

Treasury Committee

Oral evidence: Autumn 2022 Fiscal Events, HC 740

Wednesday 12 October 2022

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Members present: Mel Stride (Chair); Rushanara Ali; Dame Angela Eagle; Emma Hardy; Kevin Hollinrake; Julie Marson; Siobhain McDonagh; Alison Thewliss.

Questions 1 - 59

Witnesses

I: Torsten Bell, Chief Executive, Resolution Foundation; Professor Jagjit S. Chadha, Director, National Institute of Economic and Social Research (NIESR); Paul Johnson, Director, Institute for Fiscal Studies (IFS); Sanjay Raja, Chief UK Economist, Deutsche Bank; and Dr Gemma Tetlow, Chief Economist, Institute for Government.

Examination of witnesses

Witnesses: Torsten Bell, Professor Jagjit S. Chadha, Paul Johnson, Sanjay Raja and Dr Tetlow.

Q1 Chair: Good morning, everybody. Welcome to the Treasury Select Committee and our hearing today into the fiscal event that occurred on 23 September. I am very pleased to be joined by a panel of economic experts, five in total. I just wondered, Jagjit, whether you could start by introducing yourself before we go to the other members of the panel, please.

Professor Chadha: Good morning. I am Jagjit Chadha, director of the National Institute of Economic and Social Research.

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

Sanjay Raja: Good morning. I am the chief UK economist at Deutsche Bank.

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

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



Q2 Chair: Thank you very much and welcome. There are a lot of interesting things to discuss. We know it is all very grim and very difficult, and there is a huge challenge. I just want to spend a few minutes trying to work out how this might work, rather than talking about why we think the Chancellor cannot pull off what we think he is going to attempt to pull off with the fiscal event on 31 October.

I want to do it in two parts. The first bit I want to look at is the fiscal rules. We do not know what they are at the moment. Say you push them out further than the three years, perhaps to five years, and pick the year when you are expecting the ratio of debt to GDP to start falling as a year when the OBR thinks there will be some growth, which would assist meeting that target. In other words, you can fiddle around with that and try, on the one hand, to give yourself maximum flexibility while on the other hand trying to hang on to credibility with the markets for which these rules really matter.

I would just like to unpack that. Torsten, I know you have written a little bit about this or tweeted about this recently. You termed it “fiscal fudging”. Can you talk us through what his options are there? How does he get that balance right between giving himself flexibility and getting the market to look at it and say, “That is fair enough”?

Torsten Bell: That is a broad question. The Chancellor has told us what his fiscal rule is, broadly, which is debt falling five years out. The first thing to note is that it is not unusual, in and of itself, to have a debt rule and to give yourself a reasonable time to hit it or to extend it after bad news has occurred.

What is unusual is that, as things stand, it appears that the first bit of fudging we intend to do is to have only a debt rule and potentially not to have a flow rule for our fiscal rules. I do not think that has not happened in the whole 25 years of us having fiscal rules.

Q3 Chair: If he does not have a current budget rule, how much of a problem is that?

Torsten Bell: If he does not have a current budget rule, we have a significant problem. There have been rules that were not current budget rules, but broadly the consensus over the last 25 years has been to have a balanced current budget at some point. George Osborne went beyond that and aimed for an absolute surplus at one point, but generally a current budget rule is what you would want to see alongside a debt falling rule.

Q4 Chair: Can you identify why?

Torsten Bell: The reason it might be an issue not to have it is that, as we head further out, the debt rule might do less work in binding fiscal policy and the current budget rule would move to the fore, even though it has been the debt rule that has bound recent fiscal events. That is the first bit of fudging. That is material and it will matter. It would be noticed



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if it were the first time the Treasury set out a set of fiscal rules with no current budget element to it.

Then you go to some of the more micro points you are making. Yes, because we are talking about debt falling as a share of GDP, what is happening on borrowing is very important. We are doing more of it. What is happening on nominal GDP in a given year is really important, too. Both halves of that matter a lot. Yes, picking a year where you happen to have faster nominal GDP growth would make a material difference to your ease of hitting the target in that year.

To some degree, although he has said he is aiming for five years out, that option may have been taken off the table. That is not the only thing to think about, though, in terms of picking your year. One of the things that those people who are sad enough to spend their lives in the fiscal aggregates will tell you—I do not recommend being one of those people—is that the public sector balance sheet has quite a lot of moving parts. It is not just about the flow of borrowing hitting the debt stock every year. There are also lots of other changes to the balance sheet going on. You have discussed some of those before in your Committee. That is worth thinking about.

There will probably be more attention to what is driving any forecast fall in debt this time than there would have been previously because the markets are paying a lot more attention than they normally would. As I say, fudging your fiscal rules is something that lots of Chancellors from both the main political parties have done over the last 20 years. That is not the issue per se. The issue is the degree of it and the timing of it, when everyone is actually paying attention to it.

Q5 **Chair:** Depending upon what the OBR forecasts to be the basic trajectory of growth over the next few years, is it possible that he might therefore choose an earlier year than five years out, if that suits him?

Torsten Bell: It is possible. We will have to see what the OBR's projections are.

Q6 **Chair:** Yes. That is very helpful. Thank you. Can I just move on to the other half of what I wanted to talk about? We know what all the constraints are. We know the OBR is likely to come out and say, "We are not going to support the growth aspirations the Government have." We know the Government want to stand firm on the tax cuts. We know it is going to be extremely difficult to lean into spending cuts.

There is one area that, it seems to me, has not had much attention, which is other revenue raises. I suppose that is tax increases by another name, but these might allow some wiggle room for the Chancellor to raise revenues while being able to stand up and say, "I am standing by what I came forward with on 23 September."

I just wanted to run through a few thoughts. Maybe we can just game this. Let us just play the game: "If he can do it, how does he do it?" The



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first thing is that we have the triple lock. You could do something on that, on the basis that at the end of the day, in the long run, the triple lock is asymptotically headed towards consuming the entire output of the economy. At some point, there is an argument that you cannot keep playing the highest of the three.

Torsten Bell: It is a very, very long way away. We will all be very dead.

Q7 **Chair:** As Keynes said, we will all be dead in the long run. Could you do something there? This is back of a cigarette packet thinking, but you could make it £5 billion. The state pension and retirement age goes to 67 in 2028. You could bring that forward a bit. We are all living longer; we have labour market issues. Could there be some sizable slug there?

What happened on energy? The Government stepped in. There was a huge intervention to support families with energy prices. When energy prices go back down, as at some point we assume they will, could there be some hanging on to some of the benefit of that? By my back of a cigarette packet calculation—that is all it is—if you stuck at £2,500 for the average energy payment, you could be looking at multiple tens of billions of pounds, possibly £100 billion. You might get an enormous number, which might even swallow up most of the hole that Paul has identified as being £62 billion. You are at about £40 billion, leaning upward, wherever we are, whatever this huge number is.

Torsten Bell: It is in the same ballpark.

Chair: There is that. What about reserves tiering? What about the reserves held by the Bank of England and altering the interest rates on some of that? Effectively, that is a tax on the banks. As a downside, it will affect borrowers and depositors. It might raise some questions even around whether this is some kind of default on debt et cetera. That would potentially lever in some tens of billions as well.

There are some ideas. I have put four of them on the table. They could amount to more than enough, on the face of it, to solve the problem. What have I missed?

Paul Johnson: What have you missed? Of those four, the triple lock will not get you much unless you move away from price indexation and therefore make the real value less over the next couple of years. That is feasible, but it is politically difficult.

On the pension age, while my view is that the pension age started rising too late and is rising slowly, you would really risk the long-run credibility of your pension age policy if you brought that forward at very short notice. If people were surprised, that would be difficult.

Your equivalent to an energy tax is quite attractive, as you say. If prices came down by £1,000 per household, below £2,500, you have 30 million households, so that is £30 billion a year. That would also be consistent with net-zero priorities. That must be worth looking at. Obviously, it is regressive. It would keep energy bills high for low-income households.



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You would probably have to increase working-age benefits by more than inflation in order to make up for that because of the incidence on low-income households.

Q8 Chair: If you had some targeted interventions around that, to pick up the regressive point, you could still be looking at tens of billions, potentially.

Paul Johnson: Yes, absolutely. As I say, it is difficult. We have not put full-rate VAT on domestic energy, and this would be a much bigger imposition than putting VAT on domestic energy. It would be a big policy, but in a position where, from one year to the next, you would not be making anyone worse off. This is something worth thinking about.

As for tiering on QE, we just do not know what the incidence of that would be. It could raise tens of billions, and that would have some impact either on shareholders of banks, depositors or borrowers. The politics of doing this now, given concerns about the relationship between the Treasury and the Bank of England, would be particularly difficult.

Chair: The Bank would have to agree to it.

Paul Johnson: Yes. It is certainly possible and you might want to think about it quite seriously for any future rounds of QE. The current system was put in place well before there was any sense that we would end up with hundreds of billions of QE. There is certainly a case for doing this differently ex ante, but we just do not know what the consequences of changing it ex post would be.

In terms of other ideas, you have probably come up with the best four. Clearly, you could extend the period, for example, for which income tax thresholds and allowances and the national insurance threshold are frozen. That has another three years to run. If we have a five-year horizon, you could say that they will run for another couple of years. That raises a lot of money in the short run because of high inflation.

Q9 Chair: What is that a year, roughly, for both the basic rate and the higher one?

Paul Johnson: At the moment, we are looking at a tax rise of £30 billion over the four-year period. In the last couple of years it would be much less because the expectation at least is for inflation to be really quite low in the last couple of years.

Chair: Yes, less fiscal drag.

Paul Johnson: There will be a small number of billions there. It changes the structure of the tax system over time. There are other things in the forecast that almost certainly will not come to be, such as increases in fuel duty. One of the things in the forecast is that fuel duty will go back up to where it was and then go up in line with RPI. We might struggle to get it back up where it was. It has not gone up in line with inflation for 12 or 13 years now. In that sense, the real hole is going to be a bit bigger



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than that which the OBR is allowed to say because it is still Government policy.

