HOUSE OF COMMONS

Treasury Committee

Oral evidence: Spending Review 2020; Economic impact of coronavirus, HC 1029; 882

Wednesday 2 December 2020

Ordered by the House of Commons to be published on 2 December 2020.

Watch the meeting

Members present: Mel Stride (Chair); Rushanara Ali; Mr Steve Baker; Anthony Browne; Felicity Buchan; Ms Angela Eagle; Mike Hill; Julie Marson; Alison Thewliss.

Questions 52 - 112

Witnesses

I. Karen Ward, Managing Director, Chief Market Strategist for EMEA, JP Morgan Asset Management; Professor Jagjit Chadha, Director, National Institute of Economic and Social Research; Dr Marianne Sensier, Research Fellow, University of Manchester; Paul Johnson, Director, Institute for Fiscal Studies.

Examination of witnesses

Witnesses: Karen Ward, Professor Jagjit Chadha, Dr Marianne Sensier and Paul Johnson.

Q52 **Chair:** Good afternoon and welcome to the Treasury Select Committee inquiry session into the economic consequences of the coronavirus. We will be looking today particularly at the 2020 spending review. We are very pleased to be joined by four expert economists. I would like to just ask them to very briefly introduce themselves to the Committee.

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

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

Dr Sensier: I am Marianne Sensier. I am a research fellow at the University of Manchester.

Karen Ward: I am Karen Ward. I am the chief market strategist for Europe at JP Morgan Asset Management.

Q53 **Chair:** Thank you very much for appearing. We will be directing questions generally to a specific person or people on the panel but, if you have not been called in to comment and would like to do so, please just raise your hand and I will attempt to bring you in at that point.

Could I start by asking you, Jagjit, regarding the OBR forecasts that we have just been looking at and been presented with, what your view is of them and particularly the assumptions around their upside, central and downside scenarios? Where you think we might end up within those scenarios, for example, would be very useful to know, particularly based on any of its forecasts or assumptions that you specifically cannot agree with or that you feel are more problematic than others. It would be useful for you to set the scene for us in that way.

Professor Chadha: Perhaps disappointingly, I am going to find myself almost in complete agreement with the OBR and the way it has approached the forecasts at the moment. The first point to make is that it is a terribly uncertain environment. The progression of the economy is going to depend critically on the extent to which we are able to deal with Covid-19, the vaccine and its rollout, and the extent to which we may or may not have to go into further lockdowns or forms of stringency in the way that we deal with social interactions. These are the shocks that are driving the economy below where we would otherwise have anticipated it to be.

What the OBR is doing is saying that it depends upon our view on those factors that I have just outlined. A critical point that I want to put on the side that is going to come up a lot today is our view of those uncertainties that come along with that. You asked me at the end of that question to say which is the most likely. I cannot tell you which is the most likely; I can only really talk in terms of the scenarios in the way that the OBR has done or, indeed, in terms of a range of possibilities, any of which seem very likely to me. Individuals, when they are planning ahead, are going to say that any of these might be possible. What I want to have in my mind is a clear statement from the Government, on fiscal policy in particular, as to how they are going to deal with those eventualities when they come along.

If I go back to the OBR scenarios, we have a central case, which implies some return to the level of pre-Covid GDP towards the end of 2022 or the beginning of 2023, very much in line with the national institute's view, as well as other major forecasters such as the IMF and the Bank of England. Anything around that, whether it is earlier or later, is dependent on the factors that I have already outlined—the progression of and the way that we deal with Covid—as well as the effectiveness of the monetary and fiscal policies that we bring to bear on the crisis. They have been reasonably effective so far but, later on, we might come to some of the deficiencies that we have had in place.

In sum, the economy is going to be depressed far below where we would have otherwise have anticipated it to be. That has an aggregate consequence and I am sure we will come to this later on. It also has distributional consequences that are terribly worrying for people at the bottom of the income distribution and in certain regions of the country. Where we end up depends very much upon the consistency with which we impact on the economy through appropriate monetary and fiscal policies.

Q54 **Chair:** Thank you very much. That was very helpful. On appropriate monetary and fiscal policies, I know that, a while ago, at the time the JSS came out, if my memory serves me correctly, you were arguing for further furlough, which is where we have ended up. Is there anything on your radar—the top couple of things—where you are concerned that the Government might misstep on the fiscal or monetary side of things as we come through this crisis?

Professor Chadha: If I just go back a step in answering that, what we will see when the history books are written is that we had the furlough scheme in place for a year or so and it will look as though that was something providing continuous support to the labour market over that period, but of course you and I know, as do the other members of the Committee and the other economists on this group, that, throughout the whole course of the furlough scheme, there was uncertainty as to whether or not it would remain in place. That means that, with the announcement in the middle of the year that it would end in October, large numbers of people either lost their jobs or were not employed because employers did not have the comfort of knowing that the furlough scheme would be in place. This is absolutely a clear illustration of how uncertainty over policymaking can limit its effectiveness. Had we had a clear, state-contingent statement, by which I mean if we had said that, for as long as the economy is materially and substantially below the level of activity we saw in a pre-Covid world, we are going to continue to offer appropriate levels of support to firms, so that they can keep staff where they think they are going to need them on recovery, that would have been a much more effective way to proceed.

Right now, what we also need are those kinds of statements. We have had those kinds of statements reasonably effectively from the Bank of England and other central banks around the world, but I am concerned that, when we talk about fiscal policy and what it might do, the question very quickly returns to the question of how it will be funded in terms of taxes and whether and when certain things will be withdrawn. Too many of the statements are still in terms of a particular time horizon and, in the middle of all of this, we have also had great uncertainty as to when we will have fiscal episodes. A Budget was announced and then cancelled. The OBR, in its own report, on page 3, in a very gentle way, was mildly complaining that it did not have enough time to construct the forecast. For the fourth time in a row, it was not given sufficient time to construct an appropriate forecast.

What we really need more than anything else is a framework and a timetable for the setting of monetary and particularly fiscal policies that allow those of us dealing with the tremendous uncertainties that Covid-19 has wrought on the economy to plan more effectively. It is very hard to do that if the fiscal policy-maker itself does not commit to a set timetable for announcing policy interventions, whether they are expenditure, taxation or debt issuance. I would call for that over and above nearly anything else: much more clarity as to the timetables that are followed. From that, we can have the constructive discussions that I know we will have this afternoon, but we would like to have them more regularly than we currently do.

Q55 **Chair:** If there was greater certainty and if, for example, the Government had been able to foresee the second wave, if we can call it that, earlier, I guess they might have said, "We will stick with furlough and not go into the JSS", and then not have had to backtrack on that and go back to furlough because circumstances changed.

Similarly, I guess your second point is that giving the OBR time to get its forecasts and everything else would have been easier if we had had certainty on foresight. What I am not so clear on, Jagjit, is whether you are laying the responsibility for that at the Government's door and saying that they should have been better at foreseeing what was happening, or are you just saying that it is an unfortunate consequence of the way that the virus works and the world that we are in?

Professor Chadha: I am sorry if I was not entirely clear. It is absolutely the responsibility of fiscal policy to confront the uncertainties and not to use the uncertainties as an excuse for presenting its fiscal plans. That is something that is a cause of concern: that there has been some delay in the announcement of certain plans.

You mentioned that it was not possible to foresee a second wave. I want to be absolutely clear: I am neither an epidemiologist nor a medical man, but nearly all the analyses that I saw of how viruses spread were fairly clear that there would be some form of second wave in the winter. We could have made state-contingent statements that would have said, as soon as that became clear, that we would do what we can for firms and employees to help them retrain and move towards the sectors that are in more demand, and I am not clear that we were making those kinds of statements.

Another form of vacillation was that, in the end, we had to have a lockdown, but the advice was coming some six to eight weeks before that, if we were going to have a lockdown or a firebreak lockdown, it ought to be implemented coincidental with the school half-term. That would have maximised its effectiveness. Of course, we were running a very difficult decision around the short-run trade-off between the economy and the health of the nation, but given that we did go into a lockdown, it does look rather the case that, ex post, we would have been much better off having a co-ordinated firebreak some weeks earlier than we did.

That is particularly important because of the way the virus spreads. It is highly non-linear, as we know. As soon as more people get infected and the R rises above 1, it tends to grow very quickly. That means that there is a great return from acting promptly when you have sufficient information, and I am afraid that the delay that we saw in what was eventually the lockdown was another characterisation of Government not quite being on top of the game in terms of confronting the uncertainty we were facing. I hope that that is a clearer answer.

Q56 **Chair:** That is really helpful, thank you. I am going to stick with you and bring Karen in as well on this question, which is around the international performance of the UK in comparisons on the economy. I am looking at a chart here that I am pretty certain appeared in the OBR's forecast document. It shows weekly hospital admissions, with a huge spike particularly at the beginning, in the first wave, above most other countries, and staying a little bit higher than most countries, even in the recent past. In terms of the high level of deaths per million, compared with other European countries, we are right up towards, unfortunately, the upper end of that spread of outcomes.

It then picks up on your point about how quickly the Government reacted to the health crisis in terms of the stringency index coming in a little bit later, perhaps, than other countries and staying more stringent throughout most of the period from May through to the current time. In terms of the economic impact, there was a very substantial drop in quarterly GDP in Q4 compared to other countries.

I know that both you and Karen have made an important point in your evidence about the way in which we have treated health costs and the inflation deflator, et cetera, and whether the drop in GDP in the last chart that I referred to should, therefore, be considered to be quite as dramatic compared to other countries as it is shown in that particular chart. I wonder if you could specifically comment on that.

Professor Chadha: If I talk about the fall in GDP, there are two separate points here. One is that, however we measure the fall, this is large by historical and normal standards, so it is, in a sense, an economic disaster for the country and particularly for elements of the distribution that I have already talked about: those who have lost their jobs and do not have the prospect of re-employment in the short run. Very many measures of destitution or homelessness have shown great concern to those of us who worry about these things. Let us just say that that is the first-order point.

Secondly, if we go into the area of trying to measure, in real time, what has happened to GDP, we need to be aware that all we have at the moment are preliminary estimates at a time when there is a large amount of change. When we know that there is a large amount of change and disruption, estimates tend to be subject to error. The specific example here in the health sector is that what the measurement does is it takes the expenditure on health and social services and deflates that nominal expenditure by a count measure based upon the normal activities of the National Health Service. That is people going to appointments, dental practices and the normal activities that go on when we are not in a pandemic.

