

Treasury Committee

Oral evidence: Budget 2024, HC 625

Tuesday 12 March 2024

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Members present: Harriett Baldwin (Chair); Dr Thérèse Coffey; Dame Angela Eagle; Stephen Hammond; Drew Hendry; Danny Kruger; Keir Mather; Dame Siobhain McDonagh; Anne Marie Morris.

Questions 1-114

Witnesses

I: Richard Hughes, Chair, Office for Budget Responsibility; Professor David Miles CBE, Budget Responsibility Committee; Tom Josephs, Budget Responsibility Committee.

Examination of witnesses

Witnesses: Richard Hughes, Professor David Miles and Tom Josephs.

Q1 **Chair:** Welcome to this morning's session on last week's Budget. This is the first of three sittings that the Treasury Committee will hold to scrutinise the Budget. We have a panel of economists this afternoon and the Chancellor tomorrow, but this morning, we have you all to give evidence. I will start by asking you to introduce yourselves.

Richard Hughes: I am Richard Hughes, chair of the Office for Budget Responsibility.

Professor Miles: I am David Miles, head of economic analysis at the OBR.

Tom Josephs: I am Tom Josephs; I lead on the fiscal analysis at the OBR.

Q2 **Chair:** Thank you. An obvious first question: you are the Office for Budget Responsibility; is this a responsible Budget?

Richard Hughes: It was responsible in terms of the objectives that the Chancellor has set himself, which is, in five years' time, to get debt to begin to fall as a share of GDP. However, it does that with one of the narrowest margins that any Chancellor has had against his fiscal target. It is the second narrowest margin at just £9 billion. The smallest one was the one in the Budget this time last year.

So it is meeting the Chancellor's fiscal objective, but only just, and there are significant risks to the fiscal outlook weighing on that margin, not least



HOUSE OF COMMONS

the ones that we think are very likely to crystallise, such as fuel duty being frozen rather than indexed. This Committee has said to us to look through that policy assumption and provide some alternatives that assume that fuel duty is frozen. Even that, were it to happen, would cut that margin in half, down to about £4.5 billion.

On top of that, there are risks to the macroeconomic outlook, not least the path of productivity, and also interest rates and inflation, as well as other risks within the fiscal forecast from various policy assumptions on which the Government are relying.

- Q3 **Chair:** Obviously, there are always going to be general risks, but what you are flagging is the fact that the fuel duty is now assumed to have only been extended for one year, in your numbers—because you have to take that as given—and then, from the end of that period, at the end of next March, you have fuel duty reverting to an increase. David, did you think this was a responsible Budget?

Professor Miles: Well, I think that the Chancellor faced a difficult set of choices. There were no easy answers. To try and get the stock of debt first levelling off and then falling just a little bit meant that the size of the fiscal deficit needed to come down by about 3% of GDP, and that was achieved through, on balance, a combination of taxes continuing to rise between now and 2028-29 by another 1% of GDP—so the overall tax burden goes up a little bit and Government spending, public spending, falls by about 2% of GDP. Both those things are, in a sense, unwelcome. You wouldn't want to have to do that, but that is pretty much the only way that you could stop debt carrying on going up and up.

- Q4 **Chair:** Of course, that is the big change over the last year—just how much higher the interest bill is on the outstanding Government debt. Tom, you will have seen that we as a Committee published a report on quantitative tightening, and obviously the fiscal rule that you are asked to meet is debt falling, excluding the Bank of England debt. Do you think that that adds a lot of risk and potentially further uncertainty, in terms of your forecasts?

Tom Josephs: It certainly does. Interest rates have been extremely volatile over the recent past, and that has led to a lot of movement in our fiscal forecast. We produced some analysis to show just how sensitive the public finances are now to interest rates. On the APF in particular, we have produced some more sensitivity analysis on the—

- Q5 **Chair:** Is this the Bank of England asset purchase facility?

Tom Josephs: Yes. We have produced some more analysis on the basis of the discussion that we had last time we met you. That shows that, on our latest estimate, the net loss from the APF would be about £100 billion over the course of its lifetime, but that is very sensitive to interest rates. We have done some sensitivity analysis that shows that if interest rates were 1% higher or lower, that would reduce or increase the losses by around £50 billion. So the public finances are certainly now very sensitive.



HOUSE OF COMMONS

Q6 **Chair:** They are very sensitive to interest rates, yes.

Tom Josephs: One point to add is that as the APF unwinds, as it does in our forecast, that sensitivity to short-term interest rate movements does decline. We have some analysis that shows that if the APF continues on its current path, the average maturity of UK debt rises from, I think, around one year now up to around seven years, which is roughly where it was before the APF. So that sensitivity does decline as the APF unwinds.

Q7 **Chair:** Moving to the fact that the Government has issued a lot of index-linked gilts over the years, obviously what happens with them is that they do not pay the coupon, but they pay a bigger principal at maturity, so you get an enormous line item. There are economists who have said that you can just kind of ignore that, and that you shouldn't really be concerned about those accruals while they are happening—you should just worry about them when they come to their end, and, anyway, you will be able to refinance them. Is that a good way to do things responsibly?

Tom Josephs: This is a genuine cost. It is a genuine increase in the cost of index-linked gilts. The way the accounting deals with that is to show the impact on borrowing of changes in RPI up front, so that it is factored into the borrowing position when those changes in RPI happen, rather than pushing them out into the future.

Q8 **Chair:** Okay. Does anyone else want to add anything on those points?

Richard Hughes: One of the reasons why I think the UK has felt the fiscal pain of high inflation and rising interest rates more than other countries has been down to the fact that we see the immediate hit from higher inflation on the index-linked portfolio, as well as the shorter average maturity of our debt, because we are so transparent about the way in which we account for those interest rate costs.

One of the reasons why other countries have been slower to consolidate their public finances in the post-pandemic period is because they recognise fewer of those interest rate costs up front but leave more of them down the road to have to deal with.

Q9 **Chair:** Can I ask about the welfare cap? Parliament has legislated for a welfare cap. I think you said that the last three times you have looked at it, the Government have missed it. Do you think it should be dropped? When you are going over your numbers, do you spend a lot of time going over the welfare cap? Is it something that consumes a lot of your resources?