Chair: Yes. We also have defence spending. We do not know the profile of that and various other things.

Paul Johnson: As ever, there are other bits of the tax system that one could look at, whether that be changes to capital gains tax, council tax or what have you. There is a small number of billions there, but, as ever, the big numbers of billions are in the big taxes.

On the spending side, for obvious reasons, it is quite hard to see where you make significant cuts. What are the big spending areas? The health service is much the biggest. Even in our numbers, we have simply assumed that health spending remains flat in real terms over the last two years. That is pretty unlikely. That would be really tough. As we all know, additional cuts on that would be hard, given where we are.

The second biggest is pensions, which you have covered. The third biggest is working-age welfare or increasing benefits less quickly than inflation. That is a decision to hit people on very low incomes. The next biggest is education, which is a Government focus.

Chair: Servicing Government debt is a big slab.

Paul Johnson: Yes, they do not have much control over that. Defence is something the Prime Minister is determined to increase.

Q10 **Chair:** That leaves capital expenditure. That is a slice that has historically tended to get squeezed. Is that £100 billion a year?

Paul Johnson: Again, that is difficult to do if you are a Government that says it is focused on growth. If you look back at the 1990s and the financial crisis, that is where a lot of the cuts came.

Q11 **Chair:** Does anybody else want to come in on the specific measures that I have suggested? There are four of them there. Are there any others?

Professor Chadha: The discussion we are having illustrates one of the problems in the way we set fiscal policy. We are looking at a potpourri of ideas and throwing them at the Treasury, and we will see what comes out on 31 October. There is no obvious way by which we can make a formal assessment of these different alternatives. The OBR will, behind closed doors, have a look at some of them, and what will emerge is what it intends to happen rather than necessarily looking at all these things in the round in a sensible way that would allow us to examine the alternatives.

That is a really important lesson to have learned from the last couple of weeks. Moving ahead without proper scrutiny, whether it is by the OBR or experts such as are on this panel, is an incredibly dangerous thing to do, particularly with the financial markets so keenly watching what we are doing.



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Yes, let us have this discussion, but let us go beyond that and think very carefully about these alternatives. At the institute, we have looked at different ways of having a fiscal consolidation, which is planning for debt to be falling over a five-year horizon. That is broadly sensible. Business cycles, in the sense of expansions and contractions, tend to have about a five-year duration. Planning over that length of horizon, which is outside a parliamentary term, makes reasonable sense.

I will come to the deficit point in a minute, but let me answer your specific questions about the taxes that we might have. That is the least disruptive way of raising more revenue and achieving fiscal consolidation. The important thing is that it would also match the preferences of the population, the way we understand them. One thing that has emerged in the last couple of years is a preference for more health expenditure, more expenditure on education and dealing with the capital shortfalls we have been talking about in the last few minutes.

That tends to imply, when we look at the outcomes of different types of taxes, that the most efficient way of doing it is by reassessing income tax at different levels. That would be a way of raising the money we might need. Of course, on 23 September we had a movement away from that. They have already said that is unlikely to be reversed. If we could get to a world in which that could be reconsidered, as well as other levels of income tax across the threshold, that does seem to us like the most efficient way of achieving fiscal consolidation.

On the question of the support for energy, we have already proposed, rather than a fixed average price per unit, escalating energy price caps. We know that households that use more energy tend to be better-off households. If you had a price cap that was not just fixed on the average but increased with usage, that would in effect work as a progressive taxation, encourage greener usage of energy and provide an incentive to households that are using too much energy to reduce their energy usage.

Some of that would have to be accompanied by an increase in universal credit or energy transfer payments for the poorest households, which may have larger families and live in housing stock that is not as well insulated. We have calculations to say that need not have any cost to the Exchequer at all, if the escalating price cap were designed appropriately. We would be happy to submit that analysis to this Committee later.

Chair: I would be very interested in receiving that.

Professor Chadha: Finally, on the reserves tiering question, as you know, this is something I have worked on. If we move away from interest paid on the quantum of reserves, that is directly affecting the Bank of England's operating procedures. We have to think very carefully, in conjunction with the Bank of England, as to how those operating procedures would have to be altered, if that is what we want to do.



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The first thing that may occur is that the banks say, "We have to hold a certain amount of liquidity." Reserves are the most liquid form of asset they could hold, but the next one along is T-bills. If they decided instead to hold or buy T-bills rather than holding reserves, that would push up interest rates in the next step of the money markets. In effect, that would be changing monetary conditions. Therefore, to move to that as a form of fiscal consolidation is not the way that we ought to be thinking about it.

First and foremost, it is necessary to think about the form of monetary operating procedures that we have and to ensure they are done in such a way to get us back to price stability as quickly as possible, subject to economic volatility. Deciding to change the operating procedures without thinking that through very carefully will maybe lead us to dangers in the money markets, of which we have become very aware in the last couple of weeks. I would urge great caution in any of that. We would need to think that through extremely carefully.

Chair: Thank you very much, Jagjit. I am going to move on, but, to all of you, if you have any observations on the reserve tiering aspect of this that you would like to share with the Committee over the next day or two, those would be gratefully received. Jagjit, a note on your energy escalator idea would be really helpful.

Paul Johnson: I should just say at this point that, on Friday, we will be publishing something by Paul Tucker on exactly this, which goes through this in a great deal of detail.

Chair: Thank you. That is very helpful.

Q12 **Dame Angela Eagle:** It is a good job that people on this Committee are trying to solve the problems that have emerged since the Chancellor's mini-Budget, which seems to be more than they are doing at the moment. I just make that observation; I do not expect anyone to comment on it.

Rees-Mogg, in a round of interviews on the TV this morning, denied that the problems in the markets were caused by the mini-Budget, if we want to call it that, or the fiscal event, whatever it was. He basically said it was caused by differentials between the pound and the dollar and what is going on in America, rather than the fiscal announcements that were made here. Is he right?

Torsten Bell: I did not have the pleasure of seeing the Business Secretary this morning. I do not want to comment on exactly what he said, but, in terms of what we should focus on, we should listen more to the Bank of England's chief economist, who said to you very clearly that there was a clear UK component to what was happening.

Q13 **Dame Angela Eagle:** That is Jon Cunliffe in his letter with the very helpful graphs.



Torsten Bell: I meant Huw Pill, the chief economist, but the deputy governor also spelled it out very clearly in his letter to the Chair. Nobody who is spending their time looking at the UK gilt markets—unfortunately, that is too many people right now—thinks there is only an international and global element to what is going on.

There are some really basic things. UK gilts had a lower yield than US treasuries until the recent past, and now they have a higher yield. There are lots of things. The spread versus German bunds is up significantly. Look at the change over the last year, particularly since September, in the yields on UK Government debt. It is very clear there is a UK-specific element to what is going on. That is what the Bank of England is telling you. I would focus on what they are saying.

Q14 **Dame Angela Eagle:** Does everyone agree that there are UK-specific elements to what is going on in the international markets as a result of the mini-Budget, fiscal event or whatever we are meant to call it? Everybody is nodding.

Sanjay Raja: I have not had the pleasure of seeing or hearing the Business Secretary's comments, but there are two components to this that need to be understood. There is absolutely a UK component here—one cannot disentangle that—but there is also global component that should be seen in the grand scheme of things. When we look at markets and investor reaction, we are seeing two pieces of a puzzle that is putting itself together.

From a global perspective, we see market sentiment stretched and stressed. There is increased volatility. There are a couple of reasons for that. One is the global geopolitical tensions. In large part, what we are seeing is Russia's invasion of Ukraine. That has created a lot of volatility in the energy market specifically, as we know. There are other markets that have been affected as well, particularly the food market. That has increased risk aversion in the market; it has increased volatility in the market as well.

The second thing we cannot avoid talking about is high inflation. Central banks across the world, particularly in developed markets, are now fighting extraordinary inflation. What we are seeing now is an extraordinary synchronised global tightening cycle, which is creating a lot more uncertainty and volatility. Yes, there is absolutely a global component that cannot be abstracted from what we are seeing.

That has resulted, as Torsten mentioned, in yields going up everywhere, but, in the main, there is also an idiosyncratic and UK-specific component. That has to do with what the Governor of the Bank of England has been talking about for months and quarters. That is really coming down to the terms of trade shock that the UK uniquely faces. If you look at the trade balance in the UK, we are seeing some of the worst—



Q15 Dame Angela Eagle: By that, do you mean the problems with Brexit, not being able to get things over the border, the Northern Ireland protocol and those kinds of things?

Sanjay Raja: It is inclusive of all of that. If you look at where the trade balance is, it is at a historic deficit. We have not seen this kind of trade deficit since 1955, since national account records began. You then throw on to that the current external financing needs, which are extraordinary.

At the time of the Chancellor's mini-Budget, going into 23 September, the ONS was talking about an 8.3% current account deficit. That is an extraordinary current account deficit. If you look across developed markets and emerging market economies, the narrow basic balance the UK has is extraordinary. It is one of the worst among developed and emerging market economies.

The external financing needs of the UK are certainly a big function of what we are seeing. When you throw on the 23 September event and you have a side-lined fiscal watchdog, a lack of a medium-term fiscal plan and one of the largest unfunded tax cuts or packages of measures that we have seen since the early 1970s, it is the straw that broke the camel's back, if you will. Not only have the UK's external financing needs increased significantly because of a lot of the fiscal measures that we have seen, but there has been a lot more pressure from markets.

Given the global factors and the idiosyncratic local factors we are looking at, we are seeing increased market uncertainty, increased market volatility and increased market illiquidity. The reason why that is important is that small moves, small surprises that we see in the market, tend to have bigger impacts.