What has happened this year is that a lot of those activities have reduced, either because the supply has changed—the health service has moved to dealing directly with the Covid crisis—or because people have decided not to take up the level of supply service that they otherwise would have done. Because we are measuring only the amount of normal activity compared to the level of expenditure that has gone up, it looks as though the prices that we are paying have gone up a lot, because we have a large amount of expenditure with a small amount of activity.

In fact, what has happened is there has been a huge increase in Covid-related activities in other areas that are not being picked up by the measures that the ONS is projecting. If we looked at that or at the increase in expenditure in health services, and applied not the deflator implied by health but the across-the-board deflator, or some notion of the increase in wages or costs, we are likely to have an increase in health sector activity.

Depending on how you do that calculation—there are various methods—what you then get is not a fall in health sector real output but an increase of something in the region of 20% to 50%. Depending upon the fraction in GDP of the health sector, which is typically taken to be about 7.5%, what you then get is a fall in GDP substantially smaller—something in the region of 3% to 5% smaller—than we are currently estimating. Rather than a fall of around 11%, we may be looking at a fall of around 6% to 9% this year, but this is only one example in one sector.

We know that, when we get the balancing of the numbers next year and we look across all sectors, there may be all kinds of errors in other sectors as well, which may mean that we end up at a similarly large number as we currently have. The health sector provides a very good example of how, by counting things that the health service traditionally does in a world in which the health service is doing quite different things, we might be underestimating the level of activity in the health service and, therefore, also underestimating the level of activity in the economy. That is what has gone on, if we take the numbers at face value.

Q57 **Chair:** That is extremely interesting. Thank you very much, Jagjit. Briefly, Karen, would you agree with that analysis and do you have anything to add to it?

Karen Ward: I would just add a few numbers. Jagjit is exactly right: the problem is both what we have spent on health this year and how we account for health in our activity. Just to give you some specific numbers to elaborate on Jagjit's point, if we compare real GDP, which is what economists tend to do in all the charts that you see all over the place, the UK is down, in real GDP terms, 9.7% in the first three quarters of this year. Compare that to Germany, which is down 4%. It looks like we have had an enormously outsized contraction compared to Germany, but that is where the devil is in the detail.

Government spending on health this year is 2.6% of GDP, as far as I can work out. Compare that to Germany, where it is 0.6% of GDP. Rather than looking at GDP and total spending, if you looked at nominal GDP, it would really flatter the UK numbers, because we have spent so much more on health. Suddenly, that real GDP comes down from 9.7% to 4.1%. We need to strip out health. We cannot, looking in real terms or in nominal terms, make international comparisons, because of our very large spending on health as well as, as Jagjit says, how we measure health.

If we start to do that—I have done that analysis and I can present the full amount in written evidence to you, if you would find it useful—and come back down to relative to Germany, we get to a number for the UK that is more like a contraction of 7% against a number in Germany that is more like 4.5%. It is still worse, I am afraid—I cannot make the news that much better—but this is really important to understand the specifics of what is going on. We all tend to rely on that headline measure of GDP but we cannot do that for these international comparisons.

Q58 **Julie Marson:** I am going to turn to the spending review and the Government's spending plans. Paul, you have drawn attention to the fact that the spending review assumes zero Covid-related expenditure after 2022, no extension of the increase in universal credit and a reduction in non-Covid expenditure of £10 billion per annum. How realistic are those assumptions and the spending path announced in the spending review?

Paul Johnson: On that last point, it is important to be clear that it is a reduction of £10 billion relative to the plan set out in March rather than a reduction of £10 billion relative to prior spending. It is hard to know how realistic those are. I guess my view is that, if you take each of them together and then come up with a spending number for 2022-23, I find it hard to think that that is a central estimate because it assumes that all of those things happen: that universal credit is reduced again to its pre-2020 level, which may happen, but history's guess is that it may not.

The Treasury is allocating £55 billion for Covid-related spending next year, falling to zero the year after. That would be marvellous but it is unlikely that we will have zero spending on vaccinations, PPE, test and trace and so on after next year. While I imagine and hope it will not be anything like £55 billion, zero is probably not a central estimate of the amount that will be required.

Then there is the question of total spending being £10 billion less than planned. Some of that, of course, is accounted for by a reduction in overseas aid, but by no means all of it. It is not clear where the additional savings would come from. We know that there are additional pressures. There are pressures on the health service that are not about dealing with Covid but are about dealing with the really enormous increases in waiting lists and cancelled operations; I am afraid I do not have the numbers to hand. One certainly perceives additional pressures in some other parts of public services.

You could just about make an argument for each one of those outcomes. Even each one of those outcomes is probably not the central likelihood. You could put them all together and assume you get, as it were, in spending terms, the best possible outcome in all three cases. It is not impossible but, for me, it certainly would not be a central scenario.

Q59 **Julie Marson:** What Government Departments are going to feel the most squeeze in this spending review? Would they be the same Government Departments that felt that squeeze after 2010?

Paul Johnson: Broadly speaking, yes, to the last part of your question, because we know that there is a possibly inadequate but certainly significant increase in aggregate in health spending. Schools have a three-year deal, which, in one sense, would look a bit more generous than it did if there were a pay freeze in schools, but they will need all of that to do some of the making up for lost education. Local government are getting a bit of extra money but only if they increase council tax 5%, and that is certainly an area that local government and social care have had problems with in the past. There is some extra money in some other bits, like further education and justice and so on, but broadly speaking it is those areas that had a tight period up to 2020 and which look like having a tight period going forward, if, indeed, these spending plans are adhered to.

Q60 **Julie Marson:** A multi-year spending review was originally planned for 2020 but derailed by Brexit and now by the current crisis. Is there a risk that the multi-year spending rounds are a thing of the past?

Paul Johnson: I hope not. Of course, there is quite a lot of multi-year-ness in what we saw. We have multi-year for health, defence and education, which is something like 60% of public service spending, so it is only a minority of public service spending where we do not have more than one year set out. I have been quite sympathetic to the idea that now is not the time to be making multi-year decisions because of the level of uncertainty, and it is worth being clear that the numbers that I am referring to beyond next year are the assumptions built into the public finances. They are not fixed decisions on spending paths next year. Of course, by putting those assumptions into the public finance numbers, they, in my view, flatter the future public finance numbers relative to what a different set of assumptions would be.

I would hope that, this time next year, we are in a position to have a spending review that takes us through to the end of the Parliament. That would be a three-year spending review, which would be perfectly in line with things that have happened in the past. By then, we will pretty much know what is happening with both Brexit and Covid, and so it seems to me there will be very little excuse not to have a full three-year spending review next year, once all those uncertainties have gone. Of course, there will still be uncertainty but it will be of a different order, we hope, to the order of uncertainty that we have at the moment.

Q61 **Julie Marson:** Just turning to the Ministry of Defence, we have seen that defence spending will be about £7 billion higher by 2024-25. Public sector procurement has been in the news somewhat from the PPE perspective. Should we have concerns about problems in procurement in defence in the light of some of that?

Paul Johnson: I am no expert in defence procurement. It is worth saying that the reason for asking that, as you are probably alluding to, is that all of that increased spending in the Ministry of Defence is on capital. The current spending in MoD is either flat or maybe even falling very slightly over that period, so it really is incredibly important that that money is spent as well as is possible, as is true for all the additional money that has been spent over this period and going forward.

There is a lot of discussion, analysis and commentary on quantities of spending, but quality of spending clearly really matters enormously, and there are clearly reasons to be concerned about quality of spending in terms of procurement practice that we have seen, frankly, just in the newspapers in recent weeks, but also quality of decision-making over what the right procurement and right capital goods are to be spending that money on. I think this is something to be very careful about.

Q62 **Julie Marson:** What is your view on the Government decision to drop their commitment to overseas development aid?

Paul Johnson: That is genuinely not something for me to comment on as to whether it is the right decision or the wrong decision. It is very much a political preference. Clearly, it saves something like £4 billion a year, which is a non-trivial sum, but that is on top of a reduction that is associated with the fact that our GDP has gone down in any case. In terms of whether or not it is the right decision, that is really something that I will leave for others to have a view on.

Q63 **Julie Marson:** Perhaps I could open that up to any of the other witnesses who would like to give a view. Jagjit, I do not know if you have a view that you would like to share.

Professor Chadha: On overseas development aid, I do not have much to add to Paul. These commitments are important and need to be thought about very carefully in terms of how we nurture countries that are trying to catch up and develop, and ones that we may trade and work with. The commitment in terms of GDP is something that moves with the cycle. When our GDP is lower, the amount that we give as a fraction of that will be lower as well, so there was no need to reduce it. It did not seem to me to be an important question to address or highlight at that time, but there may have been other things in the Chancellor's mind that I cannot begin to understand.

Q64 **Mr Baker:** I refer to my registered shareholding in Glint Pay. Can I begin by asking you about something the OBR tweeted, which was a chart showing the ratio of debt interest to revenue. Does this suggest that the national debt is now more affordable than ever before? Perhaps I might ask Paul. Does this falling cost of servicing the debt mean that debt is more affordable than ever before?

Paul Johnson: In arithmetic terms today, yes, it is. It is astonishing that we have so much debt and that we are spending the lowest fraction of our revenue on debt interest as we have ever done, or at least since 1700 or thereabouts. In the short run, in the arithmetic sense, it is extraordinarily affordable. We recently sold index-linked debt out to the mid-2050s at minus 2%, which means that investors are essentially guaranteeing themselves a loss of half of their investment over a 40-year period, which is pretty remarkable. That feels like a very good time for Government to be borrowing, partly reflecting, of course, international circumstances.

That also brings with it some risk. As the OBR also says, we now hold a very large amount of debt at short-term-market rates, because the Bank of England holds getting on for £1 trillion worth of this stuff. The payment on that is, effectively, the Bank of England bank rate of 0.1%. As soon as that moves up, so do our debt-interest payments. Whilst no one is expecting those rates to rise dramatically in the short run, as and when they do rise, it is going to add immediately and significantly to debt-interest payments.