Tom Josephs: It is for the Government to decide on what its fiscal rules are, and currently, the welfare cap is part of that set of rules. It is the case, as you say, that it has been missed in the past two or three forecasts. It is also the case that the way the rule is structured means that it is only formally assessed in the first Budget of a new Parliament. In between times, we are asked to monitor performance against the rule and then the formal assessment is at that point. It is at that point that, if the cap were still being missed, the Secretary of State for the Department for



HOUSE OF COMMONS

Work and Pensions would need to come to the House and explain whether the Government was going to take action to meet the cap, or to explain why the Government is choosing not to take action.

Chair: Okay, thank you. I was going to come to Siobhain next. Do you want a bit more time?

Dame Siobhain McDonagh: I am okay, and apologies for my lateness. Do you want me to go ahead—on living standards, or I also have questions on the tax burden?

Chair: Fire away on living standards first.

Q10 **Dame Siobhain McDonagh:** This Parliament is on course to be the first in modern history where living standards actually fall. Each household is set to be £250 poorer at its end than it was at its start. Would I be right in thinking that this Government has the worst record in history, and that the Government between 2015 and 2017 has the second worst record on living standards? What factors have led to the slow improvement and now the fall in living standards?

Professor Miles: In terms of what has happened, it is a combination of unfortunate events, really. Growth in the very recent past has been pretty close to zero, just over the last six months. Over a slightly longer horizon, if you go back to just before covid, real GDP per person has fallen between then and now. That is partly not yet a full recovery from the hit of covid.

Real personal disposable income has also been hit not so much by things within the UK economy, but by big increases in imports and what they have done to consumer prices, particularly energy and gas after the Russian invasion. Alongside all that, the tax take out of GDP has been on an upward trajectory as the Government tries to stop debt carrying on going up and up.

Looking forward, some of that looks a bit more optimistic. For example, very recently, in the last six or so months, energy prices have come down yet again—so much so, in fact, that the big hit to household standards of living from the rise in gas prices in particular, but also oil prices, has more or less completely reversed itself. That is boosting real household disposable incomes right now, which are actually going up a bit, even though GDP has been flat and has not grown for the last six months.

It is that combination, really, of a rising share of tax coming out of GDP and very disappointing growth in GDP, not just over the period since covid, but actually going back much further, to the onset of the financial crisis 15 and a half years ago. Since then, productivity in the UK has grown dramatically slower than in the 30, 40, 50 or even 100 years before that—so much so that if you asked people who made long-term predictions back just before the financial crisis, they would have said that the level of GDP in the UK right now, 15 years later, would be almost 30% higher than it actually is.



HOUSE OF COMMONS

So you have had 15 and a half, almost 16, years of—by the standards of the UK's history—very low productivity growth. Since that is ultimately the single most important driver of standards of living over quite long periods, it is almost impossible, with productivity performance being that poor—and that is not unique to the UK; it has been true across a lot of the richer countries in the world, but it has been a bit worse in the UK than in most other countries.

- Q11 **Dame Siobhain McDonagh:** If we compare the UK with Australia, Canada, France, Germany and the Netherlands, typical households in the UK are £8,300 worse off. That always seems extraordinary. With 1 million households reaching the end of their cheaper mortgage deal this year and anticipating an average increase in mortgage payments of about £1,800, what impact will this have—I am sorry, I am confusing my thoughts; I don't understand my own question. I was looking for an international comparator. If people in those countries are, on average, £8,300 better off, what are those countries getting right that we are not? What might the Government have got wrong that we are not doing as well as they are?

Professor Miles: Part of it goes back to a long-run underperformance in the UK, which goes back pretty much to the onset of the financial crisis. We have had poor productivity growth; so have most of those other countries, but it has just been a bit worse in the UK. That adds up over time and drives a big gap—

- Q12 **Dame Siobhain McDonagh:** Sorry, David, but why? Those countries faced the international financial crisis as well, didn't they? They have experienced coronavirus as well. I know their energy policies might be slightly different, so that could be a significant factor.

Professor Miles: Yes, the energy thing is relevant when you compare Canada and the US, who are much less dependent on gas, and certainly imported gas, than the UK. There is a factor there in that we are unusually dependent on imported gas, although that has now unwound and is one of the reasons why we are a bit more optimistic looking forward.

The stock of Government debt, public debt, in most of the other countries you mentioned has also gone up a lot. The UK is grappling with that perhaps a bit more seriously and successfully, because—on our forecast anyway—five years down the road, the stock of debt does stop rising relative to GDP. There is a price you pay for that, and part of the price is that the tax take out of GDP has gone up in the UK. I think it has done that to a lesser extent in those other countries.

The big, fundamental question, when you look at the longer time horizon, is the one you raise: why has productivity growth in the UK been so poor—absolutely, but also relative to most of those other countries? If there was an easy answer to that, we might have done something about it and stopped the rot to some extent. It is quite difficult to work out quite why it has been so bad for so long.



HOUSE OF COMMONS

The flipside of this is that unemployment in the UK over the period—this is still true—is, relative to most of those other countries, except the US, actually very low. We have succeeded in getting a high proportion of the people who want to work into jobs. The unemployment rate is about 4% in the UK; it is higher in most of those other countries except the US. That, at least, is some offset to the poor overall growth: we do not simultaneously have poor overall growth and a very high unemployment rate. If we did, the burden of poor economic performance would fall very heavily on those who are unemployed. We do not have that problem, at least.

Dame Siobhain McDonagh: Yes, it would be pretty dreadful if we were still performing that badly in comparison with those other countries and we did not have low unemployment.

Professor Miles: Indeed.

- Q13 **Dame Siobhain McDonagh:** In the Budget last week, the Chancellor had very little to say about housing, which is the biggest issue for me as a constituency MP. A million households will be reaching the end of their cheaper mortgage deal this year and are likely to see an average increase of £1,800 over the year. What impact do you think that will have, not only on the families concerned but on the country and the Government's finances?

Professor Miles: It is going to be difficult for many households—there is no question about it. Part of the difficulty in the UK is that although we have many more fixed-rate mortgages than we used to, it is still the case that most people who have a fixed-rate mortgage fix it for quite a short period. The two-year fixed-rate mortgage and the five-year fixed-rate mortgage are very popular products now. There are a lot of people who took one five years ago, when interest rates were next to nothing, and are going to roll off next year. We have seen a fair bit of it happening already, but there is still quite a lot more to come.