To put this in the context of what we saw on Friday 23 September, the small surprises that we had, the small moves, may not have been much in the grand scheme of things—lots of the tax cuts the Chancellor was planning were leaked by the Government almost a month ago—but when we saw the big increase in issuance projections from the DMO, the £60 billion uprate, the markets reacted. We saw a textbook response where investors were saying, "Yes, we need a cheaper currency to fund the current account deficit, and we need higher real yields and higher interest rates."

I completely agree that there is a UK-specific component, but we should not abstract away from the fact that there is also a global component.

Q16 Dame Angela Eagle: Perhaps what you are explaining is that, in those febrile and uncertain conditions, launching a sudden lurch of an experiment and trashing the local structures around which the Bank of England and the OBR have traditionally worked might not have been the cleverest thing to do.

Sanjay Raja: Markets are very sensitive to what is happening at the moment. What we are seeing now from the Government is that fiscal



policy and monetary policy are moving in opposite directions. What the markets do not like, especially in this period of heightened uncertainty, heightened volatility and very little liquidity in both the currency market and the rates market, is that inconsistency. They are worried by that. That is what we have seen in the reaction.

- Q17 **Dame Angela Eagle:** The OBR has been side-lined; Tom Scholar was sacked. There were noises during the Conservative leadership election that threatened the Bank of England's independence and mandate. Has that also spooked the markets? Following the fiscal event, the Chancellor went on the Sunday news programmes and hinted there would be more tax cuts.

Torsten Bell: We discussed this in the session the day before the mini-Budget, as we are now calling it. It is wrong to think about it as having an international component and a UK-specific component. You should not be doing the UK-specific component exactly because of the wider environment, which is exactly what we discussed the day before the statement.

Exactly what we discussed is what has transpired, except it is worse in terms of both the risk that was taken and the outcomes that have followed. Nobody should be surprised by what happened. We were in this exact room discussing exactly what was going to happen.

- Q18 **Dame Angela Eagle:** You said that this kind of policy is not a joke.

Torsten Bell: It is not a game.

Dame Angela Eagle: You were quite angry. You would have been even angrier if you had realised what was going to be announced, I suspect.

Torsten Bell: Yes, absolutely. Firing Treasury civil servants is not a good idea; that has not helped. Side-lining your fiscal watchdog has not helped. The big picture is that they spent a summer telling people they were intending to abandon fiscal orthodoxy, and then they announced a package that dumped fiscal orthodoxy and said on the Sunday they were going to keep doing it. None of this should be a surprise to any of us. This is where you end up, and this is what happens if you are not paying attention.

Maybe you could have got away with that in more benign times. It would not have been a good idea in any time, but you definitely should not be doing it in the current climate, when we are moving to a higher rates regime across advanced economies. That brings with it a whole world of problems that we are going to be wrestling with.

The Chancellor and the Business Secretary are right, by the way, to say that everyone is going to struggle with that to some degree. That is going to be hard for public finances. Debt costs around the world will rise. It is going to be hard for macroeconomic policymakers in general. You are going to get this tension between fiscal and monetary policy as part of



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that mix. You are also going to have big asset price changes in the mix. This was always going to be hard, but it is exactly because it was always going to be hard that you do not do this.

Q19 Dame Angela Eagle: We now have a situation where last night the Governor of the Bank of England made it very clear that the market operations they launched in the aftermath of the mini-Budget would last until the 14th. He then said, "That is it. Get it sorted by then" to all the pension funds. This morning we are hearing whispers that that is not actually it. Do you have any comments on what on earth is going on there and what effect that is likely to have in the markets?

Professor Chadha: I would love Gemma to come in in a minute on the politics of what is going on, but perhaps I will just briefly come in on this point.

Clearly, the fire sale in the conventional gilt market after the mini-Budget was a great concern. The Bank of England did the right thing at that time to step in as market maker of last resort. There has been a lot of misguided comment describing this as QE. It was not QE. It was a temporary purchase of bonds, as this Committee knows. It is worth just saying that in public again. Even last night I was trying to explain this to someone on some media programme, who did not understand it.

These interventions will be drained and will not add permanently to the money stock in any way whatsoever. They are entirely the right thing to do when gilts had to be sold in order to meet collateral margin calls that were going on in the pensions market.

Q20 Dame Angela Eagle: If that had not have happened, what would have happened is a doom loop in the gilt markets where things would have been sold off for even less of their real value.

Professor Chadha: Exactly, yes, in both the nominal and the index-linked market. We had a move in the index-linked market on Monday that doubled real interest rates as priced in that market from 60 basis points to about 120 basis points. There has not been a movement of that magnitude for over 30 years. These are enormous changes. As you suggest, they are driven by a shortage of liquidity in that market.

The Bank of England extended these purchases, which are due to end this Friday, to include for the first time the index-linked bond market. As you rightly said, the doubling of interest rates in both the index-linked bond market and the conventional bond market was a great concern. You then have prices that are suggesting market dysfunction and ultimately a threat to financial stability. Intervening in the market was the right thing to do.

The question then was about what happens next. There was a concern earlier this week that we were coming to a cliff edge on Friday, when the interventions would not continue. The Bank of England earlier this week adopted a repo facility. People who need cash urgently now know they



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can sell their assets to their banks, and their banks can borrow as much money as they require from the Bank of England in order to keep the liquidity going in that market.

That new facility will extend until 11 November. It is going to extend beyond our planned fiscal statement on 31 October and beyond the next MPC decision of 3 November. The hope is that that will allow the market to work its way through and allow liquidity to get back to the levels it has to, in order to allow that market to function. As for whether that will be enough, we will have to wait and see. Right now it does seem a sensible course.

If I could just make one point—both Torsten and Sanjay have summarised this very well—the real danger that we saw on 23 September was on the back of what can only be described as guerrilla tactics against our independent economic institutions over the summer: the Treasury, the Bank of England and the OBR. Therefore, it was not only the intervention on that date—

Dame Angela Eagle: Let us be clear: guerrilla tactics by the Government.

Professor Chadha: I will leave you to finish that statement, but there is a sense in which that undermined the co-operative arrangement we have had between the monetary and financial institutions, which, theoretically and in practice, has led to lower interest rates and lower deficits than would otherwise have been the case.

If you move away from that, you are going to have a succession of higher interest rates and higher deficits than you would have otherwise had. It is precisely that projection the markets were taking in the aftermath of the mini-Budget on 23 September: if the Government continued on this path, there would be higher deficits than otherwise and higher interest rates, not only as a result of the mini-Budget but as a result of successive statements into the future.

It is therefore very important that there is a commitment now from the Government that any fiscal event that requires a tax change will always be accompanied by an OBR forecast. There is not a world in which that should not happen anymore, with appropriate signalling of policy alternatives as well. That is something we must think about as a result of what has happened.

It matters because lots of people have come to me concerned about where their mortgages will go and whether they can pay their bills. That is almost directly as a result of the mishandling of this mini-Budget in the last two weeks. It is not the way policy should be run, it seems to me.

Q21 **Dame Angela Eagle:** Dr Tetlow, you wanted to say something briefly. Would you also think about how this terrible mess could be sensibly unwound? My view is that we should probably abandon the tax cuts, but



you might want to make an observation.

Dr Tetlow: I will follow up on Jagjit's points about the extent to which the reaction and the problems have come not just from the specific announcements that were made but by undermining and questioning the institutions that normally surround our fiscal and monetary policymaking. I would agree that part of the problem seems to have stemmed from questioning their credibility and not asking for a forecast from the OBR.

I would agree with Jagjit that we ought to get forecasts alongside major tax changes. The only nuance I would add is that that is less necessary if you are doing temporary emergency interventions. There may have been a case—I think there was a case—this time for perhaps having announced an emergency energy support package, time-limited, that might not affect the longer-term fiscal sustainability of the UK public finances. You could have done that without a full OBR forecast.

The problem this time was in announcing permanent changes to the tax system, which did not need to be announced so quickly. Most of them are not coming in until April, so there was time to get the full OBR forecast before announcing those policies. Because they were rushed through so quickly, it is unlikely that that provided time for the new Chancellor to get a full briefing from Treasury officials on the potential impact of those changes, to think about them and to interact with the OBR about their longer-term impacts.

It was those factors that, together, contributed to the concern there was about this Government's approach to public finances.

Dame Angela Eagle: What a mess.

Q22 **Kevin Hollinrake:** Paul, the IFS kindly provided a financial forecast, which would normally come from others, around the mini-Budget. Looking at your numbers, collectively over the next five years, the measures announced and the way things are generally would increase public sector net borrowing by about £632 billion. Would that be a fair assessment of what you are predicting?

Paul Johnson: I confess I have not added up the numbers year by year. We tend to look at them on an annual basis. Certainly, there will be a very big increase in borrowing over the next few years as a result of a combination of what the Government have announced and the economy having slowed since March.

We had this nonsense over the summer about there being £30 billion of headroom, when clearly there was not at that moment because of the changes to the economy. We had £40 billion-odd of tax cuts, which is a big increase in borrowing over the period. Of course, we also have much higher interest payments because of higher debt.

Our view of the amounts of interest payments next year went up by £10 billion overnight because of the impact of the changes in the mini-



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Budget, and of course inflation drives up spending on pensions, welfare and so on as well.

Q23 **Kevin Hollinrake:** In year five, there is still a deficit of about £100 billion. Is that roughly the right figure?

Paul Johnson: That is the central forecast. It is worth saying that all of these numbers are extraordinary uncertain, particularly when you are looking five years out.

Kevin Hollinrake: Yes, but at least we have some figures.

Paul Johnson: It is a reasonable central forecast. It could be much higher; it could be lower.

Q24 **Kevin Hollinrake:** That will take our total debt to about £3 trillion by your estimates.

Paul Johnson: The debt is clearly on an upward trajectory. The worrying thing, in a sense, is that it is continuing on an upward trajectory at that point.

Q25 **Kevin Hollinrake:** Does anybody else's forecast differ markedly from that?

