going to add somewhere between 7% and 10% of GDP to the trajectory of public debt. That is a step change. It means that the main fiscal mandate is broken by about £35 billion, on our calculation—something like that.

I stress that these are estimates, not forecasts. There is huge uncertainty. As Torsten was saying, if wholesale gas prices change by a few euros, all those figures change.

Q316 **Rushanara Ali:** Talk me through the inflation effects.

Neil Shearing: The inflationary effects come principally through the freeze in energy prices, rather than the tax cuts that have been announced. According to our estimates, that would knock about 3.5 percentage points off the peak in inflation. Previously, we thought that inflation would peak at about 14.5%; we now think it will peak at just under 11%. So there will be quite a significant effect on inflation.

We can get into what that does for the Bank of England, but when we think about the effect on inflation, it does two things. It lowers the peak, but you have had what now amounts to a very substantial fiscal loosening. We got a hint from the Bank in its communications today after it raised interest rates that it perhaps adds to medium-term inflation pressure as well. So you lower the peak, but against the backdrop of a tight labour market you raise concerns in the Bank about medium-term inflation pressures, so I think the path of interest rates will be higher as a result.

Rushanara Ali: Does anyone else want to come in on these points?

Torsten Bell: The scale of this fiscal impulse is so large that GDP will almost certainly be higher this winter than it would otherwise have been. In so far as you wanted to deliver growth, it will deliver that, even if lots of that growth turns up as slower falls in GDP, but the GDP level will be higher this winter. That is mainly about households being able to spend more, and as Neil was saying, we should assume that the Bank of England will be aiming to offset that almost entirely, so that higher GDP is very temporary. There should be no lasting effect on the level of GDP because the Bank is telling us—you collectively decided that the Bank of England should be independent, therefore it is making that assessment even if the Government do not agree with it, and you might think the Government do not agree with it, given what is about to happen—that it will squeeze all of that higher GDP out, and it would usually do that over a period of one to



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one and a half years. So temporarily higher GDP in the short run; higher interest rates as a result to squeeze that out; and you will not be on course to meet your fiscal targets. That is the basic choice we are making.

Q317 Rushanara Ali: Okay. Torsten, you touched on public services and public finance. Given that this is going to be borrowing, could you talk us through the choices for the Government, and the likelihood of what would happen in terms of paying for that? If the public are paying that back over the coming years, what is the likely impact?

Torsten Bell: I think we should talk about the bits I feel confident we know. There are areas where you need to think ahead and see what history tells us tends to happen in this kind of situation. On the things we know, we are combining a largely unavoidable increase in borrowing—by “unavoidable”, I mean the bit caused by the economic deterioration, plus it is unavoidable that we borrow tens of billions of pounds to pay for some level of energy price support. That did not need to be exactly what we did, but it was going to be very large. That is the non-discretionary fiscal impulse that is going ahead.

On top of that we are overlaying a totally discretionary fiscal impulse, again in the tens of billions of pounds, that is permanent. The combination of the two means that you will see debt rising throughout the forecast period. If we are allowed a forecast, that is what our forecast will almost certainly show tomorrow, unless the Government announce much smaller tax cuts than anyone is expecting. The Government have said they are committed to debt falling in the medium term; it will not be falling on the basis of what is announced tomorrow, but they presumably mean that, so the question is where that takes us in the months and years ahead. The Prime Minister has said her top priority is growth and, by the way, we fully support that. The lack of growth over the last 15 years and the relative decline of the UK is very problematic for low and middle-income households. Low growth is a problem for poorer households, despite some people saying GDP growth does not feed through.

Q318 Rushanara Ali: Are we going to get growth with those interventions though?

Torsten Bell: As I said, let's wait and see what the package is tomorrow. In general, I would say we are going to get slightly higher GDP in the short term and no lasting effect on growth in the medium term, but that depends on what else the broad package is. There are some tax cuts that would make some improvements to growth, even if they are quite small, so where does that take us? The Prime Minister is attached to growth; she set out that tax cuts are a central part of what the Government are about. In general, that takes you to not seeing debt falling on these forecasts; maybe you do not mind that in the short term, but in the long term you will end up taking action to deal with it. As history says, for Governments that are heavily committed to tax cuts, that comes in the form of spending reductions.



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In particular, history tells us that that means public sector net investment, which is historically quite high at the moment on the Government forecast. That is the thing that Treasuries do under pressure; they want to combine commitments to tax cuts with fiscal discipline of some form. In an era when it is not clear the public want to see large cuts to the NHS—as you will have noticed—that goes to cuts to public sector net investment. Stepping back, I say that with much less confidence than saying we are going to be borrowing lots more and will not be seeing debt falling as a share of GDP. In terms of where that takes us, my judgment—based on history—is it takes us to cuts to public spending, particularly cuts to public sector investment. Increasing public sector investment has been an issue of cross-party consensus, actually, over the course of the last five or six years.

Q319 **Rushanara Ali:** Thank you very much. Can I turn your attention to the impact on households? Rebecca, do you want to kick off, and run us through the effects you think the cost of living crisis is having on households? What do you think all of this is doing to poverty levels? Do you expect poverty to rise or stabilise with the forthcoming interventions?

Rebecca McDonald: In terms of the impact of the cost of living issue and rising inflation, the cost of living squeeze in particular is having a huge impact on households—especially on low-income households. That is very clear. In terms of evidence to illustrate that, we did a cost of living survey that looked at people's household finances and their situations back in May. Instead of looking specifically at their incomes and the monetary side, we asked what impact that was having on their behaviour and day-to-day life. The figures from that were very worrying, in terms of people having to go without essentials like food, or energy last year when it was colder. For example, we know that by May there were 7 million lower income households that had had to go without some kind of essential. We know that 1 million of those households had had to take on new or additional lending specifically to cover essential bills—fuel, energy or something like that. So, those were very worrying figures, and that was back in May.

Since then, obviously, on the one hand there has been higher inflation—that issue has grown—and on the other hand we have seen a lot more Government support come into place, which is welcome and will make a significant difference to how those households are faring. As to whether that does enough for those lowest income households, I would probably classify “enough” in this financial year as not allowing them to be any worse off financially. There are longer term questions about whether even at the start of the year that was enough—I would say there are longer term issues there—but across this financial year, when you add up all the different support packages, it is not quite enough to prevent their financial situation worsening. Roughly—this is an average figure—for the average household in that lowest fifth of incomes and in receipt of means-tested benefits, there will still be a shortfall over this coming winter of about £450, which they have to find just in order to face the higher prices and higher bills.



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It is important to highlight that yes, the support that has been announced does an awful lot to offset rising costs and to prevent higher energy bill increases later this year and this winter in particular, but for those for whom any kind of worsening in their finances is incredibly difficult, there is just no wiggle room there in their finances to adjust to. There is still a gap, and I would argue that the cost of living support job is not done for this winter yet for those families specifically. Do you want me talk to the poverty question as well?

Q320 Rushanara Ali: On the poverty numbers—what do you see happening?

Rebecca McDonald: The tricky thing with the poverty figures is that the usual figure that we would often talk about is the relative poverty rate, but I do not think that that is particularly helpful at the moment, as is often the case in a recession or another period of economic shock. That might be because—this is good—a lot of the support has been targeted towards the families on the lowest incomes.

When we look at the poverty rate, all that matters is how those low-income households are fed, compared with middle-income households. If both middle and low-income household incomes have gone down over the year and they are both worse off, the poverty rate will stay the same, or could even improve with targeted help. So, in a year or two years' time, when we measure the poverty rate for this year, it might have gone down or stayed the same, but that does not fully show us how people are faring. Even if the relative poverty rate stays the same, they could be worse off financially across this year.

That is why, in this particular case, I think that surveys that tell us about the material impact on people's lives—looking at the real income of those families and how it has fared across the year—are the best way to try to assess how they are faring.

Q321 Rushanara Ali: Thank you. Louise, did you want to add anything from the CBI perspective not only on households, but on businesses?

Louise Hellem: I am happy to. First, I wanted to say that, from a CBI perspective, we really welcome the support that has been provided to households. When we have been talking to businesses up and down the country over the past few months, concern for their staff and their customers has been at the forefront of their mind as well. That that support has been forthcoming has been really important to us.

Businesses are also facing lots of pressure at the moment. Particularly, from their side, it was very welcome that we had that swift action from Government—

Q322 Rushanara Ali: Will it be enough? Some of the bills we hear about are tens of thousands of pounds. Would you anticipate businesses passing on costs to customers where they are able to do so, or will Government intervention be enough?

Louise Hellem: There will always be individual cases, but for the most part we think that the support that has been made available is far-



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reaching. It will definitely take the sting out of a lot of the price rises that firms are facing. However, the big issue for firms is the difference in how the package applies to firms; for households, it is for two years. That is the big concern for firms, that their window of time is really very short. We have had a little more detail on how the mechanism will work, although there are still a lot of questions around that, but for businesses the big question is, "What happens after six months?" There has been mention of more support coming forward for vulnerable sectors, but there are a lot of questions about the principles behind that and how it will be applied. A lot of firms at the moment are trying to make decisions for six months' time or a year's time, but they do not really know what their cost base will be.

Q323 Rushanara Ali: Thank you. You can give a yes or no answer: does removing the cap on bankers' bonuses help economic growth?

Louise Hellem: We are really keen that the FS sector remains competitive, but there is a question about the appropriate time for those kinds of measures. There are much wider measures that our members in the FS sector are keen to see, particularly around making sure we are moving forward on green financing and solvency—things like that.

Rushanara Ali: Torsten?