One of the reasons—and this is true of our forecasts into the future—why consumption expenditure is relatively subdued and is not a very powerful driver of GDP is that those people who are going to pay quite a lot more are probably going to be cutting back their consumption. On the flipside, there are some people who are getting a bit more interest income, because interest rates are higher than they were a few years ago.

In a sense, it evens out in aggregate: some people suddenly face much higher interest rates, but then people who have savings face the flipside of that, which is higher income. It is pretty likely that the people who have the savings will not change their spending as much as the people who take a hit to their available income.

In the past three or four months, since our last report in November, interest rates have been materially lower, so the hit to people's incomes that we think is coming up for those people who have not already had their mortgage reset at a higher rate is a bit less than we thought back in



HOUSE OF COMMONS

November, but it is still big for those people who are coming off mortgages that they might have taken out five years ago.

- Q14 **Dame Siobhain McDonagh:** It is about £5 a week, isn't it? If you are quite stretched, over the course of the month, that is going to be a lot to cover.

Professor Miles: It is.

Dame Siobhain McDonagh: I have a question on tax burden, but does somebody else want to come in first?

Chair: We will come to that a bit later.

- Q15 **Drew Hendry:** Good morning. Can I start with you, Richard? I want to look into departmental spending forecasts. On the fiscal forecast, you told the Lords Economic Affairs Committee, "Some people have referred to that as a work of fiction." That was probably generous: someone has bothered to write a work of fiction, whereas the Government have not even bothered to write down their departmental spending plans. Do you feel the same way now?

Richard Hughes: There continues to be an imbalance between how much detail we have on the Government's tax plans, which support its objective of getting debt falling in five years' time, and the amount of detail that we have about its plans for departmental spending, which makes up 40% of total public spending, on the spending side of the ledger.

We know the Government's plans for national insurance, and we know the Government's plans for energy taxation in five years' time, but what we know about the Government's plans for spending on public services runs out after March next year. After that, the Government just gives us two numbers to put into our forecast: one for total current spending on public services and one for total capital spending on public services. There is no detail on what that means for the national health service, what it means for education and what it means for transport. That poses a significant risk, because those envelopes are relatively constrained—they are not growing in real per capita terms.

What we do not see on the spending side is a plan for living within that relatively constrained envelope while also meeting objectives that the Government have also stated to grow certain large elements of public service spending faster than that overall envelope. They have a workforce plan in the NHS, commitments to grow defence spending and overseas aid spending in line with GDP, and, in some of those areas, ambitions to go even further. How they make that add up with the rest of the Whitehall Departments, we do not know.

- Q16 **Drew Hendry:** So it is still a work of fiction?

Richard Hughes: It is still lacking in detail and difficult for us, as forecasters, to forecast. It is difficult for people trying to understand where the public finances are going to understand. It also poses risks. We know from the past that when Governments go from not having detailed



HOUSE OF COMMONS

spending plans in the run-up to spending reviews to setting them out in detail at the end of a spending review negotiation, they tend to top up those envelopes quite significantly. Based on the past pattern of Governments, we have seen them add to that envelope to the tune of £20 billion or £30 billion when it comes time to actually divide it up between Departments.

We also know that Governments have managed to cut departmental spending in real terms and in real per capita terms in the past—that happened throughout the 2010s—but that was done on the basis of a detailed plan for implementing it across the different public services of Government.

- Q17 **Drew Hendry:** I will not read the full quote, but how do you respond to James Bowler's response that what the Treasury is doing is normal, and this has been the case since the outset for the OBR?

Richard Hughes: It is not the way we have always done things. There used to be a process whereby the Government had three-year spending plans reviewed every two years. You always had more than a year's worth of forward perspective on the outlook for public spending. We are heading into unknown territory in the sense that the Government said they were not going to have another spending review until after the next general election. That means that the planning horizon for Whitehall Departments could shrink to a matter of a few months, because those plans run out in March 2025, and the general election—well, we don't know.

- Q18 **Drew Hendry:** You are saying that the nub of this is that the Treasury has not provided sufficient clarity to the OBR on its departmental spending plans in the current fiscal event.

Richard Hughes: We have a lot more detail about the Government's tax plans than we have about their spending plans, and the lack of detail about how they will implement those spending plans presents a risk to us.

- Q19 **Drew Hendry:** To tease that out a bit further, what more detail would you expect to be provided that has not yet been given in the spending review?

Richard Hughes: There are implications for departmental spending of the sort you would have if you had done a spending review: what it means for spending on the national health service, education, transport, or defence. What we see in that area are ambitions that the Government want to achieve in terms of either workforce numbers or levels of spend as a share of GDP. What we do not see is the implications of achieving those ambitions within the envelope the Treasury has set for itself and all the other Departments in Whitehall. We have to do our own internal ready reckoning within the OBR to figure out what that implies.

- Q20 **Drew Hendry:** Does the insufficient detail you have undermine your analysis of the fiscal forecast?

Richard Hughes: It poses a risk to that forecast. History shows that those risks can crystallise to the tune of tens of billions of pounds.



HOUSE OF COMMONS

- Q21 Drew Hendry:** The economic and fiscal outlook document states: "In the run-up to the two Spending Reviews in November 2015 and October 2021, governments topped up the RDEL envelope by an average of £39 billion and £32 billion per year respectively." Is the OBR indicating that spending envelopes set out in the economic and fiscal outlook and the Government's plans are unrealistic and will require a future top-up?

Richard Hughes: We do not know what the Government plan to do with their public spending plans. All we can really go by are the patterns of past Government behaviour in these kinds of circumstances. In the last two spending reviews, we have seen significant top-ups to those envelopes. We have also seen the Government managing to plan and deliver real cuts in public spending in the past, so these things can be delivered. We are not saying that they can't, or that the Government cannot deliver a real freeze in the overall envelope or real cuts in some Government Departments. We have not seen how they manage to make those sums add up.

- Q22 Drew Hendry:** But we are asking you about your forecasts. What do you think is going to happen? Is it going to require a top-up?

Richard Hughes: One of the single biggest risks to our forecast is the future path of spending on public services.