Torsten Bell: Ours broadly matches that. We have around £100 billion borrowing by the back end of the forecast period. It hopefully should not be quite at £3 trillion, but, yes, debt will be in the ballpark of £3 trillion in that period. It is a markedly higher level of debt and borrowing by that point than we were anticipating back in March.

Paul Johnson: The fiscal target the Chancellor seems to have set himself, to have debt falling in that fifth year, is desperately sensitive to the assumptions. That is another reason why that is not a good fiscal target by itself. Small changes in what is happening to inflation in those last two years can tip that quite a lot. Agreeing again with what Torsten said earlier, I am sure you need a second leg to your fiscal structures.

Dr Tetlow: I totally agree with what has been said about how a debt rule on its own is not sufficient. The other slightly perverse thing in the maths of this is that it is easier to get debt falling if you start at a higher level of debt. That is another reason why it is not particularly good as the sole constraint on public finance management.

Q26 **Kevin Hollinrake:** Taking into account the Government's target to get growth to 2.5% rather than the trend of 2%, what does he have to do and what gap does he have to fill in terms of potential spending cuts? What figure would that be?

Torsten Bell: You mean if he achieved 2.5%?

Kevin Hollinrake: Yes, if he achieved 2.5%, to get debt falling as a percentage of GDP.



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Torsten Bell: If you stick to what we are saying is not a great fiscal rule on its own, that is something in the order of somewhere between £45 billion and £60 billion, but, as I say, that is very sensitive to what you think is happening to both real GDP and to nominal levels of inflation.

Kevin Hollinrake: That is still taking into account growth.

Torsten Bell: No, I will come on to that. The OBR, in a letter to Rachel Reeves, the shadow Chancellor, set out some rough ready reckoners of the effect of growth rates on the tax receipts at that kind of margin, which is quite significant. If you have 1% extra over five years, you have £47 billion, so you have covered most of that with higher tax receipts.

What is the history of the OBR's forecasting on growth over the last 12 years? We have been overoptimistic on every occasion. Even if that had not been the case, there have been periods when Chancellors of other parties, including in the 2000s, wanted to say the UK's trend growth rate was higher and that made fiscal arithmetic easier, which is why George Osborne introduced the OBR in the first place.

In general, you should wait to see your higher trend growth turn up and then spend the money. There is no plausible route by which these tax cuts lead to that, definitely not to that scale of increase in your trend growth rate. It is a bit dangerous for all of us to spend our time discussing what it would be if we were to get the 2.5%. If we get the 2.5%, let us have a great discussion about how we can spend £50 billion better. That is what adult policymaking looks like.

Q27 **Kevin Hollinrake:** Sanjay, can I get your view? You are heavily involved in the markets yourself. What does the Chancellor need to do on 31 October in terms of looking at debt and borrowing to give the market confidence? If he is right and it is 2.5%, it does not sound like we need to make any cuts. Is that going to satisfy the market?

Sanjay Raja: No is the simple answer to that. If I may add to Torsten and Gemma's points, it is all well and good to have these illustrative tables of what trend growth could look like and talk about what that could deliver in terms of revenues, but getting there is the bigger challenge.

For example, we see trend growth, structural growth in the UK, as somewhere between 1% and 1.5%. We think that is sensible, looking at the evolution of where capital has gone, the lack of investment, the productivity puzzle we have had in the UK and where labour is tracking and projected to travel.

Q28 **Kevin Hollinrake:** That is without increasing the labour force, presumably—that core economy.

Sanjay Raja: That is right. To get to 2.5% growth is not only a huge undertaking—it requires substantial amounts of supply side reform—but to get there within five years is almost impossible. It will take time.



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To answer your second question about what the markets are looking for, if we see the Chancellor on 31 October, on Halloween, presenting his medium-term fiscal strategy that has debt-to-GDP rising next year, the year after and the year after, and then in year five dropping by a 10th or two-10ths of GDP, the market will just not see that as credible.

Q29 Kevin Hollinrake: There would be more volatility, if that was the announcement.

Sanjay Raja: Absolutely, there will need to be a down payment, effectively.

Kevin Hollinrake: That will be spending cuts.

Sanjay Raja: Yes, or tax rises—some kind of fiscal consolidation.

Kevin Hollinrake: That is not likely. What order of spending cuts need to be announced on the 31st to give the market confidence?

Sanjay Raja: Talking to investors and looking at market sentiment, I would say roughly 1% of GDP.

Q30 Kevin Hollinrake: That is about £20 billion or something like that.

Sanjay Raja: Yes, £20 billion to £30 billion, roughly.

Q31 Kevin Hollinrake: Jagjit, in some of your forecasts you show that debt-to-GDP falls from 2025-26 based on current projections. What is the problem?

Professor Chadha: The problem is the 2.5% growth target.

Q32 Kevin Hollinrake: Does that include the 2.5% growth target?

Professor Chadha: We are not going to hit medium-term growth of 2.5% in this economy at the moment. As I have said to this Committee a number of times, this has to be nurtured over decades. It is not something we should be aiming for quickly. We can get to 2% growth in the next couple of years, but that is through a pre-election boost to demand. A business cycle boom and bust, if you will, is potentially what we are seeing at the moment.

We would be much better off dropping this 2.5% growth target, thinking carefully about what that means over the medium term and asking ourselves what policies we need to deliver that. It turns out that we have had 2.5% growth over the last 10 or 12 years in productivity, in GVA, in London and the south-east, but it has only been 1% or less in the rest of the country.

The question really is how we increase it in the rest of the country. That is part of the productivity puzzle that Sanjay mentioned. What role is there for Government involvement in that? We have talked a little bit about spending cuts this morning, but, when we start to think about how



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we get regional growth up, a lot of that is going to be conditioned on public investment that has undershot—

Kevin Hollinrake: Yes. That is a question I have asked lots of times on the Floor of the House.

Professor Chadha: There needs to be a move away from the sudden adoption of a 2.5% growth target to a better and refined definition of what that means for the economy so it does not conflict with the actual capacity of the economy to supply goods and services, which is about 1% to 1.5%.

Kevin Hollinrake: That would be a more strategic view of how we do this.

Professor Chadha: That is absolutely right.

Q33 **Kevin Hollinrake:** I am trying to get to this point. If we asked a question of the Chancellor on the Floor of the House about debt and everything, he would say, "Don't worry." Your organisation says that debt-to-GDP will be falling by 2025-26, anyway, so what is the problem with that?

Professor Chadha: It is a good question. It really depends on where we think debt-to-GDP should be as an economy. In peacetime it should be considerably lower than that primarily to give future generations the chance to deal with the problems that they may have to face.

We are not entirely sure where our debt threshold is or what fiscal space we have available to us. What concerns me when I look at the last 12 years—much of this has been driven by our low levels of growth—is that debt-to-GDP has risen and ratcheted up through three separate events.

Kevin Hollinrake: Yes, the pace has increased.

Professor Chadha: If you do not bring it down, further shocks come along to ratchet it back up again. The appropriate management of debt must be about bringing it down when you can. That is very difficult in extraordinary times.

One of the underlying problems we have in the economy is that we tend to rein in on expenditure in exactly those areas—public investment I am going to mention again, to the point of boredom—that are likely to promote growth in the economy.

Q34 **Kevin Hollinrake:** Can I just come back to one other point? This is for anybody on the panel, really. It is not just about public-sector debt; we also have a very high level of private sector in the UK. Is that a problem? We have the second lowest debt-to-GDP in the G7. What is the problem? Is private sector debt a problem—corporate and household debt?

Torsten Bell: The overall level has not gone up drastically. In the very short term, you should be worried about some very specific forms of debt



that basically collapse into energy bill arrears, which tends to be particularly difficult. If you look at wellbeing surveys, this is the kind of debt that is particularly worrying for households. If you look at the effects of it on your long-term credit rating and, for example, being put on a prepayment meter, it is really quite significant. In the very short term, I would focus on that because we are going to see very significant rises in energy bill debts over this winter.

The broader picture is of rising interest rates pushing up the cost of all borrowing for households. That will take some time to feed through. We are publishing a paper on Saturday this week setting out in quite a lot of detail what that does to mortgages across different parts of the country and different bits of the income distribution, but it is very, very large.

It is focused on different kinds of groups and people. You see it more in the south-east of England, although not London, where it will have a particularly large effect. The middle-aged, I am afraid, are about to see particularly large hits because they do not tend to own their houses outright and they tend to use more personal debt in general.

It is not about big increases in the level of personal debt that are going on; it is about the interest rate rises and how that feeds through.

Q35 Chair: Can I just pick up on one point that we all focused on, which is how realistic it is to get up to trend growth of 2.5%? Incidentally, the suggested impacts of additional growth are contained in the plan for growth. There is a table in there.

Torsten Bell: They are taken from a letter to Rachel Reeves, which the Treasury was very upset about at the time it was sent. It is being used for a very different purpose now.

Q36 Chair: That being the case, if you are going to improve the productivity and output of 30 million people in the workforce, that is a long-term play. If the question was, "How could you very quickly generate some growth?" you might look at planning reform as one area, which would be politically very difficult. The other one would be immigration. By my back of an envelope calculation, if you have about 30,000 additional people coming into the workforce who are reasonably well skilled and you apply about the average tax rate of 40% to that group and then say, "What does that do to output?", I think it broadly raises it by about 0.1%. I suppose if you were looking for a 1% gap between your 1.5% and the 2.5%, you could crudely say, "If 300,000 additional highly productive individuals come into the country, that might do it rather more quickly than investing in skills and infrastructure and all those kinds of things."

Politically, it might be very difficult to deliver. Indeed, there has been some discussion within Cabinet, pulling in both directions it seems to me. If that was what was brought forward and it was deemed to be politically deliverable, would that be something that would convince the markets that that kind of level of trend growth could be achieved?