Torsten Bell: On bankers' bonuses?

Rushanara Ali: What is the point of it?

Torsten Bell: Bankers' bonuses generally?

Rushanara Ali: Is removing the cap pro-growth?

Torsten Bell: The bankers' bonus cap is a bit silly in the way that it is designed. It makes limited difference to financial stability, which is the notional reason for doing it—encouraging more fixed and less variable pay. Is it desirable socially to have much higher rewards for some bankers when compared to the rest of society? No. Is the cap a particularly good way of achieving that? Also, no. Will getting rid of it make any material difference to growth? Not really. What I will say is that politicians should recognise that if Britain is going to start reversing its relative decline, they need to value our high value added service export sectors, including financial services, but also much broader sectors than financial services—financial services are shrinking as a share of our service exports. Having an economic policy that is aimed at growing those sectors is worth us spending more time on, but I know that is quite unfashionable.

Rushanara Ali: You could argue that leaving the single market might have—

Chair: We might have to move on. Thank you.

Q324 Alison Thewliss: I have some questions mainly for Louise around the sufficiency of support for businesses. First, following on from some of Rushanara's questions, could you tell me more about your views on the



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support package that has been announced, and the extent to which you feel it will help businesses—and if it will help particular businesses more than others?

Louise Hellem: As I said, it is a very welcome package, as was the fact that it was included in the announcements the other week. The big question for businesses at the moment is around the short-term nature of it. I think there are definitely particular concerns from smaller businesses and from energy-intensive industries about whether future support might be forthcoming. We are really keen to work with Government to understand the principles they might be looking for in designing that future support package.

The second thing that businesses are really concerned about is security of supply. Again, that is something that we have not heard a lot about from Government. There are obviously concerns about either knock-on impact from the continent around supply chains, or direct impacts for the UK. Firms are very keen to hear if there is scenario planning within Government, and how they can feed into that. Thinking about energy-intensive industries in particular, I was talking to a ceramics manufacturer the other day, and intermittent energy supply is something that can damage their infrastructure and kilns—those are not things they can turn on and off. They need a long cooling process. Firms are concerned to make sure they are part of those discussions now.

Thirdly, the other thing we need to talk about is the longer term adjustment. Six-months' time is no time at all, but there is an expectation that prices are not going to get back to their 2021 level for a long time. If the UK is facing higher energy prices for a long time, how can we as a country adapt to that? There have been some measures around energy supply, but we have not yet had anything on energy demand. That will be really critical, as will doubling down on our net zero journey. There are a couple of schemes that the Government have previously announced that are coming to an end. For example, we need to look at extending the industrial energy transformation fund and helping some of the most heavily energy-intensive users. Going back to the household side, we need to think about wider energy efficiency for households and the ECO plus scheme; we are due for the next phase of that, and we need to think about how we can expand it. I think that will help to alleviate some of the pressure going forwards.

Q325 **Alison Thewliss:** That is useful. One of the businesses in my constituency were in touch to say that they were being quoted for their energy—for electricity alone—a 345% increase in bills. Six months will buy them some time, but presumably those bills will still be there afterwards. Is that quite commonplace for the businesses you have been speaking to?

Louise Hellem: We definitely heard a whole range of measures, and some scary numbers, some even going up to 500%. Obviously, while some of those numbers are scary, how much that is hitting very much depends on the sector, on what proportion of businesses' overall costs it



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is, and on how long firms have hedged. While for the vast majority the support package will do a lot to alleviate concerns, there will still be individual cases. The main thing is that six months will not give anybody time to cope when they have those large increases coming down the track.

Q326 Alison Thewliss: The Government have talked about a review for three months after that. What would you like the review to consider?

Louise Hellem: We need to think about whether there can be some continued support available, perhaps in a similar guise, and what other support can be available. One of the things that is potentially coming down the track, and is a concern for businesses, is around business rates. That is something else that is linked to inflation. If nothing else happens, the assumption is that in April next year business rates will increase by 9.9%. That is a huge bill for businesses. That is without any reference to businesses' profitability or ability to pay. Action to freeze that rate would be beneficial to businesses.

Short-term, quick things that Government could do to support businesses include thinking about time to pay arrangements with HMRC, and making sure that those happen. Then, it is about entering into a conversation about how we can help business and industry in the long term to reduce their energy demand and increase energy efficiency.

Q327 Alison Thewliss: Do you hear from businesses that just cannot cope with these increased bills? With all the other pressures that businesses face—supply chains, employee costs and other things—will some businesses just fold because of this? Is that unavoidable?

Louise Hellem: We definitely hear instances of that, and there were concerns over the summer. That is particularly an issue for smaller businesses. A lot of the businesses that we have talked to, especially over the last week or so, think that this will be enough to keep them going, but there are big questions about what happens next.

Q328 Alison Thewliss: Different companies are on different tariffs; there is hedging, which you talked about, and other factors. Given that, will there be a number of companies, perhaps that you have spoken to, that signed up to their deals at the wrong time? Will they miss out on this support? What will the impact be on them?

Louise Hellem: It is good that the Government have said that anybody who has signed a contract since April will be able to access the same support, but there could be a window before that. While we did see the big spike in energy prices because of the Russian invasion of Ukraine, energy prices had been increasing before that. Again, there will be some individual cases in which there still might be concerns.

Q329 Alison Thewliss: You talked about some of the longer-term mitigation measures: trying to reduce energy use and make businesses more energy efficient. What kind of incentives, schemes or initiatives might be useful in that regard?



Louise Hellem: For the big energy-intensive users, the industrial energy transformation fund is one of the big levers that the Government have to support businesses. It is also worth thinking about that support more broadly across the economy, about more investment in green technology and about support, particularly, for SMEs in a similar way to households: better insulation and more information about how to make energy improvements to their businesses.

Q330 **Alison Thewliss:** Looking at the wider picture that businesses are struggling with, are there any other things that the Government ought to be looking at to support businesses?

Louise Hellem: As Torsten said, the wider thing is that we have had a long-term concern around the level of growth and productivity in the UK. On the one hand, it is great to see that the Government are focused on that, and have quite large ambitions on that side, but we are keen to see what is in the growth plan tomorrow. Alongside immediate support on things like business rates, it will be important for us to look at that broader tax package. But that is only one lever, and you need to make sure that the Government are also looking at, for example, skills and the future of the workforce.

Actually, if you think about the kind of concerns that we have had from businesses over the last year or two years, or probably beyond that, the matter of energy prices has been big and that has been growing as a concern. However, that whole time, thinking about labour market availability and access to skills, that is up there and, if anything, is the joint No.1 concern for businesses as well as supply chain challenges so really seeing action from Government to tackle that will have a big impact, hopefully, on productivity going forward.

For us, again, the main thing we hear from businesses is around the apprenticeship levy and need for reform of that to make sure it is much more agile and flexible. Also, thinking on the labour market availability side, one of the things that has been coming through from businesses is around childcare cost. That is a longer-term thing that could need to be done and which could potentially feed into the cost of living challenge as well. Then, the other big area from a business perspective is that we want to see Government doubling down on net zero and thinking about how to improve innovation and energy efficiency.

Alison Thewliss: Opportunities within net zero as well.

Louise Hellem: Yes.

Alison Thewliss: I do not know if any other panellist wants to come in on particular issues for business.

Chair: Thank you.

Q331 **Harriett Baldwin:** I want to talk about the public finance impact of what has been announced this week. In the absence of an Office for Budget Responsibility forecast, we had the IFS yesterday, which published its



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report. The only thing that is different from its assumptions yesterday is that the national insurance cut, or reversal of the increase, is going to be effective on 6 November. That news has come out since you started giving evidence.

The headline to the IFS report is that the public finances are going to be “on an unsustainable path”. Does anyone have any quibble with the assumptions the IFS made in its forecasts or with that headline that it put on its report?

Neil Shearing: The first point, as I said earlier, is that all forecasts—I should call them “estimates”.

Harriett Baldwin: They are inaccurate.

Neil Shearing: Yes, exactly. They are going to be wrong and they are subject to a huge amount of uncertainty. That being said, the numbers we crunched over the weekend and the early part of this week when the measures were trailed were remarkably similar to what the IFS produced yesterday. We published numbers on Wednesday evening that were pretty similar, actually. I gave them earlier.

As for whether the public finances are on an unsustainable trajectory, that depends on what you mean by “unsustainable”. There are a lot of moving parts here. One is what the impact on growth is. One is what the monetary policy response and the impact on Government borrowing costs are. One is what happens to the global economy and with global borrowing costs, because the UK is a relatively small part of the global economy and a lot of what influences our borrowing costs is affected by global factors.

Q332 **Harriett Baldwin:** It is a pretty emotive phrase, is it not, that the IFS used—“unsustainable”.

Neil Shearing: My sense is that debt is going to be substantially higher as a share of GDP. I do not think this is going to have a big effect on the long-run trajectory of GDP. By the same token, by far the largest part of this package is a series of one-off payments. So, by definition, those drop out. It is the ongoing tax cuts—the NICs cuts and the cancellation of the corporation tax increase—that have an effect on long-run borrowing. It is a relatively small part of the package.

Q333 **Harriett Baldwin:** Just to be clear, what I am hearing you say there is that the effect of those two measures not happening—the national insurance hike and the corporation tax hike—is not going to cause the economy to be sufficiently bigger to pay for those gaps in the public finances.

Neil Shearing: That is essentially what I would say—exactly.

Q334 **Harriett Baldwin:** You do not think the economy is going to grow sufficiently.