The short answer is, yes, it is extremely affordable at the moment; the longer answer is that that increases the risk in some sense resulting from short-run interest-rate rises and, in the long run, a small probability of a bigger risk associated with a struggling, weaker level of debt. I should stress that I see no sign that we are close to that at the moment.

Q65 **Mr Baker:** I would like to come to Karen in a moment on this point but, Paul, could I ask you to just briefly elaborate on something that you just said in passing? You said that investors are guaranteeing themselves a loss. Would you mind just saying it again and elaborating for public understanding what you understand investors are doing there.

Paul Johnson: Saying that they are guaranteeing themselves a loss is probably overstating it because, of course, prices might change and interest rates might go down even further, in which case they would be able to sell on the debt that they have bought and make a profit on it. What happened in September or October is that a tranche of debt was sold at RPI minus 2%, to be redeemed in 2056. That means that you get 2% less than inflation—to be fair, RPI overstates inflation—each year for the next 36 years, which means that, by 2056, once you have taken account of the compounding of the interest, you have lost, in real terms, about half of the money that you put in in the first place. It is like putting £100 in a bank this year and, next year, you have £98 and the year after just over £96 and so on. If that were a world of zero inflation and you were getting minus 2%, that is effectively what is happening.

Q66 **Mr Baker:** Karen, why would investors do that?

Karen Ward: It is the small caveat that Paul put in there about an expectation of how you think the market will move in the interim. It is not an expectation of what you think you are going to lock in but how you think expectations of the value of that bond will change in the short term and, therefore, a near-term gain that you will make.

Maybe I could add to this broader point. We have to be very careful with this narrative that low interest rates are good news, because we have to think about what is driving low interest rates on both sides of the Chancellor's ledger. Debt sustainability depends on our interest rates compared to the nominal growth in our economy. It is the relative position of those. Interest rates are this low because expectations of nominal growth are so very low. What is happening is that both our outlook for our spending via interest rates as well as the outlook for our tax receipts via the nominal economy are looking fairly bleak at the moment. That is really important.

It is also, however, fair to say that, on top of just concern about the outlook and demand for bonds and safe-haven assets that have pushed down real interest rates, the Bank of England's intervention has compounded that effect and, if you like, perhaps given us a little bit of a premium between where interest rates should be on the economy and where they actually are, thanks to central-bank interventions. We just have to recognise that that could be a blessing but it could also be a curse, and we just need to be very careful with that.

If it is the case that central banks globally can hold down bond yields well into the recovery, it could be very helpful in allowing us to grow into our debt. We saw, for example, in the US, after the Second World War, very high debt levels came down very easily because of that combination of the central bank holding down the interest rate as the economy gathered steam. That could be a very effective strategy but, at the same time, we are not the US; we are the UK, and we are vulnerable to global interest-rate movements.

On the OBR's point about our interest-rate sensitivity now being twice what it was a year ago, if we see external conditions in the global economy really start to improve and global interest rates, maybe led by the central bank in America, going higher, that is where we potentially get this problem between our interest rates rising and growth not going with it.

A technical but really important point is about just not thinking about interest rates in isolation. We have to think about it in the bigger picture.

Q67 **Mr Baker:** Marianne, could you just tell us what your view is on the sustainability of the UK's debt?

Dr Sensier: You have to put it in a global context: everyone else has faced this pandemic and has the same level of debt. Canada was the only country that borrowed more than us, according to the OBR's figures. At the same time, you need to ask why we had to borrow so much debt. We had to borrow a lot more because we were not as prepared for this pandemic as we could have been. According to Gus O'Donnell, in 2010 we were the most prepared country in the G7 but, after 10 years of austerity, we are just not as prepared anymore. That is why Germany does not have to spend as much of its budget on health: because it has been spending a lot more every year. The sustainability of this debt going forward will be fine, as long as the interest rates are lower. They should be low across the world because everyone else is in the same position.

Q68 **Mr Baker:** Just to pick up on one point there, we were preparing for pandemic flu, which is slightly different in its requirements to coronavirus. Is that not right?

Dr Sensier: It also required protective equipment, which was not replaced frequently enough to be ready for this pandemic. Personal protective equipment needs to be replaced every so often and those things were not being looked at. The Government systems need to take a long, hard look at themselves, because these pandemics are not going to go away, so we need to be ready.

Q69 **Mr Baker:** Finally, I would like to bring in Jagjit. Just thinking about the international context that has come up, my notes tell me that overseas investors' holdings have risen from 11% in 1987 to 27% today. Of course, I very much welcome overseas investors investing in the UK, but what does that mean for us and for the sustainability of the UK's debt?

Professor Chadha: It is part of the same phenomenon that means that interest is so low. There is a huge pool of global savings out there. The global sovereign debt market is approaching $90 trillion; it is huge. Some work that we are doing with the Bank for International Settlements is trying to measure the size of that market. This pool of savings is the thing that is driving down the interest rates that we are talking about on a secular basis for quite a long time. The good news for the UK—and we have talked about this already—is that the historic quality of our institutions and frameworks mean that there still looks like a robust demand for UK bonds. That is precisely why we are able to sell them at a high price, in the way that Paul, Karen and Marianne are talking about, and it allows us to sell them at a very low or, in some cases, negative interest rate. Demand is staying strong.

In the short run, this year alone, because of the savings that we have domestically, we do not have to borrow from abroad. It is almost identically the case that domestic savings are financing the Government's deficit this year. What this means structurally as we move on is that, to the point that you made right at the beginning, because interest payments relative to GDP on public debt are low—less than 2% of GDP—our fiscal strategy does not have to aim for very large surpluses to pay back the interest on the debt.

In the immediate period after World War I and World War II, we had to run primary surpluses of some 6% of GDP because, when you multiplied the interest rate by the debt, that is the kind of surplus you had to run to stabilise the level of debt. If we are only going for 2%, that is a relatively small number and, therefore, that affords us an opportunity to think of raising debt and putting it towards investment in the economy—building up public investment, building up human capital and other capital gaps—so that there will be growth in the future, as Karen mentioned earlier, that will allow us to grow our way out of this debt.

It is, therefore, critical that we think about the appropriate institutional frameworks for that in both the public and the private sector to build up the investment side of the economy. The capital-to-output ratio is low by historical standards, whether physical, intangible or human, and those are the things that we desperately need to build up to make this level of debt sustainable, but we certainly have an opportunity.

Q70 **Mr Baker:** I am very conscious of time but you said one surprising thing there, which I would just like to pick up on. You said that borrowing this year has been financed by domestic savings, but the OBR's charts show that the Asset Purchase Facility has been operating at broadly the same magnitude as Government new issuance of debt. I wonder if you could just account for the role of QE in the context of what you said about domestic savings.

Professor Chadha: QE is a monetary policy measure designed to stop interest rates at the longer maturities from rising. If you try to sell a lot of debt quickly, what you may find is that what has happened as we are able to sell that debt at relatively high prices is that the price of that debt may start to come off, which would imply higher interest rates. If interest rates started to rise at the long end of the maturity spectrum, what you would find is that monetary and financial conditions would work against the thrust of fiscal policy. Fiscal policy is trying to inject demand into the economy by running deficits but, if the Bank of England was not buying the debt to alleviate the impact on long-term rates, that would then effect a squeeze on the economy.

QE is simply a monetary-policy measure to try to amplify the impact of fiscal policy on the economy; it is not a fiscal policy per se. It deals with the fact that it used to be thought that short-term interest rates cannot go negative. They can but not very far, but that is not going to be enough to help stabilise the economy, and that is why we are buying bonds at the long end. I want to be clear that it is a monetary operation, not a fiscal one.

Mr Baker: Thank you very much. That is very interesting and very helpful. I am going to compare what you have said to Dr Vlieghe's recent speech but I do not have time to get into that.

Q71 **Alison Thewliss:** I have some questions around the effectiveness of the extension to the coronavirus job retention scheme and the self-employment income support schemes. I would like to come to Karen Ward first. When you spoke to us in May, you told us about the recovery, the shape of the recovery and the ideas that you had to base that on. I wanted to ask if you feel that the recovery will be slower than initially expected, or do you expect to see more structural changes to the labour market as a result of the crisis?

Karen Ward: When I spoke to you a few months ago, as we were all trying to put a letter on the shape of the recovery, I said I was expecting something fairly U-shaped. I thought the behaviour of the virus was such that we would have to have some form of restrictions in place, and it was only really when we got to the point at which a vaccine was visible that we would then get to that other end of the U. That is still my view.

The progression in the time since we have spoken is really that I can now see the other side of that U. The vaccine news that has come through over the last few weeks is the light at the end of the tunnel. Referring to the OBR's scenarios—for example, if you look at the assumptions that underlie those different scenarios—what they came down to was the behaviour of the virus and the point at which we could get back to normality, which the vaccine played a critical role in. I am more inclined towards their upside scenario here, which is one in which, specifically, the vaccine rollout is beginning in the spring. It sounds like it could even be before that from very recent news.

On that scenario, we recoup the levels of GDP at the back end of next year and early 2022. They do not have any long-term GDP scarring. Perhaps I am not quite that optimistic—I still think we are going to see aspects of it—but the fiscal implications of that are pretty stark as well, and we get to the point where debt is sustainable and starts to fall over the forecast horizon.

My core scenario is that I always expected that U. The terrific news recently is that we can see that light at the end of tunnel. I do not think that this economy will fundamentally change or that there are going to be massive behavioural changes. People's behaviour and the economy in 2022 will look very much like the economy in 2029, so that sets me up for a really strong recovery in the second half of next year.

Q72 **Alison Thewliss:** We are certainly all feeling a lot more optimistic, given the news on vaccines. In that context, do you feel that the Government need to extend the job support schemes any further, and to what point?

Karen Ward: Yes, absolutely. I have always described these policy supports as building a bridge from one side of Covid to the other. As I say, the really fortunate thing is that we can now see that landscape, but bridges do not work if they get three-quarters of the way across. They need to fully extend.

One point that I wanted to make on this furlough scheme is that we have all seen that it has been a superior outcome for workers in terms of the limited rise in unemployment, but I did some work before this Committee because what gets much less coverage is the relative fiscal cost. I compared the experience in the UK to the US, because the US took a very different approach. It did not support maintaining people in employment; it allowed the unemployment to happen and then supported incomes when people had lost their job.