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Sanjay Raja: Yes, absolutely, if the Government can come up with a more credible immigration plan to help boost productivity, GDP, through high-skilled migration, to help high-skilled businesses. That is probably one of the key supply side reforms that we can make as an economy to boost structural growth.

I think Jagjit made the key point of distinguishing between demand, with cyclical growth, and structural growth. We can certainly get to 2% potentially if we just pour a lot of money into the economy, but to have structural growth increased we need to see a more generous immigration regime that boosts the labour supply, and not just the labour supply, because that has knock-on impacts on productivity and perhaps capital investment. There is a wide literature around this. It will have knock-on impacts above and beyond the 0.1% that you put forward for a 30,000 increase in migration. Politically, of course, there are challenges to that.

Torsten Bell: We need to be a bit careful, because your maths and this general discussion is illustrating one of the dangers of talking about GDP. What we care about for living standards is obviously GDP per capita. That is what matters. Just growing the population does not make us all individually richer. Yes, at the margins, if we bring in people who are above average productivity, which we usually look at in skills terms, you can have effects over very long periods on the stock. If we are aiming to raise GDP per capita, which is ultimately about productivity—yes, it is about labour force participation, but really it is about productivity—the role of migration is slightly overstated.

Chair: In the context of the fiscal black hole—

Torsten Bell: You should be careful. Both sides of the migration row, those who say, “Increasing migration causes all the problems” and those who say, “Increasing it solves all the problems,” are not representing the literature as it stands. On the public finances, it is quite nuanced. Yes, if you are very targeted about the kind of migrants that are coming in, you might be able to have a big effect.

Let us be really clear: the Government have put in place quite a liberal migration regime. Whether further liberalisation of that is politically credible is for you guys to judge, but there is quite a liberal regime in the UK. In terms of people coming, the wider stability of the UK is as important as that liberal regime. I do not believe a further liberalisation being announced between now and the end of October would make any difference to how the markets responded to that package, because they are not going to believe that a very significant liberalisation is going to be delivered exactly as stated. As I say, in the end, the evidence does not show that it has a huge effect on the public finances or on GDP per capita growth rates.

Chair: There is a slight divergence in view there, but that is interesting.



Professor Chadha: Torsten is right. If you increase the inputs by the numbers coming in, that does not necessarily increase productivity. If you can attract the right people, they may increase productivity over time. It will not be a very quick increase in productivity.

Q37 **Chair:** Yes, but they are contributors in their own right. That is the point.

Professor Chadha: Again, it is the medium term. It is not an immediate return. The other point is that, if possible, you want to distribute them in the parts of the country that have low levels of productivity, rather than adding to congestion in parts of the country that are already growing very rapidly. It has to be another element of direction to where they settle. That stops sounding too liberal to me, but that might be something to think about as part of the strategy.

Sanjay Raja: May I make a quick rebuttal to Torsten and Jagjit's point? It is absolutely right and that is the big caveat: it has to be targeted for the first part. Jagjit brings out a very important point. It depends also where people and migrants settle. If it is all focused on London, the south-east and the big conurbations, the impact is slightly muted and dampened. There is a location policy that matters here, as well as the quality of migrants that you attract and have in the system.

To Jagjit's final point, this is not a short-term fix. This is a longer-term, medium-term growth plan, rather than something that we can do very quickly to boost trend growth.

Q38 **Alison Thewliss:** While we have been sitting, the financial policy summary has been issued by the Bank of England. One of the things within this mentions the contradictory position. It says, "The energy price guarantee is likely to reduce the near-term peak in CPI inflation and, together with other Government measures, support demand. On the other hand, rapid increases in financing costs for mortgages and other borrowing will increasingly stretch UK household and business finances in coming months". They note that this is bouncing the ball on to the Monetary Policy Committee for its deliberations at the start of November. Given all that has happened and the maxi-Budget that sits between then and 3 November, I wanted to ask the panel about your anticipation of what the MPC will do and what impact that might have.

Dr Tetlow: We had a bit of this discussion the last time we were all, or mostly all, together here. As has already been said, in a sense we have monetary policy and fiscal policy pulling in opposite directions. The monetary policy is trying to dampen down economic activity to get inflation under control and we are seeing interest rate rises, while fiscal policy is putting stimulus into the economy, both through the tax cuts and through the energy price issues.

Essentially, because the economy is running at capacity and the Bank of England overall is trying to bring inflation back under control, fiscal policy is not really able to boost activity overall. What it can do is affect who is



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feeling the pain of the slowdown that we are experiencing. The aggregate stimulus from fiscal policy is likely to be offset by the Bank of England raising interest rates more quickly. To your basic question, it seems very likely that the Bank of England will respond to greater fiscal looseness with higher interest rates than it otherwise would have done.

It means that the distributional impact of that pain is therefore different. As you were alluding to in your question, interest rate rises affect some types of people, particularly those who have large debts and mortgages that are coming up for renewal, while the fiscal package is helping a different group of people. It is helping through energy costs that households face and some of the tax cuts that are coming in.

Torsten Bell: I agree with everything that Gemma just said. In terms of the Bank of England, markets are saying 90% chance of a 0.75% rise. If we did not have that, we would have a significant problem, probably, at this stage. I think they will be considering that or a 1% rise.

There is something of a tension here between Angela's question earlier about the Governor yesterday saying that it is all done in three days and then some briefing that is in the papers this morning. At one level, people are interpreting that as the Bank of England U-turning over the course of the night. I do not think that is quite right. It is not that they have corrected what the Governor said last night. It is just that there is the reality, which is that we have a Bank of England that obviously has a financial stability mandate and has a monetary policy mandate, and it has been put in basically an impossible situation.

It is not credible that it would not step in in the face of very severe market dysfunction after Friday, but because, as Jagjit was saying, it is using an instrument that looks a lot like monetary policy, i.e. it is the same instrument, just being used for a different purpose and hopefully on a temporary basis, it is very worried about the fiscal dominance question that that is raising. That is why the Governor was probably firmer than maybe markets were expecting last night.

Two things are true: he would really like pension funds to have sorted themselves out by Friday and it is not credible that, if we had very severe market dysfunction, the Bank would not step back in, in future. That is a really awful world to be in. You do not want to put your economic institutions in a situation where they are wrestling with those irreconcilable differences.

There will be some read-across to pure monetary policy, because, in the end, if the Bank feels like it is not able to deliver the messaging it would like on fiscal dominance through its financial stability interventions, i.e. it is forced into the market again next week—let us hope it is not, for all our sakes, but if it is—the chances of a 1% interest rate rise are materially higher. In the end, in the big picture, we are asking where macro policy is settling after this big explosion.



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That is the big question and they are, rightly, trying to say, "We are going to do our job. Sterling does not need to be falling. Monetary policy will do its job of squeezing this all out." Markets are, rightly, challenging that and saying, "Hold on; are you actually really going to do that in the test, either because you are worried that you are conflicted by your financial stability objectives, or because of the usual political economy constraints that everyone has spent the last 100 years wrestling with?" That is what we should be worried about.

That is going back to what I was saying earlier. This movement to a new macroeconomic environment of higher rates was always going to be really difficult and it was always going to involve some of these kinds of tensions. Some of this tension between financial stability and monetary policy, which, in most countries, are housed within the same institutions, was always going to be there, but we have just made ourselves the poster child for those difficulties. We are now the test case for whether we can make it as difficult as possible to travel that transition to a higher interest rate world. That is why this has proved so dangerous.

Some of the blame that the Governor is getting is missing the point. There is an impossible situation. Yes, maybe tactically the comms could have been better, but, if you want something to blame the Bank of England for, or the regulators more generally, it should be the fact that we did not solve some of the non-bank regulatory questions that we knew were out there. To be fair, lots of us did not spend time talking about this, but we have known for a while we had a big problem with highly leveraged bits of the non-bank sector that would be exposed to big asset price changes. We did not put in place solutions to that. Some people would have liked liquidity regimes for non-banks, or we could have regulated some of this out of the system, but that is what you should blame regulators for—the failure over 10 years. What is going on today is because we put them in an impossible situation.

Q39 Alison Thewliss: Professor Chadha, you have argued in the past that the UK should have a looser fiscal policy and a tighter monetary policy to enable more public investment and higher interest rates. This is not quite the scenario that you were hoping for at the time.

Professor Chadha: No, we were not hoping for the shock therapy or disruption that we have seen in the markets. As I said earlier, we have gone from a set of co-operative institutions, potentially, after 23 September, to what looked like something that is non-co-operative. In that world, the markets are going to be testing the resolve of the central bank and testing the resolve of the Government to run the deficits that they want to have in their mind. That is not what we were thinking about when we asked for looser policy and tighter monetary policy.

It is right, as Torsten and others have said, that interest rates have to normalise. The negative real interest rates that we had for a decade or more were problematic. Ultimately, they damage productivity as well, because it does not encourage the recycling of capital to the most



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productive ideas. It tends to leave capital in the hands of firms that are not necessarily innovating in the way that we would want. That is one of the things we have seen in the economy in the last few years.

In all of that, we want an orderly transition to higher interest rates, and one would not describe the last two weeks as orderly in any way whatsoever. That feeds back into the decision of the Bank of England. It started its tightening cycle earlier than others and there is a danger it might have to move more quickly than it would otherwise have wanted, as a result of both market turmoil and the fiscal policy choices that have been made. I think they would have wanted to have moved gradually.

As we mentioned a few minutes ago, we are a country that has a high level of public debt and a high level of private debt. We are not entirely sure how the market, households and individuals will respond as interest rates start to rise. Therefore, the Bank would have wanted to move gradually, in steps, to raise interest rates to something of the order of 3% to 4%. The market expectations recently rose to as high as 6%. The concern is that, because of the tension or lack of co-ordination between monetary and fiscal policy, the Bank will have to raise interest rates higher than it would otherwise have to, in order to establish its credibility.