Neil Shearing: No. The framing of this has been slightly skew-whiff, actually. We have come off the back, as we have heard, of 15 years of

incredibly low growth. These tax cuts take tax rates back. So the NICs take it back to where it was 18 months ago, when growth was really low. I find the idea that it is suddenly going to spur this huge revival in economic growth difficult to believe.

Q335 **Harriett Baldwin:** So it is going to have very little impact on growth, but it is going to cost the £13 billion to £14 billion a year that each of those measures would have brought in.

Neil Shearing: Exactly. That hole will have to be filled, but in the grand scheme of things that is a relatively small hole that could be filled by economic growth returning. If anything happens and there is a revival in economic growth, it will not be because of this package but because of other things that happen.

For example, we know that 600,000 people have left the labour market since the pandemic, half of whom are long-term sick. We don't really know what is driving that—the causes behind it or the extent to which it is linked to long covid or other illnesses. We have seen in the US, for example, that people who left the labour market have started to come back in the last three to four months, and the same thing could happen here. If that happens, that will boost economic growth because we will have a larger labour market, so I would not rule out the fact that long-run economic growth could be slightly better than we might think, but I don't think that is anything to do with these packages.

My short answer to your question is that, in terms of the trajectory of public finances, there will be a step change in debt as a share of GDP by about 10 percentage points, I would guess, and a small hole, in the grand scheme—probably £10 billion to £15 billion—that will be need to be filled somehow, but that could get overwhelmed by factors on the GDP side.

Q336 **Harriett Baldwin:** Yes. When the OBR published its report on fiscal risks and sustainability in July, it made the point that we may not be prepared to pay the costs of the higher energy bills now, but we are effectively just making a way for us to collectivise them and households are going to have to pay them at some stage. Do you all agree with that characterisation?

Neil Shearing: Yes. To a large extent, that's the role of Government. It is basically smoothing the shock to the economy. In that sense, the policy makes sense and stands up, but at some point it will have to be paid for.

Q337 **Harriett Baldwin:** But Neil, is your view that it is sustainable? You didn't seem to like the phrase "unsustainable" and said that it is quite small in the great scheme of things.

Neil Shearing: The part of this fiscal expansion that is permanent is relatively small—that is the point I am trying to make. We are talking about £15 billion or perhaps a bit more—£20 billion—in the context of several hundred billion pounds.

Q338 **Harriett Baldwin:** So you don't agree with the IFS using the word "unsustainable".



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Neil Shearing: I think it is unhelpful. I wouldn't characterise it as "unsustainable" because in public finance, as we have seen from the experience of the past five years, those types of numbers could quite easily get overwhelmed by other factors.

Q339 **Harriett Baldwin:** One more macro question, if I may. How much is the fall of the pound exacerbating the cost of living in this country?

Neil Shearing: It's a good question. Obviously, there have been claims around the concept of fear and concern about balance of payments crises, but I don't think that is the right way of thinking about it. Exactly the right way to think about it is in terms of importing inflation. There is a path through. The fall in the pound might add 0.3% or 0.4% to the headline inflation we have seen so far.

The other point is that the fall has been particularly marked against the dollar, and that is what is getting a lot of the headlines, because the pound is now at £1.13 against the dollar and Black Wednesday was 30 years ago. The fall in trade-weighted terms—in other words, the pound weighted by our trading partners—has been much smaller, because the dollar growth has been very strong.

Harriett Baldwin: Yes. It is a dollar-strength story.

Neil Shearing: It is partly a dollar-strength story and not necessarily the pound. The pound is weak, but the cross against the dollar exacerbates that weakness.

Q340 **Harriett Baldwin:** Great. Can I turn to the CBI, Louise, and ask about Government borrowing? One reason why people can argue that it is unsustainable is because it crowds out businesses from being able to borrow. Are your members experiencing that and effectively being crowded out from the borrowing market?

Louise Hellem: I don't think we see that at the moment, but it is obviously important to ask the question about what that spending is going on. As you say, where the spending is going on the emergency energy package, that is very welcome, as it is for our businesses that were potentially facing increased taxes, adding to their costs, so they will not be facing those in the future.

Q341 **Harriett Baldwin:** But businesses are going to benefit from the national insurance cut as well, are they not?

Louise Hellem: Yes. It will mean that those costs will not be faced by businesses where they were looking to have them in the future. Obviously, the six-point corporation tax rise in April was a huge thing that businesses were going to face, and you saw the impact of that in some of the forecasts that we had before from the OBR, which showed the cliff edge on business investment.

But it is important to go back to what Torsten said earlier: if you are thinking about how to pay down this extra borrowing and debt, you have three choices. One is to increase taxes, the other is to cut spending, and

the other one is to grow out a bit. Again, I think that is where we need to see more emphasis from the Government.

Q342 Harriett Baldwin: I only have time to ask one last question. I am going to ask each of you in turn, and you need to say “agree” or “disagree”—only a one-word answer. Do you agree with the IFS that the public finances are “unsustainable”?

Louise Hellem: I think it really depends on the detail of the growth package tomorrow.

Q343 Harriett Baldwin: No—you’re allowed a one-word answer, Louise. Do you agree or disagree?

Louise Hellem: I am afraid that my one word will have to be “uncertain” at this point, then.

Harriett Baldwin: Honestly, you are such an economist! Torsten?

Torsten Bell: They are going to announce what they are going to announce tomorrow, and then we will find out. It isn’t just the £30 billion we are talking about. If they announce what we are expecting, which is a very significant set of tax cuts—let’s talk about fuel duty, let’s talk about raising spending on defence to 3%, let’s talk about business rates, let’s talk about stamp duty, and let’s talk about changes to income tax as well as the changes in national insurance and corporation tax—yes, the public finances will be unsustainable.

Harriett Baldwin: Unsustainable. Rebecca?

Rebecca McDonald: I will not comment on that one.

Harriett Baldwin: Honestly, why do you get these panels in, Chair? They will not even say whether they agree or disagree with this one word. Neil?

Neil Shearing: It is a good point that Torsten raises: at this stage, we only know what we know has been trailed. There are potentially other measures coming as well.

Harriett Baldwin: Based on what we currently know.

Neil Shearing: Based on what we currently know, there is a hole in the public finances that could be filled through changes in GDP, for reasons not driven by this package. I don’t think it is necessarily unsustainable at this stage, but the context here is really important. You have a huge fiscal loosening at a point when interest rates globally and in the UK are rising. That increases the risk.

Torsten Bell: Can I just add some facts on this? What has happened to 10-year bond yields across the world? They have gone up everywhere, but they have gone up by 1.5% in the UK versus 0.8% in the US and 1.1% in Germany. What do you think is going on? What do you think the markets are thinking about Britain right now?



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Q344 **Harriett Baldwin:** So you are saying the public finances are unsustainable.

Torsten Bell: As I have just said, yes. Obviously, something might turn up, but setting a path that relies on something turning up is, in my book, us being perfectly happy with things being unsustainable. The problem with waiting for things to turn up is that they do not always turn up on the side that you are hoping. You should set a course for a fiscal policy that is sustainable with a margin for error, and that is not looking like what we are heading for tomorrow.

Harriett Baldwin: Thank you.

Q345 **Kevin Hollinrake:** Can I ask about that figure? Is it 1.5%?

Torsten Bell: Yes. Economic policy right now around the world is not a game. We have not been through something like this. No living policymaker has been through a phase of trying to do a discretionary fiscal loosening on top of an unavoidable fiscal loosening in the middle of a phase when the Bank of England says there is no spare capacity to be had and is raising interest rates. I think it is time to take this seriously. Hoping that something turns up is not what adult decision making looks like in 2022.

Q346 **Chair:** To be fair to the IFS, I think they do say that there could be some luck somewhere along the way.

Torsten Bell: I am an optimist. I hope luck turns up, but I don't pay off my mortgage by hoping that someone gives me a pay rise in two years' time.

Q347 **Chair:** No; I am kind of agreeing with you in a sense. Neil made an interesting point when he said that, when it comes to the permanent tax cuts in NI and corporation tax—some £30 billion—it is a small hole to fill. Torsten, do you subscribe to that view?

Torsten Bell: Let's see the size of the hole that is announced tomorrow. We are not currently on course for it to be £15 billion, and one of the challenges we have is that the estimates of the cost of the tax measures being announced tomorrow are being provided by the Treasury and will not have been audited by the Office for Budget Responsibility. That leaves all of us in a slightly awkward situation whereby we will have to come to our own judgment, in the course of tomorrow, about whether those are a good basis for planning fiscal policy. But if they are just £15 billion, I will be very surprised.

Neil Shearing: Just to go back and put this into some context, before this package of measures and before the energy crisis, we thought there was about £30 billion of headroom against the current fiscal rules. At the moment, we are talking about £30 billion—

Torsten Bell: We should be really careful about saying something like that. The interest rate rises alone that have taken place just in the last two months wipe out all that headroom—more or less all of it. So when we



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say there was headroom, that's like saying there was headroom when energy prices were very low and when interest rates were very low. That headroom does not exist under any plausible scenario for people doing forecasts today, so relying on it for doing big, permanent tax cuts is not what a sensible policy looks like.

Chair: Would you agree with that, Neil?

Neil Shearing: I would, but I am trying to put it into some context. The context here is that £150 billion of it is the huge part of the package on price support—

Torsten Bell: But sustainability is about what is happening five years out. We are aiming now for running a significant deficit, rather than aiming for debt falling by the middle of this decade—we are not remotely aiming for that. So let's park what is happening in the short term. We can increase debt to pay for a short-term increase in borrowing that we need to get us through an energy crisis. That isn't the issue here. I don't think that is controversial among anybody.