On the analysis that I have done, the cost of the UK job retention scheme between March and the end of October, in gross terms, was 2% of GDP. Compare that to the US, where unemployment rose to 14.7%. If you add up all the many different unemployment insurances that they had to keep adding on to support those individuals, in gross terms that got to 2.4% of GDP. Our scheme was superior for workers and for the public purse. It is that aspect of the conversation that we need to bring in and is really important for justifying that final extension to the bridge.

Q73 **Alison Thewliss:** Paul, you said on Twitter that you were "taken aback" by the Chancellor's statement and the way in which the schemes had not been adapted or changed. In what way would you like to have seen a more targeted approach to the job retention scheme and the SEISS?

Paul Johnson: The big failing here is the self-employment scheme, and I understand why, to large extent, because it is very difficult to design. To have a scheme where we know that we are very significantly overcompensating a large number of people and very significantly undercompensating and, indeed, ignoring another large group, that was something entirely understandable back at the beginning of April, but really to reintroduce or keep precisely that same scheme seven months later was really quite disappointing. That the combined efforts of HMRC and Treasury could not come up with anything that was one iota better than something that was clearly, to be kind to it, extremely rough justice back in the spring was, as I said, quite disappointing.

We know from all sorts of work now that this is exactly what has happened. There really are significant numbers who saw a very small reduction, if any, in their income and have taken up a large amount of state support entirely unnecessarily, and a very large number who saw incomes fall to zero and have no state support. This is something that is worth thinking about much more generally for the future: how we think about the self-employed in our labour market and welfare systems. We know that more than a third of the growth in employment since 2008 has been among the solo self-employed. We know that their earnings have gone down over that period and they have done much worse than employees. That is not just a result of a change in the composition.

We live in a world where we know that Government policy, through tax and regulation, very significantly incentivises firms to contract with people who are formally or legally self-employed. It is all of those things together with, broadly speaking, a welfare system that is designed around the needs of employees and the mess that we have got into in terms of supporting the self-employed over this period. You see a really big gap in the way that the welfare state works. I do not have any easy answers to that—I have to be open about that—but this is a signal, I would have thought, that maybe this Committee or certainly Government ought to be doing some really serious work on how we go forward with supporting the self-employed.

Q74 **Alison Thewliss:** Would there be a means of looking at it again and meeting the needs of those who have been excluded from the schemes so far?

Paul Johnson: If you had that whole period from April through to November, where, whatever you thought about likelihood, you knew there was at least some significant possibility that this would need to be continued for longer or that some sort of second wave would occur, I would have thought there would have been time to do some significant work over that period.

Q75 **Alison Thewliss:** Dr Sensier, are there particular sectors that will still need wage subsidies after March?

Dr Sensier: Yes, I am sure there will be, because there are a number of industries, such as hospitality and travel and tourism, that rely on social consumption and which are going to take ages to come back. Even if this vaccine starts getting rolled out now, probably the uptake and the tolerance of the population against this disease is not really going to be there until the end of next year. I would like to see this job support scheme being extended into a training scheme, as they did in the global financial crisis in Wales, offering employers subsidies to retrain or reskill workers to increase their productivity.

Some industries may eventually be viable, but if there is this money coming on-stream for the green economy, maybe some workers could be retrained into those sectors. A lot more needs to be done about this. Essentially, the UK Government had to act very quickly and did very well but these kinds of schemes have been in use across a lot of Europe, and having more flexibility in the scheme would have saved money and given people more chance to do other things such as online training.

Q76 **Alison Thewliss:** That seems absolutely sensible to me as well. Lastly, if I could come quickly to Professor Chadha, you talked at the start about your concerns about the way in which the furlough extension had been managed. Do you feel that, had it been managed differently, people would not have lost their jobs? At what scale have people lost their jobs because of that last-minute U-turn?

Professor Chadha: There was a sense over the summer in which we wanted to think that people could spontaneously move to new sectors. There was this language going around whereby we could not subsidise jobs that did not exist anymore. Of course, in the long run, that must be right, but, as Marianne and Paul have pointed out, it takes time for people to retrain and it takes time for the new industries to spring up. Therefore, what we need is patience in terms of allowing that adjustment to occur.

To imagine it could have happened so quickly, in the middle of all the uncertainty that surrounds us, seems to me to have been an error. I am glad the Government have reversed the error and maintained the scheme but, as I pointed out at the beginning, as have other people, they could have made clearer statements that this will be in place for as long as that adjustment takes, which could be, as Marianne said, a couple of years before we understand the economic landscape that we might find ourselves in at the end of this crisis.

A lot of changes that are going on are ones that we might have wanted, the digitalisation of the economy being the obvious one, or more remote working, which will create opportunities for employment locally to service people who are not on the train every day to wherever they are going. All of that will take time, so we need encouragement for business start-ups and small firms in local areas, wherever they are in the country, and for people to retrain either to set up their own businesses or to work locally in different areas.

The Government have to have patience in these things. As was pointed out in the previous set of questions from Steve, we have the chance because interest rates are low. Interest rates are not forcing us to change tack very quickly at all. We can finance at least the cash-flow costs of the job retention scheme but, in net terms, the costs are relatively low as well, particularly if we keep people in employment. I would encourage patience and a framework that allowed better long-term planning.

Q77 **Anthony Browne:** For the record, I should say that I am on the advisory council of the Institute for Fiscal Studies. I have two broad areas of questioning: one is the levelling up agenda and the regional disparities, and then some follow-up questions on unemployment. On the levelling-up agenda, it has been well remarked that we have one of the greatest regional variations in GDP per capita of any major industrial country. I know that Dr Sensier has been doing work in this area. Has the epidemic exaggerated the regional variations? The northern cities have had the toughest lockdowns and they are the ones that tend to be more deprived.

Dr Sensier: There already were, as you have just said, quite extreme inequalities across the UK, and Covid has, essentially, deepened them. Even this most recent Government report that came out this week admitted that mortality rates from Covid-19 in the most deprived areas are more than double those in the least deprived areas, and there is greater inequality than seen in previous years. There has been some work by some colleagues and other academics on this and how deprivation is particularly concentrated in northern areas, although there are pockets of deprivation everywhere.

My research has looked at the resilience of regions in recovering from the global financial crisis of 2008. More recently, I have done some work looking at regions and how they would recover from this crisis. If anything, there has been less resilience over the last 10 years because of austerity and the loss of a lot of public sector jobs. These regions that were less resilient then will be even less resilient now and they are the ones that are particularly in need of levelling up at the moment.

Q78 **Anthony Browne:** Do any of the others have comments on the impact of the pandemic on regional variations?

Paul Johnson: I would add something brief to that. We know that the labour market that has been hardest hit by far is the London labour market. The rate of loss of jobs in London has been twice that of the rest of the UK, so there is not necessarily a one-for-one correlation with where the impact of the virus on health has been the biggest.

Q79 **Anthony Browne:** Do we know why that is? Is it because there is a more private-sector-led economy in London and it is the private sector that has taken the main hit?

Paul Johnson: Lots of jobs are in entertainment, tourism, retail and leisure. In a sense, it is the low-wage workers in London who have really taken a large part of the brunt of this. The health and economic impacts may be quite different. From what we can tell, if the long-term consequences of this are on those sorts of leisure, retail and hospitality jobs, there is not a negative or positive correlation between those areas that we generally think of as left behind and those that might lose those kinds of jobs.

There are some areas such as Blackpool, which is very much a left-behind place in that terminology and depends on a lot of those kinds of jobs, so there will be places that are both in the category of being particularly deprived to start with and are particularly hard hit economically. If, on the other hand, it turns out that, where the second wave has hit health particularly hard, there are long-term consequences of that, it looks like that would be more correlated with prior levels of deprivation.

Professor Chadha: What we are seeing is that, as Paul says, the bits of the economy that have been most obviously hit are those that require social interactions, and that has certainly hit many of the jobs in London.

Anthony Browne: That is hospitality in particular.

Professor Chadha: Exactly—hospitality, recreation and leisure. Where jobs will grow as we come out is very much in the high-productivity areas of IT, pharmaceuticals and finance. To the extent that London is well capitalised to benefit from growth in those areas, particularly as and when world demand takes off, these industries will likely do very well in the UK. That also means that those parts of the country that have access to those industries or that service those industries will also do well, but those parts of the country that do not, which goes back to Dr Sensier's point, will do badly and continue to suffer, unless we can provide links to them and provide the kinds of jobs and access to those high-value industries.

I am afraid that, even though it is very early days to try to work out which parts of the country have suffered more from the crisis, the country, as it comes out in recovery, will move more and more towards the sectors that have done well in the last couple of decades. That will further reveal the extent to which the regions that have been left behind will continue to be left behind, unless there are appropriate strategies for linking them up to these high-value sectors, wherever they may be in the country. That is a critical question for policy to consider.

Q80 **Anthony Browne:** I want to throw it forward to the Government's response to the regional variations and the levelling-up agenda. Last week, we had the review of the Green Book published. Just to state my own prejudices, I used to be in charge of economic development in London and I did the economic impact assessments for Crossrail. It was very easy for London to justify big infrastructure projects because we have such a vibrant economy. I have also been involved in European infrastructure projects and the approach was completely different at a European level. They look at the poorest parts of the EU and try to put all their funding there to develop them, whereas what happens in the UK is the richest parts of the country get most of the investment.

I was just wondering about this review of the Green Book and whether it will reduce the emphasis on the cost-benefit ratios to a more strategic approach and whether it will really make a big difference to the way the UK Government fund infrastructure projects in more deprived areas of the country. Again, Dr Sensier, you have done some analysis on this in particular.

Dr Sensier: My paper with Diane Coyle highlighted those differences across the north and south of the country for the benefit-cost ratios. The economic case is only one of the five cases that then make the full case, but it needed to be put in black and white in order to see that really large difference. As you have just admitted, the strategy since the 1980s has been that London is the powerhouse that is going to power the whole country and trickle down to the rest of the country. We showed in that paper that there is political bias.

Q81 **Anthony Browne:** That political bias is a separate issue from just relying on cost-benefit ratios that intrinsically reward investment in higher-productivity areas. You are saying that there is a second factor here.