That, ultimately, would be an unnecessary pain for this economy and for households, which are already suffering from large increases in energy prices and food bills. That would therefore mean a further fiscal intervention of the type we do not want. This whole process is driving us to an unstable position, and that is the thing that worries us most. If we could get a grip again on fiscal policy and then allow the Bank to move in the way that it would want to, we would ultimately be in a better position. The markets would not be pricing 6% for the Bank rate in the next year or two.

Q40 Alison Thewliss: A bigger question, I suppose, is how you step back out of that continual ratcheting against one another.

Professor Chadha: We need significantly more clarity on the fiscal policy options in front of us. We do not need announcements that are not accompanied by scrutiny and forecasts. We have talked about this before at this Committee. There is a danger that any fiscal event is prefaced by a number of leaks to try to manage the news media. Rather than manage the news media, I would rather our political masters tried to discuss these things with economists to try to arrive in the right place the first time round, rather than having to change things.

As well as whether taxes and their change, or decisions about their levels, affect activity, volatility, changing of tax regimes, affects activity in a very bad way. We have had national insurance go up. Now it is coming down again. We have had corporation tax going up and going down again. Okay, that might have a long-run benefit on supply, but volatility works against that. If we do not have a stable political regime and a stable monetary fiscal constitution, that will damage the supply



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side much more than a reduction in taxes will help the supply side. We need to get back to that world of agreement and concord across these policy options.

Q41 Alison Thewliss: Monetary policy's impact on the economy has a lag. How long does that last in the economy that we are in just now, and how long before we can see our way out of this?

Sanjay Raja: In terms of our projections, going back to your earlier point, since the mini-Budget that we have had, we have increased our terminal rate projection by about 100 basis points, from 4% to 4.75% or 5%. To Torsten's point as well, markets are pricing in a 50% probability for a 125 basis point hike in November, so substantially more than what I was thinking a few weeks ago. Also, the question is whether the Bank can deliver on that and I am not quite sure that it can.

There is a trade-off here. Either the Bank needs market pricing or deals with a lower currency. That, effectively, is the trade-off that the Bank of England faces. It creates a vicious cycle, because lower currency results in higher import inflation and you create a bit of this back and forth, to-ing and fro-ing, between monetary policy from higher rates and possibly a weaker currency.

Our best guess is that the Bank of England will likely not meet market pricing. We do not think the Bank rate will go to 6%. We think the Bank will want to stop somewhere shy of 5%. That is our best guess estimate at this point. Hopefully, by the time we get to Q1 next year, we will have a very different landscape: much more clarity on the fiscal picture of course, as well as on the energy picture. Geopolitical tensions may have eased a little bit. We are seeing the other side of the peak in inflation. That could give markets a little more confidence to start to pull back on market pricing.

The lag in monetary policy transmission will certainly weigh on growth for 12 to 18 months at the very least. The question that I would have is when we will see a policy reversal. Markets are pricing in a policy reversal around the middle of summertime next year, where we start to see rate cuts. I am not quite sure it will be that quick. Our expectation is early 2024 that we will start to see some of the rate cuts coming through and the Bank taking its foot off the pedal and getting to more normal rates, rather than the 3% to 4% that Jagjit mentioned, rather than the 5% to 6%. There will certainly be a monetary policy drag on growth for some time.

Q42 Rushanara Ali: On that point, Sanjay, could you explain what it would have been on rate cuts if the current turmoil had not arisen? Would it have still been 2024, in terms of bringing it in the other direction?

Sanjay Raja: I think so. We have not changed our view. Even though we have taken up our projected peak in the terminal rate, we have not changed our best guess of where the Bank will start to cut.



The reason for that is very simple. We are of the camp that thinks that inflation will be a little more persistent. There are two parts to this puzzle. There is the peak in inflation, which we think has been brought forward and lowered by the energy price guarantee, which is good. The flipside of that is that we see core inflation being a little more persistent over the next 12 months. There are lots of things that would change our view over the next few months. We have certainly been ping-ponged along with the markets. At this juncture, where we see core inflation, where we see headline inflation—we expect headline inflation next year to be a little over 7%—we think that that would limit what the Bank of England will be willing to do, in terms of unwinding policy tightening, until at least early 2024.

- Q43 Rushanara Ali:** I have questions on spending cuts and the medium-term fiscal plan, but I wanted to pick up on the points that were made earlier. Is the Bank of England sending a message to the Government, vis-à-vis yesterday's intervention, having had to intervene to prevent the mini-Budget's implication being that a trillion dollars could have been erased from UK pension funds, that it is over to the Government now and it cannot fix this through its instruments? Is that, essentially, what the Bank is also signalling, along with a direct message?

Torsten Bell: I would phrase it as them trying to say clearly, "It is our job to intervene to resolve market dysfunction. It is not our job to intervene to reduce risk premia, which you have just put up, basically." Then they are trying to navigate how you implement that in policy terms. There is a tension when it comes to long-term rates right now, for obvious reasons that we have all been discussing. I think that is how they would phrase the difficult path they are trying to tread. That is more or less what the chief economist said to you and what the letter from the deputy governor also set out.

- Q44 Rushanara Ali:** Is everyone agreed on that? Going on to spending cuts, would it be credible for the Chancellor to try to stabilise debt using spending restraints only in order to get debt falling as a share of GDP? I know you have touched on some of this already.

Paul Johnson: When it comes to stabilising debt, he is looking four or five years out. Making promises now about spending cuts in four or five years, after an election, will be worth remarkably little for creating credibility. That is particularly given that we know that, over the next three years, spending will be rising much more slowly than was intended a year ago, and that everyone knows that the pressures on the health service are such that we are going to struggle to keep to current budgets, let alone cut them. We have a Prime Minister who is committed to spending another £30 billion or so on defence, and we have been through a period of very big cuts over the last decade.

Sanjay made the point earlier that, if you just make a series of promises about what might happen in four or five years' time, with some either unspecified or very hard to believe spending cuts—



Rushanara Ali: It is wishful thinking.

Paul Johnson: —and you do not do anything up front, it is not going to be a signal to the markets that this Government are taking this as seriously as the markets want to see.

Torsten Bell: We did not quite answer the Chair's question right at the beginning, so it is worth looking at that. What does a vague way through this look like? It does not look like saying—long distance—"You can have your tax cuts today and I am going to pencil in some pain tomorrow in ways I cannot show you." People will not believe that is credible anyway, because they have lived through the last 12 years and do not think it is as easy to cut public spending on current budgets today as it was in 2010. They would be right. I am totally with Paul.

One of the things we have learned since the Government announced they were going to have a fiscal consolidation plan is that there is not much appetite, even on the Conservative Benches, for significant cuts in benefits via upratings, which is the way you would plausibly make large cuts in benefits in a high-inflation environment. The idea that we are going to make lots of changes to actual entitlements and things during this phase, all of which would require primary legislation, seems like it would be pushing political credibility, given that half the Cabinet have decided to be on the record as saying they do not support them.

You have a problem, which is that, on the spending side, the thing that looks credible, and history tells us is basically credible, is cutting investment spending. That is the thing that is credible, so that will end up taking a large part of the strain and it is higher than it has been in the last 30 years, so that is a very likely target. Then you are just doing the thing that would have the worst outcome for growth. That is the thing that is credible, which is why this is hard.

You can set yourself loose-ish fiscal rules to make this feel like it is vaguely plausible, but then you need to end up U-turning on more of these tax cuts. The thing to think about is not just that it makes the arithmetic add up. It is that it gives you credibility, because you are taking some pain. The markets are being told, "Okay, I have listened. I have learned." That is where you are going to get credibility. Appointing the right Treasury permanent secretary helps. Involving the OBR rather than ignoring it helps, but, given where we are, in a very serious situation, I do not think there is a plausible, credible package that is going to work on the 31st now that does not involve U-turning on more of these. Markets are going to need to see that the Government are saying, "We have changed course."

Q45 **Rushanara Ali:** Talk me through this: is it all of the tax cuts or some?

Torsten Bell: You can probably make these numbers add up. I would have thought that the most likely place where we will see a further U-turn is on the corporation tax position, because it is the easiest to do and



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you all voted on the national insurance rise yesterday, and there is a cross-party consensus on that because of the path dependency of how we have got to where we have got to. You will know more than me what the politics of that is. I would focus on the corporation tax.

It is obviously mad that we are spending £2 billion allowing self-employed people to avoid the tax they should be paying via the IR35 change. One of my first ever jobs in the Treasury was trying to deal with tax avoidance. This IR35 issue was a large part of the problem then. It then took us a decade to put in place a, yes, complicated regime, but one that was vaguely suitable to the scale of the challenge we faced. We are now spending £2 billion. We are giving £2 billion to people to let them avoid or evade tax. It is completely unhinged, so there is that.

I have no strong view on the net benefit of providing lower VAT for some tourists, but is that the core of our growth agenda, or could we possibly have some tourists paying a bit of VAT so we do not have a massive fiscal and monetary headache? I would have thought so. We should obviously not be going ahead with the little ones. On the big ones, it is going to be corporation tax and possibly the basic rate that are in play.

If we do not look at these things, we should be honest: we are cruising towards announcing a non-credible package on the 31st. That is the last thing we should be doing, because of the international regime we have been talking about and what we have done to ourselves over the last two weeks. I would like us not to be the poster child for how difficult economic policy can be in the 2020s going into November, which is what we currently are.

Q46 Rushanara Ali: I hope my Tory colleagues on this Committee can persuade our Chancellor to listen to some of this feedback. Did anyone else want to come in on this?

Professor Chadha: While it is right, ultimately, to focus on debt-to-GDP and stabilise it for the reasons we talked about a few minutes ago, in the end, debt and deficits are just instruments to bring about an economic objective. We have an economic objective that has been described as 2.5% growth. We have some severe question marks about how sensible and achievable that is, and over what horizon it should be achievable. To make a statement that it is a good idea to get towards increasing prosperity for all is probably a good way of guiding Government policy. I would be very concerned if we started to rein in public investment. It is temporarily high, but, over the 40-year stretch since 1979, it has been far below the 3% that we think we need as a post-industrial economy.