- Q23 Drew Hendry:** The OBR has stated that meeting existing commitments on health, defence, schools, childcare and overseas aid spending would imply a real cut in all other Departments' budgets of 2.3% per year from 2025-26. How feasible or realistic would such cuts be, given current pressures on public services? For example, what does that mean for council budgets?

Richard Hughes: It makes it more of a challenge. Those Departments have seen real cuts in their budgets in the recent past. We also know that where the Government will the means to those ends to produce spending in real terms in those Departments, they manage to deliver it. But it is putting pressure on a set of services that have already been subject to real cuts in the recent past and where there are indicators that services are struggling. That is not to say that the cuts cannot be delivered further, but we do not know what the plan is.

- Q24 Drew Hendry:** What would be the impact? That is what I am asking you.

Richard Hughes: If productivity could not be improved significantly in those areas, the impact would be that the real value of services would go down and the quality of services would too.

- Q25 Drew Hendry:** Forgive me, I am looking for some words that convey the impact of what would happen and not just that the quality would go down. What would be the impact of that happening? We have talked previously about the fact that productivity just has not moved, and it is not particularly likely to, so what is the real-term impact going to be like on public services in those categories?



HOUSE OF COMMONS

Richard Hughes: Again, it is hard for us to speculate because we have not seen what the Government's actual plans are.

Q26 **Drew Hendry:** But you are in the business of forecasting. You must have an idea of how that is going to look.

Richard Hughes: There will be consequences for the services; what we do not know from the Government is what their plans are for those services.

Q27 **Drew Hendry:** Are the consequences likely to be pretty dire?

Richard Hughes: The consequences will depend on whether the Government can realise their plans to boost productivity in those sorts of areas. You can deliver big improvements in productivity in certain public services. We have seen that in the past.

Q28 **Drew Hendry:** I am sorry to push you on this, but your job is looking at likelihoods. That is the whole point of what you do. What is the likelihood of those productivity gains negating the pretty dire impact on services?

Richard Hughes: Because we do not know what the Government's plans are for individual services, I cannot speculate on what the implications of real spending cuts in those areas might be. If we had had those plans from Government, we could provide you with more concrete answers.

Q29 **Drew Hendry:** Let me try a different tack with you. Feel free, Tom and David, to chime in if you feel you can add anything to this. In the Budget, the Government announced an additional £2.5 billion for day-to-day funding for the NHS in England in 2024-25, projecting funding levels in real terms to continue to improve performance and reduce waiting times. Is this real additional funding and if so, why is it described in the economic and fiscal outlook as "fiscally neutral"?

Tom Josephs: That is an allocation to the Department of Health and Social Care for next year, which the Treasury has taken out of the reserve that they hold against total public spending and pre-allocated it to the NHS.

Q30 **Drew Hendry:** Where is it made clear in the documents that it is coming out of reserves?

Tom Josephs: I am not sure if it is in the Treasury document, but I think it is explained in our document that it is fiscally neutral for that reason.

Q31 **Drew Hendry:** So that is coming out of reserves, then. If it is described as additional funding, it is not really additional funding: it is actually coming from reserves.

Tom Josephs: It is funding that is coming out of the reserve and being given to the Department of Health, so it is additional to the Department of Health's allocated budget.

Q32 **Drew Hendry:** Okay, I have a final question then. The economic and fiscal outlook assumes that net migration of 350,000 people across the



HOUSE OF COMMONS

forecasting period delivers “a net reduction in borrowing of around £7.4 billion by 2028-29, taking account of lower spending on debt interest as well.” How are increases in net migration likely to affect the fiscal deficit and the quality of public services in the medium to long term?

Professor Miles: I think the long-term implications—just focusing on the narrow fiscal implications—are almost certainly less favourable than the short run. That is because when people arrive in the UK, they are usually of what you might call typical working age or prime working age, and they have some years in the labour force. They are disproportionately of working age relative to the population in general. That is one purely fiscal plus, because many of them will end up paying tax.

Most people are not eligible for welfare payments for several years—probably about five years or so—and if the Government do not change their overall plan on the level of public spending, even though net migration may be much higher than people had thought, you are not spending any more money. Of course, you are squeezing the same amount of money across a larger population, so it is not that it does not have economic effect but, purely fiscally, if you do not change how much you are going to spend, you are not spending more on welfare, you are not spending more on public services and you are getting some tax revenue in.

For some years—maybe quite a few—it is at least fiscally beneficial, but that begins to unwind the longer people stay, because then they become eligible for welfare payments. Some proportion of those people will get to a point where they are no longer working, and if they are young when they arrive, they may have kids. So the favourable fiscal balance is at its greatest in the first five years or so—maybe a bit longer than that—after people arrive, and that is what we focus on in this report.

The other big report we do, usually in the summer, is a fiscal sustainability report, which looks at a much longer horizon. I think the purely fiscal benefit is probably significant for the horizon we look at, but it almost certainly turns around at some point further ahead.

Q33 **Chair:** Very quickly on the point about public service productivity, has public service productivity returned to the levels that it was at before the pandemic yet?

Richard Hughes: Not yet; it is still several percentage points behind.

Q34 **Chair:** If it were to, what would that represent in terms of the fiscal outlook?

Richard Hughes: It would be several tens of billions of pounds.

Q35 **Dame Angela Eagle:** How would you summarise the underlying state of UK growth, given that we are currently in a two-quarter recession?

Richard Hughes: To reiterate the points that David has made, we have seen disappointing growth performance since the financial crisis, and in particular disappointing growth in productivity. Much of what has driven



headline growth in the UK in the recent past has been getting more people into the workforce. That is good for people earning income and the overall headline growth rate, but does not necessarily help to boost productivity. More recently, some of the growth we have seen has been driven by high levels of net migration, which boosts our labour force via bringing in people from outside.

Worryingly, what we have seen more recently has been a reversal in that trend of a rising participation rate. Since the pandemic that has started to fall away again, with rising levels of inactivity and a falling participation rate. That is a worrying trend, which we had hoped in our last forecast was turning around and heading back towards pre-pandemic levels, but in more recent data—including in today's data from the ONS labour market overview—it looks as though persistently high levels of inactivity seem to be a feature of the post-pandemic environment. That is worrying from a human welfare point of view, as well as that of fiscal sustainability.

- Q36 **Dame Angela Eagle:** Do you think that might be something to do with the long waiting lists in the health service for people of working age who may have conditions that need treating?