What is controversial is that at a time when the economy is deteriorating, when our debt interest bill is rising significantly and might take us back to debt interest levels we have not seen since the end of the 1990s—when people talked about their interest, you will remember, and it was crowding out other parts of public spending, which is when people start noticing debt interest in the public finances—on top of that, we are deciding that that's the moment for discretionary increases in borrowing. That is not what normal economic policy making looks like.

Q348 **Gareth Davies:** I would like to talk about inflation forecasts, and specifically the impact of the energy price guarantee that was announced by the Prime Minister. Neil, you have answered a bit of this in your response to previous questions. You talked about the Bank of England minutes today. They have basically said that the energy price guarantee will reduce inflation in the short term but, because consumer spending won't weaken, inflation over the longer term or medium term will be higher. I think you mentioned the figure for what you think the measure will do to inflation in terms of the peak. Can you repeat that and explain it a bit more?

Neil Shearing: It knocks about 3.5 percentage points off the peak in inflation, we think, all other things being equal. That's coming all through the energy channel.

Chair: And the peak was 14.5%.

Neil Shearing: Yes, exactly—instead of 14.5%, it's down to 11%.

Gareth Davies: The Government have said they believe the impact is about 5%; you think it's 3.5.

Neil Shearing: Three and a half—something like that.



Gareth Davies: So the inflation forecasts—

Neil Shearing: I should say that the counterfactual is the key point here: what had you baked into your forecast to get to 14.5%? If you remember, about six weeks ago some investment banks were saying 18%. It all depends on what you had assumed and what was in your baseline. We had assumed an increase in the energy price cap that was more modest than in some of the 18% inflation stories or headlines that you have seen. We had an increase—I can't remember exactly what it was, off the top of my head—that gets you from 14.5% to 11%.

Q349 **Gareth Davies:** Got it. And I think the Bank of England, in its monetary policy report, equated gas prices as about 6% and, indirectly, about 1% of the inflationary forecast that it has put forward. Is that consistent with yours?

Neil Shearing: That is about consistent, yes.

Q350 **Gareth Davies:** Inflationary forecasts have been a bit all over the place. We have had Goldman Sachs and Citi go up to 18%, I think it was. The Bank of England has about 13%. You have just mentioned 14%. Do you think that a measure that basically takes out energy prices from the equation will make forecasting a bit more predictable?

Neil Shearing: Well, we have that measure; it's called core inflation. There is a measure of what is called core inflation, which strips out volatile things like, principally, food and energy. Actually, that's been all over the place as well, and there are big differences in how you measure that or construct that. In the US, they include housing costs. That is why the US and UK measures are not necessarily comparable. All these things are imperfect.

I think the more helpful thing to do, when we are thinking about inflation and the cost of living more generally, is to try to separate out what has been happening to energy prices in particular and food prices perhaps, which is basically a terms-of-trade shock being driven by what is happening in global markets and the consequence in part—to a large extent—of the war in Ukraine, and a generalised rise in inflation, caused by the fact that demand has been running ahead of supply and the fact that we are not entirely sure of the extent to which there has been permanent supply damage in the UK economy as a result of the pandemic and everything else that has happened in the past three or four years. It is that generalised price pressure that the Bank is trying to lean against—it is concerned about expectations becoming unanchored—and that policy can do something about. The first part—the energy price shock, the terms-of-trade shock—is what the energy price cap is trying to deal with. I think that is a better way of thinking about it.

Q351 **Gareth Davies:** Torsten, I saw that you tweeted about this, so I have got to ask you: what is your view on the forecasts?

Torsten Bell: What did I say? Just so I can ensure I am consistent.



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I agree with everything both of you have said. I am slightly more on the side of thinking it might well be 4.5%. I think the Government's 5% estimate on the lower inflation from the peak is perfectly reasonable, while ours is probably about 4.5%, but I think that is reasonable. I heard the Prime Minister saying that again yesterday, so I do not think that it is an unreasonable estimate. We are all making estimates.

What I would focus on, from the perspectives of UK policymakers, is wages. What is actually at risk is whether wage rises are strong enough because the tight labour market could give us a domestically generated inflation problem going forwards, so that is the metric I would look at. I would particularly be looking at it right now because of the problems we have had with trusting our earnings data. Furlough disappearing out of the numbers has now worked its way through, more or less, so private sector wages—which is what we care about—now give a pretty accurate reading of what is going on. They are showing a pretty tight labour market delivering private sector wages of 6-ish per cent. That is what the Bank of England is looking at, as much as it is looking at a CPI inflation rate, which as you said moves around a lot and is very driven by energy prices.

On one level, it is easy to look at the Bank of England's forecasts over the last year and say, "Ha ha ha, this is obviously ridiculous. Over the course of a year, we have gone from 2.5% to 10% to 14% in our forecasts." At another level, wholesale gas markets are moving around all over the place, even over the course of the last week, so I think it is a bit unreasonable given that that is the nature of this inflation shock. I would spend a bit less time looking at Goldman Sachs' forecasts for inflation. They have got business to do; they have got to give a number to their clients. I think we should pay a bit less attention to that, given that we do not pay them, and pay a lot more attention to actual average earnings data.

Q352 Gareth Davies: Thank you. The Bank of England's latest monetary policy report cited the ONS changing the weighting of energy prices in Q1 of 2023 as one of the risks to its forecasts. Can you explain what that means and how significant it will be?

Neil Shearing: This is about how you construct CPI baskets. The key point is that, to construct those baskets, you need to take a survey of consumption patterns. Those patterns will change over time, and how we capture that will change over time as well. You have got to think about the way you weigh those things against each other. There are different ways, whether you use harmonic means or other different statistical techniques. Weightings of individual components within consumer prices indices change all the time; it just so happens that this particular part of the basket is changing when the price of that component is changing an awful lot as well. That is where the risk comes in.

Gareth Davies: Okay, that is helpful.

Q353 Emma Hardy: Afternoon everyone. I want to question you on interest rates, and start off with your reactions to the news that the Bank of



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England has raised interest rates to a 14-year high. Can I start with you, Rebecca, because we often hear economists talk? No offence to the two economists that we have on the panel. Three economists. Four! I am getting this completely wrong now. You are all economists. Dangerous, dangerous—pass me the spade quickly! When we do speak to economists, we hear an awful lot about big numbers and not enough about what they actually mean. If we can start with you, Rebecca, thinking about this interest rate rise, what does it actually mean for low-income households?

Rebecca McDonald: Of course. As I am not a macro specialist, I will not comment on the level that it has been raised to today, or whether that was right or wrong or that kind of thing, but I agree with you about the effect that it has on households. It is really important to consider that.

I caveat that by saying that, of course, if interest rates had not gone up, and that had led to higher inflation, that would also have a lot of costs for low-income households. You have to balance up those two sides of the coin.

One of the things that is particularly worrying at the moment is that both during the pandemic and over the last year, the amount of borrowing by low-income households has increased. Earlier, I talked about a survey we did. We did that survey in October 2021 as well. I think it was about 4.4 million lower-income households that had had to take on new or extra borrowing during the pandemic. Fast forward to May, and we saw again that borrowing had increased. There was the figure that 1 million households were in debt to very high-interest lenders. When interest rates go up again, as they do today, that is very worrying for them. There are millions of households who are in arrears on their lending repayments and who are borrowing for their essentials, such as energy bills and food—not for one-off emergencies or expenses, but for day-to-day and monthly bills—and it is, of course, incredibly worrying for them when interest rates go up.

It is very important to bear that in mind and, in particular, for us and other bodies to assess and monitor that in as timely a way as possible. There are issues with the data that we have on arrears and debt; it tends to come with quite a long lag. However, when we consider what support is needed now, in the winter and next year, looking at that debt data and seeing how people are faring—given that interest rates are rising and debts are going up—is incredibly important, in order to keep tabs on exactly how people are faring and how that is going.

Q354 **Emma Hardy:** Earlier, you mentioned the £450 shortfall that people have. I realise that the announcement was only made today, but I wonder if you have any indication of what shortfall we are looking at, bearing in mind that interest rates have just gone up?

Rebecca McDonald: Bearing in mind that interest rates are going up? I don't have a figure on that. It will increase some of the extra costs throughout the financial year—for mortgage holders, of course, if that

feeds through soon, although for others it will be next year. It will increase the costs of servicing the kind of borrowing that families have, but I couldn't say by how much exactly. It will vary hugely depending on the family. However, it will add to the layers of extra cost throughout this financial year.

Q355 Emma Hardy: Thank you. Louise, can I have your reaction from the business perspective on interest rates going up? What does that mean to businesses, particularly SMEs?

Louise Hellem: Similarly, for any businesses borrowing at the moment, it could impact those repayments if they are on variable rates. If we look at the commercial book, it's about 50:50 in terms of fixed versus variable rates, although the flow on that is very different. About 80% of the flow in is on fixed rates, so a lot of those will not be affected at the moment, although they will in time.

We have been keeping a close watch on insolvencies for the past year or two, and we have seen them increase a little bit. We had been expecting a wave of insolvencies coming through, but we haven't yet seen that. It doesn't look like we are close to that yet. However, as I say, that is something that we are trying to keep a watch on.

The important thing is the kind of wider support the Government are providing alongside this announcement. Support on the energy side will help a lot of businesses but it is too short. We need to think about some of the wider support packages, particularly where other costs and rates were due to change in April. Business rates will be increasing because of inflation, but we also have the end of some of the covid support. We still have 50% reductions on business rates for hospitality, leisure and retail, but that is due to end in April as well. There are wider questions about what the support landscape looks like.