Dr Sensier: I suppose that what I am saying is that the Ministers who were making decisions more recently were based around London, so that kind of political bias fed into the geographical bias. The Northern Rail upgrade scheme was cancelled in 2017 because of, according to the National Audit Office, procurement failures and delays. Projects got done a lot more quickly in London. I do not know if the capacity was just there to move them ahead.

In terms of what I have seen so far about the Green Book review, we are not going to know until it is used and see what comes out of that in a few months' time. The fact is that they are putting a lot more emphasis on the strategic case, and the Government have outlined their strategy of levelling up and net zero emissions by 2050. We have these two strategies whereby people can work in places across the country to work up their submissions based on those strategies.

There is going to be a lot more transparency. The Treasury has admitted that there is a lack of capacity in a lot of places for dealing with these settings, and it is setting up a users' network and training facilities, so there is going to be a lot more sharing of best practice. Places across the country are going to benefit from that, so I am really glad that the Government took it seriously. Let us see what is around the corner.

Q82 **Anthony Browne:** Paul, will the revision of the Green Book lead to a noticeable change in investment priorities for the Government, or is it window-dressing?

Paul Johnson: It is more of a signal of change than a cause of change. I am quite gratified in a way by all this focus on the Green Book, having been responsible for it when I was in the Treasury about 15 years ago.

Anthony Browne: You wrote the old Green Book.

Paul Johnson: At the time, it never felt as though everyone I was talking to around Government was poring over the Green Book every day to decide whether to invest in HS2 or Crossrail or what-have-you, and there has always been a very substantial judgment overlay on any of the analysis that goes into these sorts of things.

The most important thing here is that no one is ever going to agree on the basis of a cost-benefit analysis that, quite clearly here, has listed one to 100 of the projects that we should do, and then that it is just what we do. That happened to some extent within Departments, for example on roadbuilding decisions or what-have-you, but on the big decisions across Government, there is a very big judgment overlay on top of that. It is really important to be transparent about what that is, so it is useful to be transparent that there is an aim to move investment in another direction.

One thing I really want to add on this point about regional disparities is that we can get very focused on this issue of infrastructure investment and cost-benefit analyses. If there is one thing we know about differences in wages across the country, it is that they are driven by one thing more than anything else, which is differences in levels of education, skills and qualifications in different parts of the country, which, of course, may be driven by the opportunities that are available in terms of work. If we focus just on building stuff and not on educating the people living in those areas or doing things to attract educated people to those areas, I fear that we will not have the positive outcomes that we hope.

Q83 **Anthony Browne:** My second area of questions is about unemployment, which we touched on a bit earlier, and really looking at how we make sure that it does not turn into economic scarring, with short-term unemployment turning into long-term unemployment. First of all, on the assessment of how high the level of unemployment will be, we had the OBR report last week. Today, we find out that we have a vaccine coming a lot more quickly. The Resolution Foundation recently predicted that unemployment would rise a lot less this time round than after the global financial crisis a decade ago. I am interested in witnesses' views on how high unemployment is likely to go and whether it is not going to go as high as we have seen in previous recessions. You have been doing some work on this, Karen.

Karen Ward: Yes, absolutely. Broadly, I would say that I am relatively optimistic that we probably will, unfortunately, see a further rise in unemployment but it will be limited. As I say, I am more inclined towards the OBR's upside scenario, in which the unemployment rate peaks at 5.1%. We are at 4.8% today, so that is a relatively modest further upside here.

Q84 **Anthony Browne:** That is a very small increase compared to the scale of what we were braced for.

Karen Ward: Yes, exactly. That is also predicated on the extension to the furlough scheme really getting us to the point at which that vaccine provides us the scope to get back to full normality, but I would just reiterate my earlier comments in that I truly do not believe that there will be a fundamental reshape of our economy. People are desperate to get back to restaurants and to life as we knew it. Even on things like business travel, I am not even sure you will see significant changes there either. In terms of our whole service sector infrastructure and those many people who service that, those roles will come back, so I am optimistic.

The one thing that I would just caveat that with is my optimism is about those who have had roles remaining furloughed and going back to employment. The one segment that is not necessarily covered there is those school-leavers or education-leavers who have not reached that employment destination, and we need to be really vigilant that they do not get lost and that they are helped in their transition into employment, when they have had a year in which they have not been able to do that.

Q85 **Anthony Browne:** I am going to ask a question about that but in terms of the scale of unemployment, are the other witnesses as optimistic as Karen is?

Dr Sensier: No, I am afraid I am not as optimistic. If you look at the whole country, there are already persistently high rates of unemployment in parts of the north-east and the north-west, particularly in post-industrial areas that have had scarring over 30 or 40 years from job losses. This means a loss of opportunity in those areas and a loss of human capital. There is some work that has been done by Beatty and Fothergill, academics from Sheffield, who have estimated the number of hidden unemployed. They have also looked at how post-industrial towns recovered from the financial crisis, and they had much smaller employment growth than other parts of the UK—around 2%, when employment growth in London was about 7%.

The claimant count rate, even though not perfect, is quite a good signal to give you a more granular picture across the country. In certain parts, it is already one in 10. Middlesbrough is 10%, having increased about 4%. Blackpool is 11.3% and has almost doubled. Digging into London, Haringey is 10.7% and Barking & Dagenham is 10.1%. These have had even larger increases because of the loss of precarious, lower-wage jobs in the service industry that were immediately lost.

Q86 **Anthony Browne:** I want to focus on a point that Karen mentioned at the end about how you help make sure the newly unemployed and particularly those coming into the labour market for the first time do not end up long-term unemployed. That is what the Kickstart scheme that the Government announced is aimed at doing. 18-to-24-year-olds who have been unemployed for six months have their salary paid at the minimum wage for six months to encourage employers to give them a financial incentive to take on short-term unemployed people and make sure that they do not become long-term unemployed. Is this likely to be effective? Is it a good approach? It is different from other schemes but similar to the Future Jobs Fund that they had in the past.

Paul Johnson: I do not have a terribly strong view, to be honest. It looks like the Future Jobs Fund was reasonably effective and it does appear to have been modelled on that, so there is some good reason to think that this is a sensible design. The challenges are all around delivery and rollout, particularly at the moment, when demand for very cheap or virtually free labour is going to be pretty constrained in a large part of the economy, particularly in those parts of the economy where, very often, young people start their careers. We know that there has been a big shift towards young people starting their careers in some of those lower-paid occupations in the areas of personal services, leisure and hospitality.

The challenge is probably bigger than it was back in 2010 for young people coming into the labour market, because of the kind of shock there has been, at least at this particular moment. It may well be that this scheme becomes much more effective and, certainly, we will be working in a much more helpful environment after next spring or whenever we move back towards something like normality. I am afraid I do not know much about how it is going at the moment, but my guess is that it is going to be pretty hard to be running it this autumn and a lot easier to be running it in the second quarter of next year.

There are a lot of important issues here around apprenticeships. We have had a cohort that has a real problem getting into apprenticeships this year and there is going to be, therefore, additional competition for the next year or two to get into those sorts of roles. Again, Government can do things in the sorts of schemes they are running to encourage more of that, but there are constraints on how much it is possible to deliver. Getting the details of the scheme is going to be important but I am afraid I do not have anything deeper than that to add at this stage.

Q87 **Anthony Browne:** Professor Chadha, you talked earlier about the furlough scheme. That is the big scheme at the moment. It is for people who currently have jobs and about trying to protect those jobs. How can the Government best help those who are unemployed to get back into the labour market and make sure they do not stay long-term unemployed? We have the Kickstart scheme and the Restart scheme, which is traditional job training, as it were.

Professor Chadha: Listening to these excellent responses from my colleagues, there is something to just take away. There is this average notion of unemployment and I tend to agree with Karen on the extent to which the furlough scheme has helped shave off the upper numbers that we were looking at and that were very worrying earlier in the year. The potential for the vaccine to come in earlier than we might have suspected may help a lot, so that is exceptionally good news.

I am happy for that average but Marianne and Paul were both talking about some extreme variation around those outcomes. I pointed out earlier on that, in certain industries, in low-wage service sector bits of the economy and in parts of the country that have not only been terribly affected by this crisis but have been in industrial relative decline for a couple of decades now, we are seeing some very worrying unemployment numbers and, as I said right at the beginning, worrying numbers on destitution and homelessness.

There needs to be some thought at the very local and regional level on what can be done there. That goes back to the point about trying to create opportunities for the high-value industries that are very much operating—not solely in London and the south-east but very much so—to grow in other parts of the country and to create jobs for people there, which will prevent some of the worst outcomes that we are talking about here from occurring.

How we do that is going to require a connected-up industrial strategy, because it is not clear that someone siting bits of capital anywhere around the world would necessarily choose those parts of the country at the moment. It is a really critical question for us as to how we deal with that. That is where we should not allow—I am as guilty of this as anyone else—the average or aggregate numbers to mask what is considerable regional and spatial heterogeneity, as Marianne was talking about. To get it there, we need to understand that local firms create more confidence in the local areas, so that they are prepared to take on and retain people in those areas, so that the human capital that they have is retained in those regions.

The circularity of the country is just so often that it all gets dragged down to the south-east, which is something that we need to address if we are going to create these jobs for these people. I am not sure that we have those answers yet but I just wanted to draw a picture.

Anthony Browne: I totally accept that point and agree with you.

Q88 **Rushanara Ali:** Good afternoon. Just picking up on the point about unemployment, if you take a constituency like mine, in east London, what we see are rising levels of poverty on top of having the highest child poverty level in the country. To the point that Paul was making about the London labour market, in areas like mine, where we have a lot of people in the front line doing insecure work, they have just been hit very hard. This point about regional imbalances and inequality, and not just focusing on averages, is very well made.

I wanted to focus my questions on the impact of Covid on the economy but also on what the impact of no deal would be on top of that, if we end up with no deal or some sort of free trade agreement. Just kicking off with the first question, how does the impact from Covid compare with the impact of a no-deal scenario or of a typical, as the OBR framed it, free trade agreement with the European Union?

Paul Johnson: Very briefly, Covid has a far bigger effect in the short run—Brexit is not going to knock 20% off the economy next year—but probably a much smaller effect in the long run. The OBR's central scenario is that, four or five years out, Covid will knock 3% off the size of what the economy otherwise would be. Karen thinks that might be overly pessimistic. I am not sure about that but, even so, if that is right, it is considerably less than the long-run impact of Brexit, either with the fairly thin free trade agreement that we are looking at or a no-deal Brexit. The short answer is that Brexit has a bigger effect in the long run but Covid has a much bigger immediate effect.