Q47 Rushanara Ali: What else does the Chancellor need to restore credibility for the medium term? We have talked about that.

Professor Chadha: We need statements about the kinds of interventions we need to help growth, the horizon over which they will work, the parts of the country that will benefit, so that we can measure the tangible



progress over time and ask ourselves whether we are getting any nearer towards that. That will be part of a credible package towards growth in the economy, not just focusing constantly on the debt or the deficit.

We need to think carefully about the outcomes resulting from that that reflect the preferences of people, as we said earlier, in terms of greater health, education and infrastructure expenditure, but also in generating higher levels of wellbeing across the country. That is also part of it, as well as the statements on changing expenditure: a proper way of tracking progress in these areas. It is just all too nebulous at the moment. That is what we would like to see more of.

Q48 Rushanara Ali: Finally, departmental spending was set a year ago. Inflation was just over 4% and the cash settlements are not very realistic in light of what is happening. What do you see as being the challenges of the Government going down this austerity 2.0 route? We have not talked about—apologies if I missed it—welfare spending and earnings rather than the prices debate. What are your thoughts on those? You have talked about areas that could be dumped, but there are obviously other areas where there is real pressure and it seems there is not going to be political support for a reversal of commitments that have been made. Do you have any thoughts on those points?

Dr Tetlow: On the public service spending side, as you say, budgets were set last September, when inflation was expected to be quite a lot lower than we now think it is. Those budgets were initially expected to be quite generous, and particularly generous this year. The plan was to increase public service spending by 3.3% in real terms over the current spending review period. That now looks like it could be less than half that, maybe 1.5% real terms increases over that period because of higher inflation.

That means Departments are already having to spend more than they had expected on public sector pay, for example, with the roughly 4% to 5% settlements that we saw this summer, compared to more like 2% that was probably factored into those budget plans. They are not as exposed as households to things like energy costs, but Departments spend a sizeable chunk of their budgets on those. They are obviously facing higher costs there as well. It is pretty clear that they are struggling to get on top of the backlogs that a lot of that extra funding was intended to try to tackle—some of the backlogs coming out of the pandemic. It is pretty clear that is already not happening to the extent that was hoped for in the health service and in the criminal court system, for example.

The aspiration for last year's spending review is already looking like it cannot be delivered within the existing budgets, so, if you wanted to take money out of services in the next few years, you would have to be thinking about the scope of the services offered. It is not the sorts of other levers you might have hoped for that we have used in the past decade, like holding down pay or so-called efficiency savings—trying to do things differently. There is not a lot of evidence that those are credible



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ways forward. On the pay side, obviously we have already seen quite a lot of industrial action and private sector pay is expected to go up more quickly, so outside options for workers may increase recruitment and retention problems.

Torsten Bell: I agree with everything Gemma says, which is why I think people will not interpret current budget cuts being pencilled in for four years out on the back of that as particularly credible. That is the question on day-to-day spending. It is clearly deliverable to implement a lower uprating of benefits this year and possibly next year, in the two high-inflation years. You all know the politics better than me, but it is difficult.

We have ruled out, basically, lower upratings for pensions. You would need a vote to lower the uprating below prices for disability benefits and a few other areas, which is a large chunk. We are basically talking about universal credit and its predecessor benefits, with a few additions. Child benefit is the other big one where you can lower upratings without a vote, necessarily, in the House of Commons. There will be a vote, but not one that would actually be able to stop it going ahead. That would save you in the region of £3 billion, so, broadly, big cuts to benefits for working-age households is the price for letting people avoid their self-employment tax. It is the same kind of ballpark.

Is it a good idea? It is clearly not. The Treasury would save £3 billion if you went with a 5.5% earnings-related uprating, rather than a 10% inflation-related uprating. The effect of that is a £500 permanent hit to the incomes of working single parents with one child and around £1,000 for a working couple with three children. Working families would lose most because of the combination of child benefit and universal credit, particularly if you also freeze the work allowances in universal credit. That is where the big numbers will start coming through.

We should step back and think about the context. The context is big falls in living standards for everybody next year. Because our inflation uprating system is lagged, even if we went ahead with the full inflation uprating in April, the actual level of benefits on average over the course of next year would still be 6% below its real level in 1920. It is still going to feel tough, because we are waiting for the next uprating next year to catch us back up, because every year we are playing catch-up.

This year, we are not playing catch-up in quite the same way because the Government are adding these one-off payments, these energy support payments, to people on lower incomes. Those disappear after this year and it is the inflation uprating that, basically, one for one, replaces those. If we do not go ahead with that uprating, we are talking about really significant falls in incomes for lower-income households next year. It would mean benefits being at their lowest real level in four decades, 40 years, and the economy has grown quite a lot during that time.

On the substance, is next year a good time to be holding down benefits, in terms of prices? No, for the reasons I have set out about it being a



difficult time. Would it save you some money? Yes, around £3 billion. I can list you other ways of finding that money.

- Q49 **Emma Hardy:** We are definitely not on this Committee to cheer ourselves up this morning. Things can only get better. I wondered if we could talk a little about the distributional impact of the growth plan. Considering what we have discussed today, I wonder if your comments could also include the projected distributional impact of the growth plan. Obviously, it is very much dependent on what the Government do and what the market does. Paul, what difference does this reversal of the additional rate of tax make to the distributional impact of what the Government announced in their growth plan?

Paul Johnson: The additional rate itself was, fiscally, probably the smallest thing in the entire document. Clearly, by not doing it, you are not giving away a couple of billion quid to the 1% highest-income people in the country.

- Q50 **Emma Hardy:** In terms of the distributional impact of the overall package, changing that one thing does not really make much difference?

Paul Johnson: It costs some extremely high-income people quite a lot of money. Clearly, if you are reducing the basic rate of income tax, the biggest gainers in cash terms will be people earning £50,000 a year and above. The reduction in the national insurance rate, certainly cash terms, benefits you more, the more you earn.

Indeed, as a proportion of income, this clearly does not help people towards the bottom of the distribution at all. Because the tax system is broadly progressive, it gives more in proportional terms, as well as in absolute cash terms, to people higher up the distribution. It is always important to think about your baseline, and clearly the baseline changes over time, but those particular changes are, broadly speaking, giving away substantial amounts of money and most of it is going to people on relatively high incomes.

- Q51 **Emma Hardy:** Torsten, could you comment on the distributional impact of the growth plan?

Torsten Bell: I agree with what Paul just said. One way of thinking about it is the reversal of the scrapping of the 45p. The bad news for the top 5% is they lose about 60% of the tax cuts they were given on average, but those are very top heavy within the top 5%, I should say. They lose 60% of the tax cuts that they were given in the mini-Budget. The good news for them is that they are still receiving 40 times the tax cut of the bottom 20% on average, in cash terms, so it is still a very regressive package, but it is significantly less, particularly when you are getting to these very high numbers right at the top.

If you combine that with the wider packages on the tax and benefits side that the Government have announced since the pandemic, the change to the scrapping of the additional rate basically means we now have a pretty



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progressive set of tax and benefit changes over the longer term, so not the ones announced in the mini-Budget but the longer-term trend. That is mainly because the four-year freeze on income tax thresholds is taking much more away from the top and the middle than it is from the bottom.

The only people who were really net gainers from policy changes after the mini-Budget, when you go back to the beginning of the Parliament, were the very top, because of the top rate tax cutting. Now that is gone, almost everybody is a loser and the highest incomes are the biggest losers. There are some lower-income households that will be winners from the increase in work allowance and the cutting of the taper rate in universal credit. There will be some winners at the bottom, but, big picture, they are broadly flat and the bigger losers are at the top. It is broadly a progressive package, looking at the Parliament as a whole, and it is a very regressive tax cutting package, looking at the mini-Budget specifically.

Paul Johnson: That is true across the population. It is worth saying that freezing the income tax personal allowance is just about the least progressive way of increasing taxes and certainly direct taxes. It has a big impact on relatively low-income basic rate taxpayers and no effect on people earning more than £125,000 a year. While what Torsten says is absolutely true across the population as a whole, if you look at income tax payers that is the least progressive way of freezing the allowances.

Torsten Bell: That is important, because we are cutting some income tax. We are cutting the basic rate. We are raising income taxes by the threshold freeze and cutting income taxes by the basic rate freeze. The net effect of those two is definitely not progressive within the income tax population.

Q52 **Emma Hardy:** The net impact of those two would mean that people on the lower rates are paying more.

Torsten Bell: Yes, of those two.

Paul Johnson: Yes, absolutely.

Torsten Bell: Everyone is paying more. Let us be really clear about that. On tax, everybody is paying more.

Q53 **Emma Hardy:** Were you surprised that the Government did not provide a distributional analysis of their mini-Budget?

Torsten Bell: There are two reasons why you should not be surprised. One is that they said that distributional analyses are taboo. People who think they are a bad idea in principle probably are not going to publish them. Secondly, had they published them, they would have shown a very regressive package. You are probably less incentivised to publish them in those circumstances. They would have shown huge gains for the very top millionaires, taking home a £55,000 tax cut. You probably were not going to publish those in those circumstances.



They have also set out an argument, a view, which is that we focus too much on distribution in British economic policymaking and that is holding back growth. That is a view. It does not quite match the reality of what policy has done, in terms of the recent past, but, given that they have set out that view, I do not think any of us should be surprised they did not publish a distributional analysis.

Q54 Emma Hardy: Gemma, in response to the UK's fiscal package, the IMF stated that it "does not recommend large and untargeted fiscal packages at this juncture" and that the UK's package will likely increase inequality. How unusual is it for the IMF to comment on a fiscal package like that, and why do you think it did?