Q356 Emma Hardy: Further to that, on the current uncertainty over what will happen in the next few months for businesses, are you seeing that impact the investment decisions that businesses are or are not making?

Louise Hellem: Yes. Reflecting on the conversations I had at the start of the year, although businesses had come through quite a lot of shocks, there was a lot of optimism. When you walked into the room, you were talking about, "We now have the opportunity to grow and think about investment plans." There was lots of enthusiasm for net zero and things like that. Now, when we walk into the room, we have to try not to bring doom and gloom to the conversation.

We are definitely seeing that investment intentions have fallen. It is interesting that there is a divergence between investments on the energy efficiency side—businesses are largely trying to keep hold of those, or, where they can, double down on them—and the wider investment landscape, which has at least flatlined, if not seen a reduction in investment intentions. That is quite worrying. We are getting into the risk of a cycle of the kind of low growth, low productivity that we have been in for the past 10 to 15 years.

Emma Hardy: Torsten, referring back to your Twitter, which we all follow with great interest—

Torsten Bell: Oh dear! This is a problem for productivity.

Q357 **Emma Hardy:** No, no—it's all fine. To quote from Twitter, you said: "Key sentence from @bankofengland – Treasury spending big on energy support may push down on measured inflation in the short term but means higher inflationary pressures in medium term – which is deeply unsubtle code for higher interest rates". The bit you highlighted was this quote from the Bank of England that says: "All else equal, and relative to that forecast, this would add to inflationary pressures in the medium term." Can you expand a bit more on that? Why do you think this was secret Bank of England code?

Torsten Bell: Well, it is not very secret, as it is in public. It is basically the same question that Gareth Davies raised with us earlier. The measured inflation is lower in the short term because of the energy price caps. It is important to say that that is measured inflation. The terms-of-trade shock is still happening; we are just passing the cost on to future years. The measured inflation that consumers face is lower in the short term, but because it leads to households being significantly better off than they would otherwise be—households will still be worse off, but they are better off than they would otherwise be—the Bank of England is saying to us, unsubtly, "Because the energy crisis will be doing less to slow demand in the economy than it otherwise would have done, we will fill in the gap." That is what it is saying.

It is saying, "In future, you have got more inflationary pressure because household spending is not going to be falling as fast as it would if you allowed all these price rises to come through. We are telling you that we can't keep the current level of demand, because we need a fall in demand"—that is what the unemployment forecasts are telling us—"and so we are going to make sure that even if you allow a higher level of GDP in the short term by supporting household incomes, we will squeeze that out in the medium term."

By medium term, I think you should assume that we are talking about a year or a year and a half for the effect of higher interest rates to come through into GDP. It will then take another year for it to come through in the effect on inflation itself. I think that is what it is telling us. That is what the markets are hearing, which is why you are seeing market expectations of interest rates rising. Again, they are probably rising faster than I would personally agree with, but let's park my view—the markets are telling you interest rates are heading to 4.5%.

Q358 **Emma Hardy:** We have just had an interest rate rise today. If we are expecting interest rate rises, who will be the winners and losers in the situation where taxes are being cut but interest rates are rising?

Torsten Bell: That is a big question. The first thing to say is that we are all losers. The country as a whole is getting poorer. That is the big picture



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of what is happening this year; it is almost certainly the big picture of what is happening next year. Everybody is poorer.

On interest rates, if we went back to the “confident phase” for businesses at the beginning of the year, we were expecting interest rates to start rising, but we were expecting maybe a percentage point being the rise that we were going to see; the real hawks out there were saying we had to get interest rates to 2%. That level, combined with the fact that fewer UK households are exposed to interest rate rises than they were last time we went through a significant tightening cycle, which was in the 1990s, because we have fewer homeowners, and of those homeowners, fewer of them have mortgages, and of those that have mortgages, fewer of them are on variable rate mortgages—so we are not in the 1990s situation at all, because a far smaller proportion of the population has very large borrowing on a variable rate—meant that you would have, at the beginning of the year, thought that this interest rate rise cycle wasn’t going to make that much difference to household incomes.

We are not in that world any more, for two reasons: first, because we are talking about 4%-plus interest rates, not one and a bit per cent interest rates; secondly, because we are talking about them lasting. That is the other big change. Don’t just look at the short-term interest rates; look at market expectations of those higher rates to last. It is that that is causing people selling new fixed-rate mortgages to be offering, even if you want to buy a five-year or 10-year mortgage, 4% rather than the 2% you maybe would have got a while ago.

That is where you are going to start seeing material effects on households. In general, middle and higher-income households will mainly be affected by those rate rises via mortgages, because the bottom 20% who Rebecca was talking about earlier with the £450 stat tend to not have mortgages. Some do, but they tend not to have mortgages.

I think we are now heading into the world where, as people start rolling off fixed-term mortgages through the course of next year, we will move into this affecting millions of people. I think I saw an estimate that around 1.5 million households will flow on to new mortgages during the course of next year. We are talking about those people seeing a doubling of their interest bills on their mortgage. The reason that matters is because if you lose your job, you can easily stop paying the capital part of your mortgage, but it is the interest part that, in general, you will need to keep paying. You should be expecting that to double for lots of people remortgaging over the course of next year.

Those on a high loan-to-value or a high mortgage-to-earnings ratio will find that very difficult. Interest rates basically disappeared from British politics over the past 20 years, but give it until March next year; once significant numbers of people are rolling on to those mortgages, you will start to see people noticing, because the change is significant.

On the tax cuts that we are talking about, the only one that we know we are definitely getting tomorrow is on national insurance, possibly for



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November. That is a very top-heavy tax cut, so it is not one that is well targeted at those suffering from the cost of living crisis. Twice as much of the gains go to the top 5% as do to the entire bottom half—we have talked about this before—so it does not do anything, really, for the bottom half of the population.

Stepping back, the overall pattern of tax that that is leaving us with for this Parliament—this is partly conditional on us not having lots of other big tax cuts announced tomorrow—is that you still, generally, have tax rises going ahead, but the tax rises going ahead are less progressive. They will still be progressive, because the threshold freeze is putting up taxes very significantly for the higher-income households, but by reversing the increase in national insurance rates, you will make it significantly less progressive.

Q359 Emma Hardy: Thank you. Finally, Neil, you have written that, “by raising interest rates to squeeze inflation, central banks are also removing the key prop to housing markets.” What are the risks of large falls in house prices?

Neil Shearing: They are significant, I think. On the point that Torsten just made, I think the issue is less the people with high loan-to-value ratios; the repayments-to-income ratio is the key point here.

This is a very simple story. Interest rates have been incredibly low for the last 10 years, and that has bid up the prices of all manner of assets, of which housing is one. That is sustainable as long as interest rates stay low; as soon as interest rates go up, the prices of assets, including housing, start to come down.

We looked at that at the start of this year, when we were thinking, “Maybe rates might get to 2%; what’s that going to do to the housing market?” and our property team thought, “Well, things don’t get really significant unless interest rates get to 3.5% or 4%.” We kind of all looked at each other and thought, “That’s okay, isn’t it?”, and now we are here. I suspect that, by the first quarter of next year—maybe the second quarter—interest rates will be at 4%, at exactly the point when people roll off and are fixed on to floating rates.

It is difficult to gauge these things, but I would have thought that price falls of 5% to 10% are a reasonable ballpark to be thinking about. However, the impact on household consumption and disposable incomes, because of the follow through in mortgage payments, is the significant thing.

Q360 Emma Hardy: Finally, do you see a potential for negative equity in the housing market?

Neil Shearing: I think that is less of a concern now than it was in 2008, because regulation of the banking sector is much tighter. Loan-to-value ratios generally are lower, so there is more equity in housing when people are purchasing their houses. It is much more about affordability than levels of equity.



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Q361 Dame Angela Eagle: Torsten, fiscal policy seems to be more and more at odds with monetary policy. That is what you were talking about: we are going to spray vast amounts of money at the economy, from various places, to kick off some growth. However, by definition, putting interest rates up to get inflation down chokes off growth and is more likely to lead to recession. Which of those do you think will win out?

Torsten Bell: That is a good question. The first thing to say is that fiscal and monetary policy should be pushing in different directions right now. The existence of tension is not a problem; it brings problems and challenges but, in and of itself, it is not a problem, because they have different objectives. Fiscal policy should be worrying about the distributional effects of this large energy price shock, and only fiscal policy can address that, whereas monetary policy should be worrying about whether higher inflation lasts.

There is nothing wrong with fiscal policy providing some of that support, and providing it particularly to lower-income households, and monetary policy squeezing some of that out in other ways, because the policies have different objectives. I think that is reasonable. What is less sensible is not making more effort to reduce that tension. You don't want to maximise the tension in the system, because higher interest rates are a problem.

The Chancellor has explicitly said that monetary fiscal co-ordination is a thing he will be doing; while that is true, it is not normally a thing that Chancellors say. In general, you would look to minimise some of that tension in a difficult phase like this, because it will reduce the chances that we are misinterpreted or that we make the problem harder for ourselves. You have now got a Government trying to borrow a lot of money at exactly the time when the Bank of England is saying, "We are going to proactively make it more expensive for you to get to that money." That is when you start to get political economy tensions in the system that we would like to minimise. Obviously, people re-mortgaging would also like to minimise how much higher their interest rates go, but the fact that, marginally, interest rates will be higher because the Treasury is doing some additional borrowing in the short term is not a problem, I think. It is the scale of it and the lack of attention to maintaining the quality of our institutional set-up while that is happening that is sub-optimal.