Q89 **Rushanara Ali:** What would be the long-run effect in a no-deal scenario and with a thin free-trade agreement? If you had to put numbers on it, would you concur with the OBR numbers?

Paul Johnson: I defer to Karen and Jagjit, who do their own work on this, but yes, the OBR is well within the consensus of what most people who have worked on this believe.

Q90 **Rushanara Ali:** If you had to put numbers next to that in relation to unemployment in the long term, would you agree with the head of the OBR in terms of the potential number of up to a million in a no-deal scenario? What might the figures be with a thin free trade agreement? Would you be able to put some numbers next to unemployment?

Paul Johnson: If we are looking ahead a decade or more, the long-term effects of these kinds of policies are not in unemployment rates but in lower productivity and lower wages. The unemployment will come in the short run, as the economy adapts. Thinking about the regional impact or the sorts of people who are likely to be affected, particularly in a no-deal scenario, that is likely to have a particularly negative effect on various aspects of manufacturing and on quite a lot of people in areas like the west midlands, certainly Northern Ireland and the north-east, and often men with mid-level qualifications in those areas. We know from history that the impact of unemployment there can be quite long-run but, in the longer run, the main impact would come on a restructuring of the economy and probably lower wages.

It is also worth saying that there is a real issue around how this will impact services. The UK is more dependent on services exports than any other country in the world, or at least any that are not a tiny island. Services exports are clearly very much helped by the way that the single market works and, without the sorts of mutual recognition and so on, it could have a significant negative impact. That is much harder to know and much harder to model than the impact on manufacturing.

The long-term consequences for the structure of the economy, and particularly for some of our more productive sectors, could be quite significant, but one should think about it in terms of average living standards and wages rather than unemployment in the long run, although you can certainly think about unemployment as a big short-run impact.

Q91 **Rushanara Ali:** According to the OBR, unemployment is set to peak at 8.3% in a no-deal scenario. Would you agree with that?

Paul Johnson: We do not do our own modelling of that but that is probably a pretty consensus sort of figure.

Karen Ward: I agree with a lot of what Paul said, certainly in terms of the timing in which we would feel the effects, and that is because, in my view, the Covid shock is largely a demand-side shock and the no-deal scenario is largely a supply-side shock. The implication of that is that it is much harder to offset with policy. We have talked a lot about some of the things we have managed to do to cope with and assist the economy through Covid.

It is not as obvious, because the main damage that happens through no deal is via investment. We have already seen, since the referendum, that investment in the UK has stagnated. Compare that to Italy, Japan, the US, Germany and France, all of which have been double-digit; in fact, it is up 20% in France and 15% in the US, during a time in which the UK has stagnated, just to flesh out some of the numbers on the point that Paul made about investment. It is very hard to get people investing when they are just not certain about their opportunities and their demand outlook. We do not necessarily have policy levers to counter them.

In terms of the specific numbers, I have been through all of the assumptions that the OBR made in its projections and they all look reasonable to me. Perhaps there is one where I would be slightly more pessimistic: it has a 5% decline in sterling in the event of no deal, but I would suggest that it is going to be significantly larger than that and more like 10% or more. That can, in some ways, help the economy to adjust in the long run but, in the very near term, through rising import prices, it would be real problem for consumer spending at a time when incomes are weak. It has 4% off long-term GDP and, as you say, that near-term rise in unemployment. Because my Covid scenario is lower, but with the increment in terms of what it is adding on from its Covid scenario and adding on no deal, those numbers look reasonable and balanced to me.

Professor Chadha: From an academic point of view, it is incredibly interesting to look at the Covid shock and the Brexit shock, and the sense in which they are filling the gap that the other one is not hitting. Covid is a short-run shock, as Paul and Karen have said, of an extreme nature. In all the modelling that we have done and we have been reading in the last four years, the Brexit shock is something that affects the long run. We have a given structure of the UK economy that is endogenous to the trading structure that we have with the European Union. Just as we were talking about the labour market earlier on, changing to the new structure takes time. I am not saying that it is something that will be devastating to the economy, but moving and shifting those resources to a new set of structures will take time and impose some costs.

We have short-run and long-run shock—Covid and Brexit—but we also have Covid and Brexit hitting different parts of the economy. In comical circles, they have been calling Brexit the Heineken shock, because it hits the parts of the economy that Covid cannot. It is affecting manufacturing, finance and retail, and many of these areas—certainly online retail—have done reasonably well in this process. Overall, there is another shock coming along that is affecting the economy.

The way to think about this is not in terms of growth rates. Paul is right, and I do not want to get into unemployment. I simply want to say that, compared to the level of activity we might have anticipated the economy having in, say, four or five years, each of these shocks look likely to remove something between 2% and 4% off the economy compared to where we otherwise would have been, in the absence of further policy interventions. It is huge. Taking both together, on average they are going to reduce income by something like 5% to 8%.

Q92 **Rushanara Ali:** Just to wrap up, one of those—Covid—happened to us, and the other is a political choice. Given that we are not yet clear whether or not we are going to get a deal and, even if we do, it will knock percentages off GDP, is there a case for not imposing another shock on the population, given that we have just had this Covid shock, and seeking an extension if we cannot secure a deal? Yes or no, Professor?

Professor Chadha: I do not have to reply yes or no. Brexit is a political choice. It is also a choice of the British people. If we were in an economic model only and not responding to the political directives we have been given—a number of elections and referenda have gone a particular way—clearly, deciding not to do something that materially affects people's prosperity might be a good thing to do. That said, those results are very much dependent upon the given structure of the economy. With a different form of assumptions, you may well get some longer-run benefits from Brexit.

Dr Sensier: There has been academic research on the effect of Brexit on regions. Essentially, it says that the regions that are more heavily reliant on manufacturing will have the greatest hit to their GDP, particularly because they rely on supply chains running backwards and forwards across Europe. You are looking at pockets of the north-west, the north-east and the midlands that are heavily reliant on those manufacturing industries. As Jagjit just said, it will work against Covid. Maybe those sectors have been working through Covid but the hit from Brexit will make things worse.

What this Government are doing to agriculture is quite worrying. We all realised how important food was in this crisis and, if we are really going to start threatening the supply and security of food in this country, damaging the income of farmers who we want to look after our land and to help with flood defences and other important things like that, we need to really respect their rights and wishes. Fishermen, agriculture and farmers should be right at the middle of the policymaking process going forward.

The other thing that I would say is that, if the forecast for unemployment is 8%, it is going to be very different and much higher in those regions that rely on manufacturing, if there is a bad deal for those areas and that trade, because the jobs will go to eastern Europe; the jobs will go where it is easier to trade and manufacture.

Rushanara Ali: It does not bear thinking about. Thank you very much.

Q93 **Ms Eagle:** Dr Sensier, what will be the regional impact of the public sector pay freeze?

Dr Sensier: The Resolution Foundation has done some work on this in its analysis of the spending review, so I am borrowing from that. It looked at public sector jobs excluding human health activities. First of all, women are going to be worst hit because 15% more women work in public services. Across the country, Wales has the largest share of public sector workers, so it will be hit more strongly, along with Scotland and Northern Ireland, with the north-east, the west and London having a 14% share of public sector jobs. Wales has an 18% share. The region with the smallest number is the east of England, with a 10% share. It is going to have a stronger regional impact.

I would say that it is important to increase the minimum wage. The national living wage is going up and that is an increase but, in terms of people who earn below £24,000, there is only a 1% increase. In terms of the CPI numbers given by the OBR projection, it says inflation should be 1.3%, so that is a real-term cut in the numbers there.

Q94 **Ms Eagle:** The Chancellor's reasoning about this is that, somehow, the private sector has been worse hit and the public sector has security of tenure. Given the pay freezes that have happened in the last 10 years, was his argument acceptable?

Dr Sensier: The IFS has a study on this, so maybe Paul will comment on that. There is a narrowing of the gap between public and private sector wages, but what I would say is that these public sector jobs are really important for local areas because, in a lot of places, they pay the highest wages in those areas and really hold up local economies. They are the multiplier and the lifeblood of those economies, and the anchor institutions. When you start cutting them, you are essentially cutting back on the regions and widening the inequalities that we see in society.

Q95 **Ms Eagle:** Paul Johnson, you have done a little bit of work to compare the two sectors. What has it shown you with respect to the relative differences between the public and private sector in the last 10 years?

Paul Johnson: There are a number of things that are relevant here. In very broad terms, we know that there are differences between the public and private sector, in the sense that lower-paid people in the public sector are paid better than lower-paid people in the private sector, and higher-paid people in the public sector are paid worse than higher-paid people in the private sector.

One of the curiosities from an economic point of view, though I completely understand the decision, which repeats the decisions that were made in the 2010s, where things are made better for lower-paid public sector workers and worse for higher-paid ones, is that the gap between the public and private sector increases. It will also, I fear, result in longer-run problems in things like the recruitment of teachers and graduates into the public sector, particularly in areas like London and the south-east, where there are significant gaps in a negative direction between the public and private sector at that graduate end of the labour market.

If you look at the period since 2010, you have an immediate period, which you often get with recessions, where the public sector was doing a lot better than the private sector, because there was a two or three-year period when public sector wages were rising quite quickly and private-sector wages were not. We have then had seven or eight years of retrenchment where, two or three years ago, you have got back to the point where the public sector went below where it was pre-2008 in terms of earnings relative to the private sector.

That analysis does not take account of what is an increasing gap in favour of the public sector when it comes to pensions, because there are essentially no longer any pensions in the private sector of a defined-benefit variety. It is quite a complex pattern and what worries me about the sort of announcement that we got last week is that it is a sledgehammer kind of response to a very complex question, and one that I am not sure addresses the underlying issues in the public sector labour market.

Q96 **Ms Eagle:** Can I ask you about something that the Chancellor did not announce but that some of us were hoping he would? That is the lack of an announcement to extend the increase in universal credit payments or the local housing allowance, which is funded only up until the end of the financial year in March. Have you done an analysis on what that will mean for some of the poorer members of society?