Dr Tetlow: I think I am right in saying that those comments were actually in an interview with a Reuters journalist, rather than being a pre-planned press release, so it is perhaps not as out of line as it might appear. They have published various pieces of work recently looking at the relationship between inequality and growth, which conclude that inequality is bad for growth. It is perhaps not that surprising, given the research that they have done, that they would flag that concern.

Also, more broadly, in response to all Governments considering energy price support packages, they have been warning against doing aggregate fiscal stimulus and being more targeted, for the reasons that we were discussing earlier. Given the type of shocks that we have experienced and the fact that most countries are bumping up against supply constraints, fiscal policy cannot boost in the aggregate. All it can do is think about the distribution. Therefore, the IMF has been advocating for everyone the importance of targeted support, rather than untargeted support packages. They had been saying that for a while, even before this package from the UK Government.

Q55 Emma Hardy: Thinking about the future and bearing in mind the distributional impact—what is going to happen to different groups in society—what impact will the forecasted interest rate rise have on the distributional impact of what is going on here?

Paul Johnson: In a sense, there is almost a random and unintended effect of interest rate changes. We have had the changes to taxes. We can see very clearly what the impact is. Then you have had this unintended, from the Government's point of view, change to interest rates. That will clearly directly make anyone with a mortgage worse off, as Torsten sort of indicated. That might be middle-income, middle-aged type people.

Torsten Bell: Some of whom are furious. Middle age is bad enough as it is.

Paul Johnson: There is obviously a direct effect there. People who have bought more recently are going to be more affected, because they tend to have bigger outstanding debts. Anyone who is a homeowner will be



affected in some sense, because their wealth likely goes down as a result of that, although that is obviously a much less significant effect.

It is worth saying that, again, a lot of the problems here are about the speed and the way that this is happening. Most of us, possibly all of us, on this panel have felt for a long time that we would be in a better position, from a distribution of wealth between generations perspective, ignoring the other impacts they might have had, if we had had higher interest rates over a longer period and lower asset prices. In the long run, getting to more normal interest rates and lower asset prices probably will be helpful to that intergenerational wealth distribution, but, in the short run, it is going to cause real problems for a minority of the 8 million or so households that have mortgages.

While we have the energy price issue and inflation issue this year, the gradual move of people to fixed rate over the next couple of years means that the pain, as it were, is going to be spread out over a longer period. It is one of the things that will likely hold back the economy more next year than would have been the case as other price rises start to dissipate.

Q56 Julie Marson: Paul, could I follow up on something from earlier about the energy price guarantee? The Treasury provided a costing of that for only the next six months, to the end of the fiscal year. Did that add to the uncertainty and the lack of transparency? Is that another area where it would have been better to give, say, a full two-year costing, even if you had had to build in some stress testing and some confidence bands within that? Would that have been a much more preferable approach to take?

Paul Johnson: Yes. From the point of view of transparency, you can quite easily say, "We have a reasonable idea of the costs over the next six months. Over the following 18 months it depends. Here are some scenarios." I cannot see any reason why they would not have done that.

There is a broader issue as well. I also do not understand why they have guaranteed it for two years, rather than, frankly, spending £1 billion working out a better way of doing it for next year. You could save an enormous amount of money, have a fairer distribution and have appropriate incentive effects and so on by having a more targeted policy. I can just about understand doing what they have done this year, though it is broader and more expensive than what most other countries have done. I cannot begin to understand why you would not put the most enormous amount of resource into coming up with a better policy for next year.

Professor Chadha: On the energy price cap and following the comments about distribution, the way it was set up is offering much more of a benefit to better-off households. The top income decile is getting something like £2,200 benefit and the bottom income decile is something nearer £1,000. That is the distributional impact of this that really needs to be spelled out.



We are seeing a great concern. We had a question a moment ago about interest rates from Emma. In fact, large numbers of households over the next year or two are going to see their savings completely dwindle. Our estimate suggests that, by the end of 2023, something like 11 million households will have very few savings left. That is going to be increasingly difficult, as they are going to have to find other forms of credit if there are further income shocks. That is alongside an increase in destitution.

That matters with a growth agenda, because one thing we have seen as well is that the spill-overs—some people call them trickle down, but I will call them spill-overs, because that is less nuanced—are not there. We are not seeing spill-overs, either from London and the south-east to the rest of the country, or indeed necessarily from the wealthiest to the poorest, in terms of actually leading to higher levels of activity, growth or income than we might otherwise see. That is part of the repair set of policies that we need in the economy as well.

The best way of measuring that is continuing to measure the distribution, the impact of policies, which, as well as at the household level, should be displayed at the regional level more obviously. That would help focus attention on these issues. That analysis is something we would ask for alongside any fiscal event.

Q57 Julie Marson: Perhaps I could follow up with you about the labour market and labour participation. That is part of the growth agenda. That is one of the areas that the growth plan has identified as a constraint on growth. There are various measures that have been talked about, such as childcare; we have talked about migration. What do you think about the labour market participation in terms of its real constraint on growth and what the Government are suggesting they might be doing about that?

Professor Chadha: Clearly, we had a reduction in participation very much focused on people over 50, who are taking stock of the Covid cloud, which maybe we are just about emerging from, but I am very wary of saying such a thing. People have taken particular views about the extent they want to participate. Maybe they are also taking a view on their underlying financial position, where their pensions sit and where their income is going to be.

I am not surprised, in a way, that people are thinking carefully about whether to re-enter the labour market. I have argued at this Committee a number of times that there ought to be more of an incentive for people to enrol in vocational education to try to meet some of the obvious gaps in labour supply that we are seeing reported from around the country. That just has not happened, unfortunately. That would require funding for higher educational authorities providing vocational education, but, as well, for providing incentives for individuals who have suffered from Covid—and, to be honest, most of us have—to do that kind of training, so that firms that are short of staff can access them.



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That is not going to immediately solve the problems that we face, but it would have been entirely possible, alongside the development of online learning, which most higher education authorities have developed in the last couple of years, to bring a lot of that forward. We have missed yet another opportunity, with the start of term right now. If people are not participating, at least get them into some form of training. As far as I can gather from the people we talk to as part of the Productivity Institute and the research productivity fora around the country, firms are absolutely feeling a shortage of skilled or semi-skilled labour in many areas. We need to address that. It cannot be done immediately, but a process could be started so that it could be addressed.

Torsten Bell: Clearly, the UK is standing out as having an increase in labour force inactivity. That should concern us. We need to distinguish between the different drivers of it. We would probably be more relaxed about the increase in student numbers that we have seen. A lot of the increase in younger people's inactivity is driven by a combination of more students and some increase in mental ill health, which is a long-term trend.

Among those who are 50-plus, we have this very big increase in ill health. It does not look like it is tied just to Covid. It is important to recognise that there is growing evidence that it is being driven by wider failings in our health system in keeping people in a position where they are able to stay engaged with the labour market. We should worry about that.

I am personally sceptical that a labour market intervention is the answer to that. I would have thought a health intervention is the right answer to that, but I appreciate that that is not everybody's view. We should also worry less or at least be humble about our ability to intervene. The ONS's stats often focus on inactivity among the 16 to 65-year-olds, which has highlighted this 50 to 65-year-old group.

If you extend it to the whole population, you also have a big increase in inactivity among the over-65s compared to where we were pre-pandemic. Again, that is associated with ill health, but not just that. You probably have more people there where they are making, as Jagjit is saying, lifestyle decisions about when they wish to retire. I have no faith in policymakers' ability to change their minds, so I would focus less on that as well.

Dr Tetlow: I agree with what has been said. To add to what Jagjit was saying on further education and skills, it was welcome that the levelling-up White Paper in February recognised further education as important. That was one area where the target for increasing participation in FE was pretty unambitious. It was really just getting it back to where it was a few years ago, so you could definitely do more there if you wanted to improve skills and labour market participation.



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Also, there was a notable absence in that plan of early years education, which is where the evidence is that you have stronger skills returns. Depending on how you did it, it could also interact with labour market policies for parents, thinking about childcare and facilitating work by parents.

- Q58 **Siobhain McDonagh:** In defence of young would-be homebuyers, rather than middle-aged ones, two days before the mini-Budget a young friend of mine had hopes of buying her home through shared ownership. She was offered a mortgage of 4.28% interest from the Halifax. A day after the statement, that offer was withdrawn and it has rocketed to a two-year fixed rate at 6.9%, and 6.1% for a five-year period. That is an increase of £150 a month overnight because of the Government's unfunded giveaways. Given that I have an array of very clever people here, do you think my friend should risk it and take the deal on the table, or should she hold out and wait?

Paul Johnson: Do not ask me. I always make the wrong decision on these things. I bought a house six months ago and I am regretting it.

Professor Chadha: Are we licensed to give mortgage advice?

Torsten Bell: No, so we should be really clear that we are not regulated. Rather than offering your friend advice, the big picture is that, in the long run, a world of higher interest rates, given that it will lead to lower house prices, will benefit first-time buyers. For many, the deposit is the barrier, rather than the monthly repayments. The challenge, which is basically what Paul was saying earlier, is that the transition to that new world is quite painful.

It is painful for existing homeowners because they are going to see their house prices fall. If we are talking about interest rates that are staying remotely over 4%, 6%, we are talking about quite significant falls in house prices in the coming years, low transactions in the short term, big house price falls in the medium term. For young people though, the problem is the short term. If they are in a situation where they are being charged a high interest rate but the house prices have not yet fallen to compensate for that, that might be suboptimal. Your friend would have to draw their conclusions from that, so that we do not breach the rules about regulated financial advice.

- Q59 **Siobhain McDonagh:** She should wait.

Torsten Bell: You might conclude that from what I have said. A way to phrase it might be that I am not planning to buy a house in the near future.

Chair: The most interesting discovery is that Paul bought a house six months ago. That was a huge mistake. The Government are probably right. We should not listen to any of you.

Thank you so much. That has been hugely helpful and we look forward to



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your various other observations over the coming weeks as we approach 31 October. Thank you very much indeed. That concludes this session.