Richard Hughes: We looked at this in detail, partly because the Committee has been very focused on it as well, in our last fiscal risks and sustainability report. Basically, what has been driving the big increase particularly in health-related inactivity in the workforce? Being out of the workforce for health reasons is now the single biggest reason to be outside the workforce if you are an adult, as well as the fastest growing.

When we looked at it and compared it to people on the waiting list, we did not find that much overlap. Their reasons for being outside the labour force did not seem to be principally because they were also the people who were on the NHS waiting list; there seemed to be multiple different causes depending on people's age. For older people it was often because they had musculoskeletal conditions, whereas for younger people it tended to be more because of mental health issues. So we think there are more complex reasons than just the waiting list.

- Q37 **Dame Angela Eagle:** Is UK growth being largely driven by migration? Your chart E in box 2.3 gives some scenarios in which migration could be neutral, positive or negative for GDP per capita. We know that GDP per capita has gone down for the last seven quarters and that the tiny amount of growth we have had—even though we are in a recession at the moment—has been, according to your analysis, due to migration.

Richard Hughes: In the last few years much of headline growth has been driven by higher levels of migration. By the time you get to the end of our forecast, and you compare the endpoint to where we are now, the overall level of GDP is a bit more than 10% higher. The level of per capita GDP is about 4.5% higher, so there is some per capita GDP growth in there, but some of it is also being driven by a larger working population, with some of those extra workers coming from outside.

- Q38 **Dame Angela Eagle:** The trend growth rate, though, is declining from



HOUSE OF COMMONS

what is has been in the past and seems to be diverging from other countries, such as the US, for example.

Richard Hughes: Certainly, compared to the pre-financial crisis period, our estimate of trend in growth is significantly lower. We do have it actually picking up for the next few years in our forecast, to something like one and two thirds by the end of the forecast period, which is higher than we have seen in the recent past but nowhere near as high as we saw before the financial crisis.

- Q39 **Dame Angela Eagle:** You find, once again, in your assumptions that Brexit will reduce potential productivity by 4% over 15 years, and you say that is broadly on track, so the uncertainty or the damage around Brexit is costing 4% over 15 years. But the Centre for European Reform and Goldman Sachs doppelganger analysis, which you cite in footnotes, finds that GDP is down 5% already. Do you think not only that Brexit has caused this loss but that, actually, the risks might be on the downside?

Richard Hughes: I would say that there continue to be risks on both sides of our estimate. I think it still remains pretty much in the centre of where the macroeconomic community comes down when looking at the impact of Brexit. Certainly, our overall trade performance has been more disappointing than the rest of the G7. Trade as a share of GDP has bounced back less in the UK after the pandemic than you have seen in other countries, but I would describe that as broadly on track with our assessment of what we think is going to be the medium-term effect of having left the EU on our overall trade performance.

Within that, there has been some disappointing news as well as some encouraging news. The disappointing news is on goods trade, which is performing significantly worse than in the rest of the G7, and probably worse than we would initially have expected. But we have seen one of the biggest rebounds in services exports in the G7, so our services trade is actually performing relatively well compared with our peers in the rest of the world. Within that mixed picture, I would say there is disappointing overall trade performance, and some encouraging signs on services trade but more discouraging signs on goods trade.

- Q40 **Dame Angela Eagle:** What impact would the plan to abolish employee and self-employed national insurance contributions have on the likelihood of the Government meeting their fiscal rules?

Richard Hughes: Well, it depends on their timeframe for doing it. The Government currently raise something around £50 billion a year in employee national insurance, and the overall tax take from national insurance is well above £100 billion, so it would depend on what the Government's timescale is for meeting that ambition, and it would also depend on what their plans are for the rest of the tax system in that context.

- Q41 **Dame Angela Eagle:** Did the Government tell you about their plan to abolish national insurance contributions, or ask you to forecast the impact of doing it?

Richard Hughes: If they had done, you would have seen it in our economic and fiscal outlook.

Dame Angela Eagle: So it came as much of a surprise to you as it did to the rest of us that the plan is to abolish national insurance contributions completely.

Richard Hughes: It was not a measure given to us to cost in our EFO.

Dame Angela Eagle: Very interesting. Thank you.

- Q42 **Keir Mather:** Turning to the subject of inflation, Mr Hughes, are there particular measures announced in the Budget that you feel are either explicitly inflationary or deflationary?

Richard Hughes: David may want to say more, but the overall policy package in this Budget had very little impact on inflation. The single measure that had the largest impact was the freeze in fuel duty, because our forecast assumed that it was going to be indexed—that goes into the inflation basket and would have otherwise pushed up CPI inflation a bit this year. When I say “a bit” I mean by small tenths of a percentage point.

The other elements of the package have a very small impact on the overall headline inflation number, partly because they are relatively modest in size and partly because we have a negative output gap opening up over the next few years, so a bit of slack in the economy. So to the extent that there is a small fiscal loosening in the Budget in the near term, that is providing a stimulus during a period in which we see a bit of slack in demand in the economy.

- Q43 **Keir Mather:** I see. When Andrew Bailey came before the Committee last month, he said that he expected that inflation would return to target in the springtime but would not stay there, due to large, particularly negative, energy effects that would not be permanent but that would cause a bit of a pick-up by the end of the year. Does your forecast tally up with the Governor’s perspective a month ago?

Professor Miles: It is similar in the sense that we, too, think that inflation will come down pretty much to the target level within a few months from now—maybe 2% by the middle of the year—and maybe even dip slightly beneath it for a while after that. Our central forecast is not quite as pessimistic as the Governor about it then possibly moving back meaningfully above the target level. In fact, our forecast is that it gets to 2% and then hovers around that level as far ahead as one looks.

To add something to what Richard said, the big measure in the Budget in some ways was the cut in national insurance contributions. In itself, that will increase people’s disposable income and, if nothing else changed, will boost demand a little. If it did not do anything to the supply potential of the economy, that would mean that demand had gone up a bit relative to supply, which might be somewhat inflationary. Actually, our assessment was that it does do something positive to the supply potential of the economy, because more people will be in work, and that extra supply



HOUSE OF COMMONS

potential more or less offsets the demand thing. I think that the Budget, broadly speaking and apart from the fuel duty thing in the short run, was pretty much neutral as regards inflation.