Paul Johnson: I believe there was an announcement on the local housing allowance. That has been announced to now be frozen going forward at the thirtieth percentile of current rents, which, in a sense, repeats the error of seven or eight years ago, where you freeze the benefit at a particular moment in time and then get these disparities between regions, according to how quickly rents grow in those different regions.

On the costings, this still leaves the system more generous five years hence than it was last year, but clearly, if, as will be legislated, the squeeze carries on forever, it will eventually become less generous. That avoids immediate cash cuts while returning, in a sense, the system to one that is similar to what we had before but, as I say, repeats previous errors, in my view, in terms of design.

Clearly, the bigger sum of money is associated with the temporary £20-a-week increase to universal credit. That represented, certainly for childless people out of work, much the biggest increase of the last 50 years in the generosity of those benefits. If you take all of the changes over the last 50 years, that one change is bigger than all of those put together for childless people out of work, but it remains the case that, for that group, our system is pretty ungenerous relative to certainly most continental European countries.

All of that said, there was a clear statement when this was introduced that this would be a temporary increase while the labour market was in a difficult position. You might think that the labour market will still be in a difficult position come next April, so you might think that there is at least a case for extending it that long, but I can certainly see the point of view that says, "This was done as a temporary measure. It costs £6 billion or £7 billion a year. If we end up making every temporary measure permanent, we are going to be really quite scared about doing temporary measures in the future that we need to do to support people over a period of time".

Q97 **Ms Eagle:** Dr Sensier, is there a regional aspect to that as well?

Dr Sensier: I suppose it will go along with the claimant count, in that you will have greater numbers of people in the areas with less opportunity claiming universal credit, so you will have higher concentrations in areas where you have pockets of deprivation and less opportunity going forward. I have not looked at that specifically, but the Social Mobility Commission did a really good report that, essentially, looked at opportunity across England. It also looked at education and said, "You cannot close this gap just with education. There is this glaring lack of opportunity across the country". It is not just rural versus city; it is everywhere, and in London as well.

Q98 **Ms Eagle:** Finally, Paul, what about the difference in treatment and support between those who are homeowners with mortgages and the increasing number of people who rely on rent?

Paul Johnson: Are you referring to the possibility of mortgage holidays as opposed to rent holidays?

Q99 **Ms Eagle:** Yes, mortgage holidays for those who own as well as the moratorium on being evicted if you are a renter, which may or may not be extended. What are the economic implications?

Paul Johnson: We know that there are far more renters than there were 10 or 20 years ago and they are, on average, significantly worse than off than mortgagors. If you were looking to design a policy that was beneficial for those in the most straitened or concerning financial circumstances, you would certainly want to make sure that you were supporting renters at least as much as you are people with mortgages.

Q100 **Mike Hill:** My three questions in this section are going to be directed at

Dr Sensier. It is quite appropriate that you are in Manchester, the home of the original industrial revolution, because we are going to talk about the green industrial revolution and green investment, if we may. The recent spending review has prioritised the green industrial revolution and has funded the Prime Minister's 10-point plan to the tune of £12 billion. Is that enough to kickstart a green recovery and will it support the promised 250,000 jobs?

Dr Sensier: No, it is not enough. If you compare us with what Germany and France have already invested, Germany is investing €40 billion and France €30 billion on ecological transition. Also, if you look back to the global financial crisis and at how much Obama invested in green technology then, you will see that there was a much bigger multiplier from that green investment then. Now is the right time to invest. Remember that if we grow our GDP, it shrinks the size of our debt, because the debt is being talked about as a share of GDP. A lot more investment needs to happen.

Q101 **Mike Hill:** Is it enough to give it a kickstart?

Dr Sensier: As long as it is targeted. In particular areas, it has been increasing the amount into research and development and into the green homes deal. Although I work in Manchester, I am based in west Cumbria, which is an area that relies quite heavily on the nuclear sector. There has been a commitment to invest in research and development of the technologies in small modular and advanced modular reactors, to replace the really large nuclear builds. If you look at the sums committed by Government, they are very small and are not going to turbocharge any kind of change. We are in competition here with Canada. Who is going to reach that first? With Brexit, we need to have tradable solutions that can be used across the world, so you really need to start investing heavily into those areas.

Q102 **Mike Hill:** That is quite an interesting sub-answer. I have to declare I am the co-chair of the APPG on Nuclear Energy. One of my questions was about capital investment in projects like new nuclear, as they call it, and SMRs. I will not ask that question because you have already answered it.

The long-awaited national infrastructure strategy is now out. It prioritises decarbonisation and sets out measures to achieve this by 2050. Do you have a view as to whether the strategy simultaneously achieves the Government's levelling-up and decarbonisation agenda?

Dr Sensier: The schemes that they have announced so far are in the regions of the country that are desperate for investment, such as Teesside, with carbon capture and storage. I know that there is a large commitment to wind power, with the large Siemens factory in Hull and strategically placed factories across the UK.

A colleague of mine at the University of Manchester, Richard Jones, has written a blog about this and said that what they are committing to in terms of renewables is not going to fill the gap that is needed in the future, when the older industrial nuclear power plants go offline. There is going to have to be some commitment probably to more large nuclear new build, and maybe the national infrastructure bank, which has been announced in the strategy, will help fill that funding gap, because the main problem has been Government not wanting to take on too much financing for those projects. Hopefully, that will be a longer-term solution.

Q103 **Mike Hill:** There are some big ideas but they need stimulus and focus in those relevant areas. As you talk about that bank, it is noted that it is going to be sited in the north of England, interestingly. Are you hopeful that it will bring investment into green technologies and green infrastructure?

Dr Sensier: Just locating a bank like that and the infrastructure outside of London will help move jobs into a city or the regions outside of a city that really need that investment and will bring those higher-paid jobs into the region. Having people living in those areas—and they have also talked about the Treasury team moving to the north-east—will give them a better scale of the challenges and of the investment that is seriously needed to overcome these problems. That is definitely a move in the right direction. I would also recommend looking at smaller-scale finance. The Government are possibly backing regional banks, and the community finance structure needs to be looked at in the round.

Q104 **Mike Hill:** Do you think, believe or hope that such a bank or banks would stimulate and support regional growth in a positive way?

Dr Sensier: Yes, because, as the Government have signalled their commitment to levelling up and net zero, we assume that these projects will now pass the Green Book stage. Various funds have been available in the north. The British Business Bank has set up the northern powerhouse fund, which has been distributed throughout the north. When you look at the other British Business Bank funds, they are mostly concentrated in London and the south-east, as is a lot of venture capital funding. Just having the location of the bank there, with the projects on the doorstep, will definitely help.

Q105 **Mike Hill:** I am one of the Tees Valley MP so I hope that all that you are saying is correct there. Maybe this is an impossible question, but do you realistically think that the activities of such a bank could plug the gap left behind by the European Investment Bank?

Dr Sensier: It is not just working on its own, because the shared prosperity fund and the levelling-up funds together will, hopefully, help with the strategy. I have no idea how much they are going to capitalise that bank, and I assume that it will also need private sector involvement to access those funds. I really hope that it is going to be a step-change, because we really cannot go on with these regional divides. I grew up in the south-east. My first job involved commuting into London, so I have seen the differences in this country and how these differences have changed over time. Now when I go back to London, I just cannot believe how crowded, congested and polluted it is. I just feel that we have reached a tipping point in this country, where you cannot keep investing in places that are, essentially, not good for humankind. You need to spread out these opportunities across the country.

The national infrastructure bank and the levelling-up fund are a start. We do not know exactly how much money the shared prosperity fund will have. None of these funds go anywhere near replacing the regional development agency funding, which, up to about 2010, was £2 billion a year. Under austerity, it was reduced to £500 million a year. The investment then was very targeted towards city deals, and regions outside of cities did not really get much support at all. Moving to the LEP system meant that there was a lot less capacity within smaller regions to apply for such funds, so I am slightly worried about the competitive nature of the process that has been introduced.

With the levelling-up fund, smaller regions may not do as well from that fund, because they do not have the capacity to apply for funds. I really hope that the specific projects—carbon capture and storage and these things that have been earmarked in the national infrastructure strategy—will go ahead and that the national infrastructure bank will allow that to happen.

Professor Chadha: I just wanted to come in very briefly. The previous questions from Angela were about the response to the public sector. The Covid shock has been dealt with very much, by and large, by the public sector—the health and education sectors. The immediate response, as Paul Johnson was saying, is to try to respond to that by sending a signal in a very complex moment that we are not valuing the public sector by limiting the pay rises. The reason I have started with that point is that what we need is a consistent policy. If we value the public sector, we need to think about the wage structures there to attract people into the public sector.

If we go back to the question of investment, we have known for a long time that real investment in the UK has been low relative to our main trading partners, and possibly something in the region of 5% of GDP per year over a very long period. One of the main drivers of that low level of investment is a lack of confidence in the future and a high level of uncertainty in firms not only in the prospect of revenues but whether they can raise money consistently as they expand. That is a problem that has hit SMEs and larger companies, and it hits people outside of the south-east in particular.

Therefore, I am encouraged to hear about the national infrastructure bank and some of the plans we are talking about, but there is very little information or detail at the moment. The European Investment Bank has given the UK something like £120 billion in its existence, which is a large amount of money compared to any of the numbers that I have heard being kicked around for the national infrastructure bank or anything else. There are two aspects: one is the size and one is the consistency with which we need financing of these projects at the small and medium-sized enterprise level and at the larger level. It cannot be something subject to the vacillations of policy, where we suddenly decide to pinch against it a couple of years down the line because political circumstances have changed.

Again, it goes back to my point across this afternoon that we need a consistent framework, so that those planning know that these funds will be available in significant magnitudes and quantities across the country, year after year. I am afraid that there is just not enough detail at the moment for me to say that that is going to be the case. I would like it to be the case but I am not sure that we can say it will be.

Q106 **Felicity Buchan:** Good afternoon, everyone. My questions are on monetary policy. Let me start with Karen. The Bank of England has said that it is contemplating whether negative interest rates could make sense for the UK. What do you think?

Karen Ward: Let me start by outlining what the potential pros and cons of such a policy are. On the negative side, the question really is about the ability of commercial banks to pass on negative interest rates, because households have the option to take their money out of those commercial banks and, therefore, there is a risk that, by imposing negative interest rates, you dampen bank profitability and their ability to extend loans. That is one of the concerns with negative interest rates.