Q362 Dame Angela Eagle: On that point, the Chancellor has made a point of saying he wants to see the Governor of the Bank of England twice a week. To what extent does that effectively rip up the independence of the Bank of England?

Torsten Bell: I think we should judge the Bank of England by what it does and says. It has said very clearly today, "If you borrow significant amounts of money, we will put up interest rates."

Dame Angela Eagle: I think it is a case of "Watch this space."

Torsten Bell: Possibly, but that is what an independent Bank of England should be saying. I think you should have the Governor in and ask him whether he has time for two meetings a week.

Dame Angela Eagle: Don't worry; I intend to.

Torsten Bell: I think his productivity and his workload are the issue, rather than it immediately calling into question the Bank's independence.

Q363 **Dame Angela Eagle:** Do you think tax cuts that mainly go to the already well-off lead to growth?

Torsten Bell: I think we talk about tax too much, full stop, when it comes to growth. Most advanced economies have better growth records than us over the last 15 years. That is what relative decline looks like. Lots of the ones that have grown faster than us have higher tax rates, or tax takes, than us—such as Germany, France, the Netherlands, the Scandinavian countries—but some countries that have lower tax takes than us have also grown faster than us. The United States is obviously the famous example.

It is important to get tax policy right. It is important for distributional reasons and efficiency reasons. There are some very bad taxes, and reforming them would make some difference to our growth rates, but overall, the level of taxation is not a primary driver of countries' different growth trajectories. Focusing on it risks distracting us from some of the other ones. The reason we focus on it is because it is the one where you have a lever you can pull and announce something in the very short term. That is why it happens. It happens to politicians from both main parties, but it is not the most important driver of growth.

Dame Angela Eagle: Louise, do you think the same? Do tax cuts that mainly go to the better-off lead to growth?

Louise Hellem: I am mainly here to comment on the taxes on businesses. I would definitely say that they are an important part of thinking about what your growth strategy should be and making sure you have the right investment environment, but I very much agree with Torsten's point that that is not the only thing. We are keen to make sure that Government pull the other levers that I actually do think they have at their disposal, although they are definitely harder to pull. There are trickier questions, as I said, on the longer-term development in skills in the UK, making sure we have higher skills, and skills at the right level. We need to see lots more flexibility there, particularly when thinking about servicing some of the new markets in the economy.

Dame Angela Eagle: Of course, the more tax cuts you have, the less your tax take, which means that you can spend less on things like skills.

Louise Hellem: Again, it goes back to what Torsten said. If you can think about the rates, you can also think about the structure of those taxes—there are lots of taxes that you can make more efficient—as well as looking at the headline rates.

Dame Angela Eagle: I am talking about corporation tax, for example, or the national insurance cuts.



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Louise Hellem: On corporation tax, when that increase was announced, three things were true. One was that we had just spent a lot of money supporting households and businesses over covid, and that debt needed to be repaid. That remains true. Secondly, we were expecting this increase to come in when growth had rebounded. That is not now the case. Thirdly, we were expecting lots of other countries to increase their rates as well. That also hasn't happened.

Q364 **Dame Angela Eagle:** But of course we did not have huge rates of growth when corporation tax was at its previous level, so taking it back down to that level will not suddenly spur growth, will it?

Louise Hellem: It is definitely important, as Neil said, that we do not expect that reducing it to what it was will be a magic bullet. In this debate, it is also important to think about what was going on in the wider investment environment for businesses. It was obviously a period of incredible uncertainty for businesses; they have faced lots of shocks over the past few years. If we think about the wider tax structure, while those headline rates of CT came down, the base for CT was widened considerably. We need to think about that in the round. The OBR did a really interesting chart when the increase was announced; it showed that the effective corporation tax rate was pretty flat over the entire period, because we had this realignment across the rates and the base.

Q365 **Dame Angela Eagle:** The super-deduction, which is essentially a tax relief that paid people more money than they were going to invest, didn't work either, did it?

Louise Hellem: Again, it is important to put the super-deduction in context. It was introduced when the CT rate increase was announced. If you look at the numbers, all it meant was that a business investing today had the same incentive to do that as it did when the CT rate increases were announced.

Q366 **Dame Angela Eagle:** Yes, it was meant to bring investment forward, but it did not work, did it?

Louise Hellem: The surveys that we have done in the CBI showed that investment increased by about 41% because of the super-deduction; 20% of that was investment that was brought forward. There was additional investment in the UK as well. As I say, tax is an important part of investment decisions for firms, but again, you have to look at the wider investment environment and think about all the shocks that firms have faced over the last few years. We do not know what investment would have been without that super-deduction; I think it would have been significantly lower.

Q367 **Dame Angela Eagle:** Torsten, there has been talk about creating inland tax havens, or inland freeports, or whatever you want to call them, where all sorts can happen without regulation and with lower taxes. Do you think that will increase economic growth?

Torsten Bell: Again, I would like to see the Government's proposals before answering in great detail. Similar approaches have been tried, in



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the UK and in lots of other places around the world. There has been briefing that a key reason why this is different from previous attempts is that there will be lower personal tax rates. I would be very surprised if that gets announced tomorrow. That brings with it a lot of operational challenges and will end in tears, almost certainly.

On the wider lessons on this kind of approach, first, it really matters where you do this, where you are aiming for, and what you are trying to achieve. The approach could boost GDP in some areas, though some of that will come from displacement. If that happens but the package of measures that make up the enterprise zone don't also lead to an increase in land supply, all that increase in GDP will just go to existing landowners. It is questionable whether that is a big objective, but you might get that, at the price of higher GDP. It is not nothing. It is not clear to me that those who want enterprise zones, or politicians who represent those areas, really want the increase in land supply that would be required to make a success of them.

There are some really big dangers. If an enterprise zone provides buy-outs to bits of regulation that exist to stop a large negative externality happening—

Dame Angela Eagle: Like pollution.

Torsten Bell: Pollution is the key example. If you speak to a lot of water companies, who have their own problems on the pollution front right now and are worrying about inland, they will definitely be worried that you may raise GDP in one part of a region but significantly reduce wellbeing for the region as a whole if you get this wrong; I am slightly worried.

I am hoping that this isn't true, but it seems that we have asked places to say within a few days whether they would be interested in being an enterprise zone, without giving clarity about what an enterprise zone is. That would be the opposite of what I was saying. You want to choose really carefully what you are trying to achieve. Thinking about the places that you are choosing and how people will wish to use it, is it likely to raise GDP without there being significant wellbeing trade-offs? Overall, is it likely to make a very large difference to our aggregate level of GDP? Probably not, unless it is a trial run for a much wider approach—in which case you should probably say so.

In the end, serious attempts to focus on how we grow the UK economy will be much more broadly focused on how we make a success of some of our large cities. In particular, how do we make sure that they can be successful service exporters in the years ahead? How can we get some actual business investment to happen in a country that has proved very reluctant to do that? Those are the big-picture things that matter much more than whether you have a handful of local authorities trialling uncertain levels of deregulation.

Q368 **Dame Angela Eagle:** To what extent do you think that the uncertainties around trade caused by Brexit and the lack of, for example, a US trade



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deal will impact on the potential to get growth from 1% to 2.5%, which is what the Government say they want to do?

Torsten Bell: For a long time, we have had total certainty about a US trade deal: anyone who pays any attention to US politics knows there is zero chance of a US trade deal, and that has been the case for the past few years. It is not really about the Biden Administration. I know it gets written up like that, because everybody wants to make it into a partisan thing, but it is not really. It is not because they don't like this Government or they didn't like Boris Johnson; they do not want to do a trade deal with almost anybody. That is not where US politics is right now. They are not going to be doing a trade deal with us. That is completely off the cards.

The bigger problem we have—we published a paper on this back in the early summer—is that we are becoming less open as an economy generally. Obviously that is mainly about Brexit, but the effect of it appears to be that we are becoming less open relative to trading partners that are not the EU—such as Japan and the US—and that is a bigger problem. If we were starting to focus on the substance rather than the top-line politics of it, that is where we should be focused.

There was never going to be a US trade deal. The situation is that we have chosen an economy that is significantly less open. We thought that the nature of that openness would be just vis-à-vis the EU; that is not what is actually transpiring and, instead, we are becoming less open via all our major trading partners. That is a serious problem for our long-run productivity and living standards, and that is what we should be focusing on.

Q369 **Chair:** Can I quickly pick you up on that, Torsten, before I come to Kevin? The trade intensity of the UK economy has diminished. It did during the pandemic, as it did for other countries; the pandemic sort of swept through, but they have come back up and we have not. What you are saying is that some of that is EU-related, but a lot of it is not. I can get why the EU bit might be more problematic, but why is it worse in other ways?

Torsten Bell: That is an excellent question. I don't feel I have all the answers to that question; I will send you the paper we have published that gets into the data in detail. It is not totally clear what is going on, but the UK appears to be playing less of a role in lots of supply chains as a result. As I say, that is not just to the EU. Those of you who have spent time travelling around the world, and obviously in the EU, will have had conversations about how people see the UK as an economic prospect. That has a trade aspect, just as it has a markets aspect right now. We can either take those things seriously or we can pretend they are not happening.

Q370 **Kevin Hollinrake:** My questions are about business, what challenges it is facing and how we can make its life easier. Making business's life easier is a matter very close to my heart, and I declare my interest in that area.



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First, on deficits, I think you said earlier, Neil, that the current plans will, as far as you understood them, add about £100 billion to spending this year. What is the total deficit you are predicting this year?