- Q44 **Keir Mather:** I see. I appreciate that you cannot whip up a forecast on the spot and that the Government's ambition eventually to abolish NI contributions was as much of a surprise to you as it was to us, but do you have a headline view of whether a tax cut of that size would be inflationary?

Professor Miles: I think it would have the same kind of dual impact as the actual cut in national insurance announced last week. On the one hand, it would give people more disposable income and they would spend some proportion of it, so everything else being equal that is somewhat inflationary. Of course, some of that spending will leak out on to imports into the UK, so it does not just drive up the demand for UK-produced things, with no change to supply. But it would also have a positive effect on labour supply. So far, we have judged those things to be about the same magnitude.

- Q45 **Keir Mather:** Okay. Mr Hughes, you note in the economic and fiscal outlook that you are having to place less weight on the labour force survey while you wait for the ONS's transformed labour force survey, due in September. Is that hampering your ability to assess the tightness of the labour market and therefore the outlook for inflation and growth?

Richard Hughes: I think it is a challenge for us. The Bank have also talked about the challenge that it poses for them. I should say that we have lots of sympathy for the ONS, and it is taking a number of steps to try to provide the partial and real-time information to the extent that it can, while it develops its transformed labour force survey, which will provide the more complete and consistent picture of the labour market.

In the meantime, we look at a range of indicators. On top of what the ONS tells us, we get information directly from the benefits system in putting together our welfare forecast, which can also give us a better view of underlying trends in things like inactivity and health-related inactivity, because these people turn up on the benefit rolls if they end up claiming benefits.

We try to draw on information from a range of different sources. What they tell you at the moment about the labour force is that it is both relatively tight, but loosening as vacancies come down, but also that one of the reasons why it is tight is that there are worrying numbers of people who are not in the labour force at all and not looking for work. That is something that one worries about from an economic and a fiscal perspective, because if people are not working, they are not paying tax and are more likely to be on benefits. So that is something that we draw attention to in the work that we do here, as well as in our fiscal risks report.

- Q46 **Keir Mather:** Turning back to some of the inflationary implications of some of the Budget announcements, we often talk about the inflationary



HOUSE OF COMMONS

impact of fiscal stimulus, but this Budget in effect partially pays for its tax cuts by having real-terms cuts to the per capita, day-to-day spending of unprotected Departments of 13% over the next Parliament, which is £19 billion, or 71% of the cuts repeated that we saw in the first austerity Parliament. I appreciate that you do not have detailed plans on how those departmental spending cuts will play out, but do you have a general view of what the inflationary or deflationary impact of such reductions in spending on public services might be?

Richard Hughes: Not in an inflationary or deflationary sense, in the sense that, by the end of our forecast, we have inflation more or less getting back to target. We think that the Government's fiscal stance in the medium term is consistent with delivering that. But, as you say, within that—at least in this Budget—there is a modest tax cut, but also a further erosion in real per capita spending on public services, because those plans have been left more or less unchanged in the face of both a higher price level and more people in the country.

- Q47 **Keir Mather:** Do you have a view on whether cuts to unprotected Departments, local government—talking about economic vitality and our ability to level up our high streets—or regional change will have any knock-on effect on our inherent ability to achieve growth over the next Parliament?

Richard Hughes: Again, we are being asked to speculate on plans that do not exist.

- Q48 **Keir Mather:** What have been the challenges in forecasting inflation? Obviously, the rate went higher than was expected quicker than was expected and now has sort of tapered off and is beginning to fall at a rate that was not quite predicted. What were the main challenges in anticipating those fluctuations?

Richard Hughes: When we did our forecast evaluation report this time around, we looked back at the lessons from the Russian invasion of Ukraine and the big rise in inflation that we have seen since then. Like lots of forecasters, that came as a surprise, and the peak ended up being higher than we thought.

The lessons that we learned are that, on the one hand, in order to understand energy price shocks, you have to look back at history and see what they have done to the UK and other economies in times like the 1970s. I think you have also got to adjust for the fact that our economy does not look so changed since then; it is less energy-intensive in terms of production, but it is really no less energy-intensive in terms of consumption, so the impact on households is still quite significant.

It is also the case that, in anticipating how much pass-through there would be from inflation coming from the outside world into domestic prices, both we and others underestimated how much pass-through you would see on the way up. But, also, we have adjusted how much pass-through you get when prices come down, through to things like wages. So we have made some adjustments on the way up, but also some adjustments on the way

down, in terms of, as imported inflation comes off, the speed with which that then reduces inflationary pressures within the domestic economy. David, do you want to add anything to that?

Professor Miles: No.

Keir Mather: Do I have time for one more question, Chair?

Chair: Ish, yes—just a short one.

- Q49 **Keir Mather:** Okay, I will be very brief. Very finally, the Governor talked about the particularly negative energy effects. Could you outline what they were and why you think they do not have an inflationary impact in the way the Governor proposes they will?

Professor Miles: I think the energy price stuff obviously did have a very substantial inflationary impact, particularly in 2022 and into the early part of 2023. It is the unwind of a lot of that that has got inflation coming down. So it is both the reason why inflation went up more than almost anybody forecast and, now, is coming down a bit more rapidly.

It has a positive effect as things come down, not just on people's bills, which directly go through to consumer prices, but also on profitability in the private sector, the business sector—nearly everybody uses energy one way or the other—and that is very helpful.

Keir Mather: Thank you, Chair.

- Q50 **Dr Coffey:** I wanted to turn to forecasting, which is your *raison d'être*, and the assessment against that.

Can I just go briefly back to inflation? There is a significant gap between your forecast and the Bank's. You have probably more access than any forecaster to the internal back-and-forth within Government's policy discussions. Help me understand why you and the Bank have such a different view on the near term and, indeed, the medium term on this.

Professor Miles: I think we are a bit more optimistic on productivity. All else being equal—in other words, crucially, if wages do what they do, but productivity is a bit higher, unit labour costs are lower—that helps bring inflation down a bit more. We are a bit more optimistic on productivity.

Productivity is really difficult to forecast. Fifteen years ago, people thought that the level of GDP in the UK now would be 30% higher than it is. That has been absolutely transformational. It has been catastrophically bad for a long period of time, and I do not think anybody—any economist—really saw that coming. It is a really difficult thing to predict.