The other concern is confidence. I am sure you have been having conversations with your constituents about what this means in terms of how they can be being charged on their savings, so it is not necessarily clear that it would boost confidence.

Turning to the potential positives side, it is very good for borrowing costs. We have talked about high levels of debt and how, if the central bank can maintain those interest rates at low levels, it will really help ease many of the conversations we are having about the need for austerity. Taking interest rates into negative territory would help those Government interest-servicing costs even further. If we look to Germany, for example, even on 30-year debt, Germany has a negative interest rate. In fact, European companies also have a negative interest rate, so easing the burden of all this debt we have created would be a benefit. It could also potentially put downward pressure on the currency, which would potentially help with exports.

Those are the relative pros and cons. Where do I sit? At the moment, it is not obvious that that is the direction of travel that is necessary or required, but the Bank of England is doing the right thing with a full analysis and review of what those relative pros and cons are, particularly how it would work via the commercial banks, and keeping it in its toolkit.

Q107 **Felicity Buchan:** What has been the international experience of negative base rates?

Karen Ward: Europe is the main area where we have had negative interest rates for quite some time. If we look again through those pros and cons, the concern has been about whether it has helped or hindered the banking system to support the economy. The evidence is that it probably has not done too much harm. In terms of borrowing costs for Governments and for companies, the experience is that it has worked tremendously well. Germany came into this Covid crisis with very low levels of debt by international comparisons. Part of that was its management of public finances but I would say that more acute is the massive decline in its interest payments because of these negative interest rates. I would say that the European experience certainly suggests that there can be relative positive effects.

Q108 **Felicity Buchan:** Jagjit, can I bring you in with the same question? What do you think of negative interest rates?

Professor Chadha: I do not have that much to add to Karen. On the margin, they look as though they are helpful, and the European experience suggests that they are. We have to remember that many European countries do not have the flexibility and fiscal policy that we have here. Many of them are, in a sense, up against their debt constraints in a way that we are not, so the negative interest rates may have helped them and may have been needed more than they are here.

They will not be a silver bullet. By themselves, they will not cure the economy of its problems. As I think we are all agreed, the current shock that we are living through is one that is best cured by a vaccine and, failing that, a better approach to dealing with the virus and targeted interventions rather than, necessarily, negative interest rates. It is something to think about having in the toolkit. We do not have it in the toolkit now but it would be of some marginal help. I do not envisage a world in which we go to a negative 7% interest rate; it might be up to negative 1%.

Karen talked about a review. I would like that review to be very open, with a discussion whereby the costs and benefits or pros and cons are laid out in a way that there can be a debate and an argument before any decisions are made on negative interest rates. The big concern, of course, is for the financial sector and whether negative interest rates damage the stability of the financial sector, because it no longer has any margin to pass to depositors, and whether that would, in any way, cause some issues for their funding through their deposit base. That is the biggest concern that I have with negative interest rates.

Q109 **Felicity Buchan:** Let me stay with you but change the focus and move to forward guidance. The Bank of England has changed the nuancing in terms of the 2% inflation target. What are your thoughts on that? Secondly, the US Federal Reserve has an employment target plus an inflation target. Given the Chancellor's focus on jobs, should we also be introducing a focus on unemployment?

Professor Chadha: There is always a trade-off between output volatility and inflation. In effect, we have been following a flexible inflation-targeting regime for a very long time. What I mean by that is that we do not try to hit the 2% target at every point in time. We are allowed to move to it over some time horizon, in a flexible manner. We have had a number of occasions where the exchange rate has fallen rapidly and inflation has gone up, and we have not immediately raised bank rate to try to bring inflation down to target. If we had had to do that, output would have fallen and created volatility in output and, therefore, employment and unemployment in a way that we did not want to see.

It is much more preferable to maintain an approach of flexible inflation targeting, which is really what the Fed has with its price-level target, simply saying that, over the long run, average inflation will be 2%, which means that there are periods in which it will be over 2% and periods in which it will be under 2%. That will help stabilise the price level because, if you had a period of undershoot, you have immediately informed people that you were going to allow a period of overshoot to get back to your average inflation level, and that period of overshoot is, by itself, a loosening of monetary conditions. That makes a lot of sense.

If you then say you further want an explicit trade-off, so that, if inflation was high and unemployment was also high, as would happen under a supply shock, you are then asking the central bank to choose immediately between the two, and that is a problem. That is not really what the central bank is about. The central bank is about trying to stabilise nominal quantities and price stability, financial stability and monetary stability. Employment will go where it is as a function of firms' choices, the labour markets that we have, and global and domestic trends in activity, demand and productivity. It is not something that is ultimately under the central bank's control.

We should not be setting objectives for the central bank that are, essentially, outside of its control. What is in its control is inflation and price stability, and that is a much more sensible way to proceed. You can deal with any fluctuations in real quantities simply by allowing the central bank more time to hits its objective, which is, essentially, what a price-level target or a flexible inflation target does.

Karen Ward: It is essential right now that the Government do not change any element of the central bank's mandate. We talked about the extraordinary capacity of the Bank of England to absorb all the Government debt issuance this year. The reason that international investors continued to invest in the gilt market through that whole period was because it was seen to be the central bank acting independently, in a sensible manner, given an inflation target. The second the Government start to change the goalposts and imply that the central bank should aim for something a little higher, we could cause some ructions that I would not like to see. They would certainly give me a very interesting day. I just wanted to get that note on the record.

Q110 **Felicity Buchan:** Karen, let me stay with you, since my next question is about Bank of England activity. We had the decision for an extra £150 billion of QE. Especially in light of the very positive news on the vaccine and the fact that there is an argument that QE is less effective now, given the low level of interest rates, clearly it was very important back in March, in particular because of the market dislocation, but we do not have that market dislocation now. Is £150 billion of QE potentially too much?

Karen Ward: Although we have the vaccine and that light at the end of the tunnel, we still have a difficult winter ahead and we know that, with ongoing restrictions, it was clear that the Government were going to need additional issuance. Therefore, in terms of that backstop for the gilt market, it was important to signal that they would still be there through these difficult winter months. In terms of whether it needed to be £150 billion versus £100 billion, perhaps not, but its impetus to act and a demonstration that it would continue with the Government to provide the stimulus necessary through the winter months was appropriate.

Q111 **Felicity Buchan:** Let me bring in Jagjit on QE. Is there a limit to how much QE we can do? We are clearly now up to a programme of £875 billion. Can we just go on and on?

Professor Chadha: It is a concern. At the moment, we are not far off 30% of GDP in terms of QE, and possibly larger. It is certainly something that is potentially structurally affecting the bond market. This is now a world in which there may be good reasons for it, because we have a credible monetary regime, but there may also be bad reasons in that we do want risk, in a sense, to be priced if a country is becoming riskier. In the short run, if the central bank is absorbing all the debt, we may not see risk being priced in the economy in the way that we would like to see. That is not an immediate concern but there are some limits out there.

The extent to which bond markets now automatically expect QE to be carried out as soon as there is a negative shock is something to watch and monitor. It is an emergent issue. Nobody wants this level of QE to be in place permanently, and so, at some point, the Bank of England's MPC will have to reduce its exposure to QE. Certainly, to the extent that it may have done, or offered to do, too much in the last month or so, it can always unwind that, and it should be more prepared to make statements that it will aim to reduce the level of QE over time, and to what level, given the conditions in the economy.

In the same way as we had a different set of forecasts from the OBR, with the optimistic, central and pessimistic cases, the MPC could give more forward guidance as to the level of bonds it will hold under these different scenarios, providing some guidance to bond markets that it does intend to reduce the stock of debt that it holds and that it is not a permanent holding, which it should never be.

Q112 **Felicity Buchan:** Let me move to Paul, with a non-monetary-policy question. We clearly have very high levels of corporate debt out there, partly as a result of a lot of the schemes—CBILS and the bounce back loan scheme. Are you concerned that this may affect business investment going forward and, therefore, prolong the recession? As a follow-up question, TheCityUK has said that quite a bit of this debt may have to be recapitalised. Does the private sector have the capital to do that?

Paul Johnson: It is crucial to recognise that this is very different by different business. There are some businesses with a lot of debt and some with large amounts of cash and that have done really quite well over the last period. It is important to look at the macro numbers but it is also important to be aware of the fact that there is a big distribution between companies. One of the risks that this crisis creates is that some of those strong companies will stay and some of those weak companies will go, and we will have a change in market composition and market power, with quite a big effect on the structure of the economy for at least a period.

The second thing to say is that there are other things crowding out investment. We have had lots of firms putting lots of investment into making their places Covid-secure, and the level of uncertainty is reducing investment. There are a lot of things that have reduced investment, on top of uncertainty around Brexit over the last few years, so we really do want to do everything we can to avoid any further headwinds against companies investing and, indeed, against things like FDI.

On the extent to which the sorts of outstanding debts associated with Government support are going to create problems in that dimension, I am afraid I do not know. That is not something that we have looked at directly but it should be clearly on the Government's radar. It may well be that Karen has more to say on that than I do.

Karen Ward: It is not something that I have done specific analysis on. I could certainly look into it in further detail and write to you, if you would find that useful.

Felicity Buchan: That is okay. We have taken quite a lot of evidence on corporate debt, but thank you for the offer.

Chair: That brings us to the end of this session, so could I thank our four witnesses very much indeed? The sheer depth of knowledge and expertise that you all have is striking, and it is really valuable for this Committee to be able to tap into that and into the insights that you have. As regards the OBR forecasts and what might happen in the future, it is not surprising that there is a reticence amongst you to speculate as to what may now happen over the coming months and years, but Karen did stick her neck out just a little bit when she said that we might end up at the more optimistic end of the scale, which, incidentally, for what it is worth, is broadly where I think we might end up as well, but who knows? Let us hope so, because I think we are all ready to go out and have dinner with our friends, invite people back into our homes and put up with, once again, queuing up at the bar for an inordinate amount of time in order to get a drink. I just cannot wait for that to happen.

Professor Chadha: You do not queue up at the House of Commons, do you?

Chair: I do not but I am sure there are some who do. Once again, thank you so much. It has been an excellent session and it has been great to have you with us again. That now concludes this inquiry session.