Neil Shearing: It will be just over 10% of GDP.

Kevin Hollinrake: So about £200 billion.

Neil Shearing: We have an extra 4.8% of GDP, so yes, it's £225 billion.

Kevin Hollinrake: Which is about £60 billion higher than it was in 2010.

Neil Shearing: Exactly.

Q371 **Kevin Hollinrake:** And the year after?

Neil Shearing: We have £225 billion this fiscal year, £160 billion the year after and £105 billion the year after that. Obviously these figures come with the usual health warnings.

Q372 **Kevin Hollinrake:** Roughly—okay. When Harriett asked you earlier, you were a little bit reluctant to say that the public finances were unsustainable on that basis; how could that be described in any way as sustainable?

Neil Shearing: Perhaps I should clarify what I was saying and where I was coming from. The first point I was trying to make was that by far the largest part of this package is a series of one-off measures that will fall out. You are then left with a series of permanent measures. By 2025-26, you are left with a deficit of about 3.5% of GDP, on our measures.

Torsten Bell: Three and a half?

Neil Shearing: About 3.5% of GDP, so £70 billion to £75 billion.

Torsten Bell: It is going to be a lot higher than that.

Neil Shearing: I think the point is that it is subject to a huge amount of uncertainty. We don't quite know, right? We are talking about something three years out, and we have had two huge shocks in the space of two years. And that is based on an assumption that some parts of the labour market start to heal and we get a return of some of the workers we have lost during the pandemic. If that doesn't happen, then there's a problem. There might also be a slight rebound in productivity—not a huge one. That is a problem, too.

Q373 **Kevin Hollinrake:** Okay; I will come to that. By 2025-26, you think that there will be about a £75 billion deficit. Torsten, you do not seem convinced by that.

Torsten Bell: Well, we will publish our numbers tomorrow when I have seen what—I do not want to publish numbers; I want to see what the Chancellor actually announces. That would be a conservative estimate, on the basis that I am more in line with what the IFS set out yesterday, which is that borrowing will be significantly above that.



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The sustainability question is not, "Are they borrowing shedloads this year and next year, and so the stuff in the medium term looks small compared to that?" That is what happens in recessions; if it looked like it was similar to the stuff in the middle of it, then that would be a big problem. What matters is your long-term fiscal stance. As I say, it is very unusual to be significantly loosening your long-term fiscal stance at the same time as your economy is driving a worse set of public finances.

Neil Shearing: Just to clarify that point, those numbers are based on what we think we know so far; there could be a whole load of things coming tomorrow.

The second point is that whether a deficit of 3.5%, 4% or 4.5% of GDP is sustainable depends on the rate at which your economy is growing and what your interest rates are doing. The rate at which the market will lend to you as a Government will depend on whether they believe you have a credible plan to get the debt trajectory down as a share of GDP over the long term and whether they believe your growth plan. The answer to whether this is sustainable or not depends on whether the Government can come up with a credible plan that the markets believe will grow the economy and reduce long-term debt to GDP. That is the bit that's missing.

Q374 **Kevin Hollinrake:** I understand. Looking at SMEs, Louise, you have mentioned before that insolvency rates were a little bit high. I think they are actually 26% higher than they were pre-pandemic. Are you not very concerned by that?

Louise Hellem: It is something that we are obviously concerned about. What we haven't seen so far, although that number is high, is a wide spread across the economy. Whenever you have these shocks you will have some kind of shakeout, but we were anticipating that rate to be much larger, which we haven't seen yet. But yes, obviously, where the numbers are is concerning, as is the risk that they will get higher.

Q375 **Kevin Hollinrake:** Sure. Judging from businesses in my constituency that contact me, the impact of energy prices has just started to hit lots of businesses, and hit really dramatically. It occurs to me that this might be the thin end of the wedge in terms of the difficulties that business might face over the next few months.

Louise Hellem: Yes. That is why the swift action from the Government last week was incredibly welcome. Over the summer, we were hearing a lot of horror stories from businesses about the percentage increases they were having. While we have this six-month respite, we really need certainty from Government about what will happen in terms of support for business after six months. If further support isn't forthcoming for those most vulnerable, I think we will be back in that situation again where businesses are thinking about what their future is.

Q376 **Kevin Hollinrake:** Sure. Having been in politics and in business, I know that a week may be a long time in politics but six months is a very short time in business.



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Louise Hellem: It is a very short time, yes.

Q377 **Kevin Hollinrake:** How easy will it be for the Business Secretary, the Chancellor or whoever—the Prime Minister—to identify what they will do after that six-month period? We are talking about vulnerable sectors, but is it not the case that any business can be vulnerable to this stuff?

Louise Hellem: It will be important to look at it from a couple of different criteria. One is definitely from a sector perspective. We can already identify that energy-intensive businesses will probably need some support, but it is also important to look at the size of businesses and the other vulnerabilities that they might have. Again, I think something for SMEs will need to be forthcoming. There is a question about whether all of that is through an energy-type package—package 2.0, as it were—or whether you are thinking about a wider base of support, and whether some of it is perhaps sectoral, as we have had before for hospitality and leisure. Consumer-facing sectors are, again, probably quite vulnerable, so there is a question whether there is support for them, which could come either through energy prices or through business rates reliefs and things like that.

Q378 **Kevin Hollinrake:** I have seen comments already—this becomes a political football, of course—that you will suddenly throw millions of pounds at Amazon to cut their energy bill. I understand that that is not politically palatable to some people, but is it possible to deal with it in terms of business size? Yes, we want the small pubs to get through this, but don't we also want Wetherspoon and the like to get through this? Some might not, but Wetherspoon—this might be sensitive—probably can't face an eightfold increase in its energy bills.

Louise Hellem: I am obviously not going to comment on Wetherspoon specifically, but when we had the energy package the other week, it was right that we had a balance between speed and targeted support. We needed to do something quickly, and that is obviously why we only have a package for six months, which should provide time to look at a more targeted package of measures. It is right to do that. As you say, some firms will be able to ride this out because, although they might have seen quite large increases in their energy bills, it is quite a small overall proportion of their cost, but for some firms, because of either their size or their sector, that will obviously not be the case.

Q379 **Kevin Hollinrake:** Sure, and it is not the only problem on the horizon, is it? You are seeing consumer spending tighten because of the obvious—the credit card companies are saying that—which affects some sectors worse than others. Interest rates are obviously increasing, and businesses laden with debt are going to find that pretty tough. According to the Bank of England, credit availability is becoming more difficult for SMEs, and recruitment is a big issue. It is a perfect storm, isn't it?

Louise Hellem: Yes. As I said before, when we talk to firms about the economy, we try not to bring the doom and gloom into the room, but obviously at the moment it is almost a perfect storm, as you say. A lot of these challenges have been long-running. Whereas earlier in the year



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firms were facing higher costs but were potentially able to pass them on to consumers, now we are starting to see that those issues are really affecting demand, and consumer sentiment is falling. Businesses are very concerned about that. We definitely will need some further package of support, whether or not it is more targeted, and, as I say, we need to look at the wider business landscape. It was really good that, earlier in the summer, we had the extension of the recovery loan scheme, but we need to look at wider liquidity support, time to pay and what will potentially happen with business rates and other taxes, depending on what is announced tomorrow.

Q380 Kevin Hollinrake: Have you or any of the other members of the panel thought about how on earth you would pick out the sectors that you would support? Is there a mechanism for doing that? Can we tell the Chancellor and the Business Secretary right now? I would be fascinated to know that.

Louise Hellem: That is something that we are turning our attention to at the moment, given the volley of announcements that we have had over the past few days. Again, looking at the proportion of energy costs as bills will be very important, and you should think about firms' ability to pass those on. The other important thing, particularly for energy-intensive industries, is to look at the competitiveness of the environment. They are obviously often competing with other firms in Europe and elsewhere in the global economy, so you should look at what support is provided to those firms.

Torsten Bell: To state the obvious, it is really hard, so you should be sympathetic when you are talking to the Business Secretary or the Chancellor. The sectors that stand out in terms of energy intensity are the obvious: hospitality and manufacturing are the two that I would highlight as clearly at significant risk. How you think about those two sectors is very different.

I should also say that there is huge variation within all these sectors in people's exposure to rising energy bills. One of the good things about the policy package they have come forward with is that it does a good job of avoiding dead weight. I wouldn't want grants being provided via the business rates system to everybody, because lots of firms are still on longer-term contracts and are not facing these price rises or anywhere near the peak of price rises. You do not want an across-the-board sectoral approach; you need to focus on those who are facing higher bills.

It is then worth stepping back and saying, "What are we trying to achieve overall?" In so far as we are facing permanently higher energy costs, because that is a terms of trade shock for us, it makes us poorer. You are not going to be able to get rid of the permanent bit of that. That means firms closing and firms producing less. What we are really saying is that when we get to April, if energy prices look remotely like what they look like now, we will be in a recession. We can delay it via this mechanism, but that is what is happening. On the consumer side, that looks like less spending power, and on the business side it looks like, "I will try and put



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up my prices to reflect these higher energy costs, and I will therefore produce less because my customers are not price insensitive," and the two will come back into equilibrium at a lower level of output. That is what a recession is in the face of an energy price shock. The choice for Government is how much you think this is temporary and therefore you can smooth households and businesses through it. In so far as it is permanent, you can't, and you will need to suck it up.