As I say, we are a bit more optimistic than the Bank. We have taken the view, and it is no more than an educated guess, and maybe not even terribly educated, that the last 15 years are so bad that, more likely than not, things are a bit better over the next five or 10 years than they have been, but not as good as they were in the—pick any period you like, almost, going up to the financial crisis, when productivity used to rise by



HOUSE OF COMMONS

2.5% a year. It has been barely half a percent for the last 15 years. With 15 years of 2% lower than before, you have lost 30% of the wealth of the country.

Part of the reason why there are no easy choices for any Government right now is that GDP is that much lower than people thought. Perhaps the expectations of people of what Government can do in terms of public services have not fallen back in line with the reality of how much less well-off we all are.

Coming back to your question about why our inflation forecast is a bit lower than the Bank's, it is partly that we are a bit more optimistic on the productivity outlook, which, all else equal, would mean somewhat lower costs. That is one factor. You probably have the numbers in front of you; I do not have the Bank's latest forecast right in front of me, but I know what ours is. I would say that the broad shape is not that dissimilar.

Q51 **Dr Coffey:** To give you a sense, you are suggesting that in a year's time inflation will be below 2%—

Professor Miles: A little bit.

Q52 **Dr Coffey:** Only a little bit. But the Bank suggests that it will be 3%.

Professor Miles: Yes, you are right. That is meaningful—that is a meaningful difference.

Q53 **Dr Coffey:** So your assessment is that you think productivity is likely to be better than perhaps forecast.

Professor Miles: Yes, that has been the difference between our forecast and the Bank's for a little while now. To be fair, so far, they have been more right than we have been right, because we have been on the optimistic side of reality.

Richard Hughes: We also took a later vintage of energy prices that had been coming down as both of us had forecast, so going a bit later meant that we picked up a slightly later print of what was happening to gas prices.

Q54 **Dr Coffey:** Where both the Bank and the OBR were very pessimistic was on employment. In fact, you forecast some very high unemployment related to covid. That has not been borne out. Help me to understand where you came to that conclusion, given the furlough schemes that have happened and other support that was given to business. I felt particularly stung because I was at DWP at the time, but anyway.

Professor Miles: I think one of the things that happened was that employment turned out much closer to our predictions than unemployment. What has happened is that there has been an unfortunate rise in the number of people who are inactive. They are not in the labour force. As you will know, they do not count as unemployed, and they are not unemployed; they are people who feel that they cannot work.

Q55 **Dr Coffey:** Or don't want to work.



Professor Miles: Yes, they cannot work or they do not want to work. What happened was that employment did not bounce back particularly dramatically. Unemployment has stayed very low, which in itself is a good thing, but unfortunately the number of people inactive and not in the labour force went up a lot during covid and, so far, has not really come back down. It looked like it was coming down for a while, but over the last six months inactivity levels have moved back up again.

- Q56 **Dr Coffey:** Building on that, you talked about productivity in terms of your forecast. Would productivity by default almost rise if unemployment was a lot higher? Do you take that sort of economic assessment?

Professor Miles: It would be a painful way of getting higher productivity.

Dr Coffey: I agree with that.

Professor Miles: Well, yes, arithmetically if it were the case that a high proportion of people who became unemployed were relatively low paid, productivity would go up, but not in a good way. One of the reasons that I think the OBR was being slightly more optimistic than the Bank on productivity comes back to the story of why the last 15 years have been so disappointing. The UK's manufacturing sector, as we all know, has shrunk to a pretty small level. About 10% of GDP now is in the manufacturing sector. Historically, productivity in manufacturing and making physical things has tended to be considerably higher than in services.

One of the reasons for being guardedly optimistic is that some of the most recent technological changes—I am thinking particularly of artificial intelligence, ChatGPT and things like that—look like they may have many more applications in the service sector, or as much as they would in the manufacturing sector, and they would be in health, in particular. If that turns out to be the case, and I hope it does, you would get better productivity performance in what is now overwhelmingly a service economy in the UK.

- Q57 **Dr Coffey:** One of my experiences, having been a Secretary of State, is having quite a lot of interaction with DWP and OBR on assumptions. Again, help me to understand a bit more about some of the other forecasts being made. We saw a lot higher migration than I think the OBR had forecast economically, yet there are suggestions that you have quite a blunt way of allocating growth per person migrating.

Professor Miles: You are right: the level of migration in the last couple of years has been dramatically higher than we had thought likely. We got a leading indicator of that when we got, with a lag, data on how many visas had been granted. As you will know probably better than me, there is a big difference between knowing the number of visas that have been granted and knowing the number of people who are actually going to turn up. Universities are always being surprised by the difference between the number of offers they make, where people look like they have accepted them, and how many they actually get in September. Sometimes it is more than they thought; sometimes it is a lot less. This time round, even



HOUSE OF COMMONS

more people have turned up than you might have surmised just looking at the number of visas that were granted.

It is very difficult to predict. In this forecast, we have taken the view that the numbers of net migrants coming to the UK will fall back really quite sharply. That is partly because of the Government's measures, and partly because one of the drivers—not the only driver—of net migration being much higher than people had thought is the number of students coming to UK universities being a lot higher. Although some of those people will stay, a lot of them will not, so after you have had a couple of years of extraordinarily high net migration, and very high numbers of students, with a time lag then of about two or three years depending on the courses they are on, you see quite a big pick-up in people leaving again.

The combination of that and the Government measures cutting down on dependants coming, and the higher salaries people have to earn to get some of the classes of visas, is why our forecast—about which there is a great deal of uncertainty—is for net migration to fall very sharply. I think I am right in saying that, a year or two down the road, our central prediction is something like us being down to 300,000, coming from almost 700,000.

- Q58 **Dr Coffey:** On forecasting more generally, it is nigh-on impossible to get a forecast 100% right, but you will be aware that the implications of your forecasts do link to policy choices. You did an internal review—a working paper—which suggested that your forecasts are slightly less accurate than those of external forecasters, and that you tend to be overly optimistic, but less so than Treasury used to be. Are you looking to get some external review in? I say this because you have more access to Government plans than any external forecaster, in terms of the dynamic interaction you have.