You should think about those sectors, though, differently in that regard. The manufacturing sector is largely, at least theoretically, a tradeable sector. I wish more of it was tradeable, but lots of it is tradeable, so the relative levels of support across countries is something we should definitely look at. When it comes to the hospitality sector, that is not the case. What you should look at there is what is your best guess at how much of this is permanent. You are going to have to let that through, and then you should try to deal with anything you think is still temporary. That is basically the framework I would use.

Louise Hellem: There is one other thing I want to add to that. Throughout this, it is important to think about where we can in the longer term reduce energy demand and increase energy efficiency. That can be the potential win-win from some of this.

Kevin Hollinrake: Sure, okay.

Rebecca McDonald: Can I add one more thing? In terms of what you were saying about the policy goals, I do not necessarily think this should be the primary concern or goal, but we should think about limiting rises in unemployment and about how job losses could be very concentrated within sectors or localities. It is very difficult, especially if these are permanent costs, because you don't want to hold people to jobs if it is a permanent change in cost, but that job loss side of it needs to be considered within the policy cost.

Kevin Hollinrake: That is a fair point.

Louise Hellem: Yes, and the impact on the wider supply chains.

Q381 **Kevin Hollinrake:** Sure. This is against the backdrop of a time when we are going to try to get growth—the jury is out on that, as you have said, Neil—by getting business to invest, which seems a bit unlikely right now when they are facing all these problems. Before I talk about that, though, Torsten, you talked about public sector net investment as the area you might look, or the Government might look, for cutting—

Torsten Bell: I did not say I would look. I said, "What does history tell you happens next?"

Q382 **Kevin Hollinrake:** No—the area the Government might look. But doesn't that kill levelling up? A lot of that is about infrastructure and that kind of stuff, isn't it?



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Torsten Bell: There are a lot of ways you could go about trying to deliver a levelling-up—poorly defined—agenda. The way we have actually gone about it is via lots of public sector net investment, with pots of cash doled out to areas. Yes, that would make that difficult. In general, what history tells us happens is that you get towards or near-ish an election and you need to be able to forecast debt falling, so you commit to cutting net investment in future, at the end of your forecast period, so that you can see debt falling at the end of the forecast period but you do not actually have to do anything in the near term.

Q383 **Kevin Hollinrake:** Isn't that absolutely bonkers? Levelling up would take decades because parts of the country would have been so left behind. East and west Germany is a comparable disparity in terms of economic activity and output, and that took three decades.

Torsten Bell: Bonkers is not the technical term but, broadly, the approach that the British Government has taken over 40 years—low levels of public sector net investment that get cut whenever we have a consolidation phase and are not prepared to put up taxes or be honest about the wider implications of that for public spending, and having it yo-yoing up and down—is a complete catastrophe. Everyone rows about whether or not privatisation did big things for the trains in the '90s. I will tell you what definitely did big things: not investing in them for 20 years, whether or not they were publicly or privately run. Has anyone met our water companies recently? The big picture is that if you have low levels of public sector net investment, it has long-term costs, whether it is in housing or the quality of your NHS. So, yes, it would be bonkers.

Q384 **Kevin Hollinrake:** Okay. In terms of business investment, in 2019 UK private sector business investment was about 10% of GDP. It was about 30% higher in France and Germany. How much of that is just because we do not invest? Didn't business investment drop off a lot in 2016, and it has not recovered?

Torsten Bell: Business investment growth stopped in 2016. The level did not drop off. The level is lower than it would otherwise have been, but, basically, we have not seen any growth since 2016. That is because we have said to every business in Britain, "Would you like more uncertainty than you have ever had before?"

Q385 **Kevin Hollinrake:** Which is your point, Louise. Are you dancing around the word "Brexit"? You would rather not mention it. Is it not part of the equation that businesses are not investing because of the uncertainty around Brexit?

Louise Hellem: It definitely goes back to that point about uncertainty, and that is very damaging for investment intentions. The best thing to do is to set out—as I think the Government are trying to do—a growth plan saying, "These are the ambitions that we are aiming for," and then businesses can get behind that and support it.

Q386 **Kevin Hollinrake:** You said, I think, that the net effect of the super deduction has been to increase business investment by about 20%. Is



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that right? You said 40%, 20% of which is brought forward and 20% of which is—

Louise Hellem: Yes, 20% new investment, 20% brought forward, 1% into the UK.

Q387 **Kevin Hollinrake:** So that has a positive effect.

Louise Hellem: Yes. One of the interesting things with the super deduction is that, like I say, the level was quite carefully calculated so that, in real terms, it did not make a difference if you invested now or when CT increased. But the mechanism is quite different, because capital allowances mean you can very slowly over time take the cost of your investment off your taxable profits and therefore you have a lower CT bill. The super deduction gave you that money off your CT bill in that year of investment. It is that kind of model that would be interesting to explore for the future.

Q388 **Kevin Hollinrake:** So you think extending the super deduction or something like that would be the right kind of measure to incentivise business investment.

Louise Hellem: There is a question about the level. Obviously, the super deduction was greater than 100%, but you can take the current model they have for capital allowances, and if you give that money up front to businesses, that improves their cash flow without actually having a long-term impact on the Exchequer. That is something that, from conversations with businesses, we think would have a real impact on investment and would affect boardroom decisions, as well as the headline CT rate, which is also important for businesses.

Q389 **Kevin Hollinrake:** So are you saying keep the super deduction or go for something more generous—full expensing or something?

Louise Hellem: We would love to keep the super deduction—it is more generous than the proposal we are putting forward, which is 100%, but it is the fact that you are able to benefit from that now rather than over potentially 30 years of however long your investment is.

Kevin Hollinrake: Okay. Torsten, you were shaking your head a bit.

Torsten Bell: I don't think anyone thinks we are keeping the super deduction. We are not going to give people 100 and x per cent.

Q390 **Kevin Hollinrake:** Is it too generous?

Torsten Bell: It is not too generous in the period it existed for because it is not really a deduction; it is just about stopping people having an active incentive not to invest. It was basically a good bit of comms presented as a big new incentive, but basically it just stopped you having a big disincentive to invest in those future years. Unsurprisingly, the result is that the evaluations showed that it did not deliver the comms. That is what happens when you oversell a policy. We said that at the time it happened, and we are where we are.

Q391 Kevin Hollinrake: What should we do?

Torsten Bell: That is a good question. One of the problems we have in this debate, which has ended up being, "Would you like Rishi's 26% or Liz Truss's 19% of corporation tax?", is that it has basically obscured this wider question: "What is your balance between wanting to narrow the tax base by taking more forms of investment out of your tax base in exchange for maybe a rate in between those two levels?" That is probably a more sensible debate to be having.

We went through a whole decade of politics where everyone said, "It's a big contest about the level of corporation tax," but the effective tax rate has basically been flat right through the 2010s, so those saying that it had no effect and those saying it led to loads of great investment are all—but all I would say is that you are rightly focusing on the business investment question. Tax is way down the list. The tax regime is not why people are not investing in Britain.

Q392 Kevin Hollinrake: So what is it?

Torsten Bell: Well, it is that we look like a bit of a basket case.

Kevin Hollinrake: Uncertainty, really.

Torsten Bell: Massive uncertainty, not serious about protecting our institutions, not recognising the real trade-offs that exist, big changes in policy. What have we said to business? We are saying to business, "You should really focus on your tax rate," and then we are reminding them that a Government of the same party have proposed a 26% and a 19% rate within about a minute of each other. Do you think that gives business a good deal of certainty?

Q393 Kevin Hollinrake: We are a very broad church. Can I ask about something else? Andy Haldane said in an article that the productivity puzzle is not actually to do with larger companies; the problem is with the "long tail" of SMEs that do not learn from the best practice of the bigger companies. There are two things that disincentivise investment in the UK. One is business rates: you pay more rates if you invest, in various ways, in your premises. The other, which is more controversial, is the VAT threshold. How many businesses stay under that threshold deliberately? How many of your members, Louise, do that deliberately? I know you mostly represent larger businesses, but how can it be sensible that, if you go over a certain turnover threshold, you are worse off?

Louise Hellem: I definitely think that, when you design tax systems that have cliff edges and thresholds, that can create effects that you do not want to have.

Q394 Kevin Hollinrake: Should we get rid of them? Should we smooth? In 2015 or 2016, I think, the OTS said that we should have a smoothing mechanism to get people through that threshold.

Louise Hellem: I think the wider point is that while there should be some focus on the tax system, if you look at the wider debate about how to



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increase productivity and business investment in the UK, you probably need to focus a bit more on some of the other mechanisms around this. You need to think about how we can create a stable investment environment, and how we can make sure that businesses understand the Government's goals and growth plan. Also, one of the crucial things that comes up when we talk about businesses is whether they have the right skills to make those investments. That comes back to the "long tail" point from Andy Haldane—do businesses have the right management and leadership skills?

Kevin Hollinrake: Thank you.

Chair: That brings us to the end. Thank you very much to our panel. You have informed our thinking a great deal at an important time, on the eve of the very significant statement from the Chancellor tomorrow. We will certainly want to know what the range of costs might be for the energy bills support. We can be certain, I think, about the corporation tax and NICs changes, but there are other things that have been mentioned—stamp duty, income tax, and who knows what else there might be tomorrow?

I think we all agree that of huge interest is what will drive growth back up to its trend rate of 2.5%, so we will be listening very hard on that. Of course, there is the absence of an OBR forecast, so we will be interested to hear what the Government say all their measures will lead to, particularly in respect of growth and the sustainability of the public finances. The analysis that you will bring out after the event tomorrow will be of particular interest to the Committee. Thank you all very much indeed for coming here today. That concludes the session.