Richard Hughes: Every year, we do a forecast evaluation report, which looks back at our forecasting record for the last two years. Through that, we look at where we got things right or wrong and at lessons learned. About a year and a half ago, we produced a report looking back at our forecasting record since 2010. It showed that our forecasting record compares reasonably well to those of other independent forecasters in the UK. It shows that we are better than a lot of the official forecasters elsewhere in Europe and that we have a better forecasting record than the Treasury. We do quite a lot of self-evaluation of our forecasting record, as well as, every five years, having a statutory external review, which is required in legislation.

- Q59 **Dr Coffey:** When is the next one due?

Richard Hughes: The next one is due in 2025. Our non-executives are in the process of looking for somebody to conduct that review. We had one produced by the head of another fiscal watchdog—the one for Canada. We had one that was done in 2015, and we had one done by the OECD in 2020. Our board is currently looking for somebody to do the review for 2025. We do have a built-in statutory review mechanism.



- Q60 Dr Coffey:** Building on that, you tend to be quite way out in the short term and then perhaps a bit more optimistic in the longer term, but you can keep adjusting that. It is useful to hear that the external review will be coming next year.

More generally, however, the OBR is accused of being cautious in assessing dynamic tax changes. Tell me why you think that the national insurance cut, for example, will lead to an increase in the market growth of people coming to work. I will give you the contrast: a few years ago, you were not particularly impressed by the reduction in the taper rate to 50%; you didn't think that it would have any impact on people coming into work. Help us to understand that.

Professor Miles: Briefly, we took a long, hard look at some of our assumptions about the sensitivity of people's decisions—how much you want to work to the tax system—and we increased our assumption about that sensitivity for a significant proportion of the workforce.

That was one reason why, when we came to look at the cut to national insurance rates—both back in November and last week—we got a bigger impact than would have been the case if you go back a few years to the older assumptions about how sensitive people are to questions like, "How much do I want to work, given changes in take-home real pay?"

The reason why we had a really quite substantial number for the national insurance cut was that, plus the fact that it affects pretty much everyone who is working. Something close to 30 million people have had a non-trivial cut now—two lots of 2%—in the tax they pay. It affects such a large proportion of the workforce—pretty much everybody who is working—and with a slightly higher sensitivity on labour supply than we had assumed in the past, that gave us quite a big effect on the labour supply.

Dr Coffey: Okay. I had better hold off there. I might come back with a few more questions later.

Chair: I think we could go on for a long time on this issue, but others are waiting. Stephen.

- Q61 Stephen Hammond:** Thank you, Chair. I want to ask a few questions about productivity and then some about tax-free shopping. Professor Miles, a moment ago you said that in the early part of this century, productivity growth was about 2.5%—

Professor Miles: Yes.

Stephen Hammond: Am I right in recollecting that in the latter part of the period—say, from 1992 to 1998—business investment rose fairly substantially in the UK, and that might therefore be one of the reasons why you saw that sort of productivity growth?

Professor Miles: Yes, that seems very plausible. Overall investment in the UK has been, by historical standards of the UK's own past and relative to other countries, pretty low for much of the last couple of decades probably.



HOUSE OF COMMONS

- Q62 **Stephen Hammond:** Leading on from that, I also remember that if you looked at the analysis of that 2.5% figure and split it out, public sector productivity was falling in that period of time, or growth in public sector productivity was falling, and it was private sector productivity that was driving that 2.5% figure. Would that be right as well?

Professor Miles: That sounds right. There is a reason why historically productivity in the public sector has been a lot lower, because it's nearly all services in the public sector, which typically has been low—

- Q63 **Stephen Hammond:** The number of people employed in it expanded dramatically, yet outputs didn't.

Professor Miles: Yes, that's why it looks—

- Q64 **Stephen Hammond:** Is that the possible explanation?

Professor Miles: Yes, absolutely. In a nutshell, that's what happened.

- Q65 **Stephen Hammond:** A moment ago, Mr Hughes, you said, "We have seen instances where public sector productivity plans have worked." Would you outline to the Committee one or two of those instances, so that we have a clear idea about when that was?

Richard Hughes: In the period leading up to the pandemic, you did see real growth in productivity in the public sector. I think that was partly keeping the same output while reducing inputs, as well as getting better outputs for the inputs going in.

Measuring productivity in the public sector is very difficult because there are no prices on a lot of these services. You also have to adjust for the fact that it is getting more difficult to get the same outcome for a number of services because we have an ageing society with people with more complex illnesses; making or keeping them healthy becomes more of a challenge for the same amount of input going in.

More recently, what the ONS has been doing, with some success, is use quality-adjusted measures of productivity, which account for the fact that you have more complex cases presenting themselves, and more older people presenting themselves to the health service and being harder to make well for long periods. However, even making those adjustments, there have been periods where you have seen improvements in public sector productivity. Also, anecdotally, you have also seen cases of big turnarounds in the public sector; a lot of people talk about those. The Passport Office is the most famous.

- Q66 **Stephen Hammond:** Professor Miles, in one of your answers to Dr Coffey, you said, "I think we look at the boost to productivity from technology." Have you ever worked out how big or small a factor that is in productivity growth?

Professor Miles: In some sense, over the very long term—going back over centuries—technological progress has been the driver of us being so much more productive. You just work out better ways of doing things, like growing crops, and all that.



HOUSE OF COMMONS

Q67 Stephen Hammond: In particular, you made the point about AI in manufacturing and now in services. This question is for both Mr Hughes and yourself: if, on the basis of what the Government set out last week and given what you said about technology and how resistant the NHS in certain areas has been to its introduction, you have a productivity-based plan based on raising technological standards and improving some of the throughput by new methods, what levels of productivity gain out of that plan should we be looking for?

Professor Miles: I am not expert in the provision of medical services and the use of technology, but one of the things that AI is very good at—just as an example—is recognition of patterns. When people get medical tests and scans and are worrying about whether they have cancer, AI can potentially handle a very large number of scans and interpret the results. It does not need to wait for the consultant or the expert.

Q68 Stephen Hammond: The point I am trying to get to is whether you think this plan has a fair chance of successfully raising productivity in the health service.

Richard Hughes: There is potential. We were not asked to look at these plans in any great detail, so it is difficult for us to provide our own internal assessment. We know as much about them as you do.

Q69 Stephen Hammond: Can I ask four quick questions about tax-free shopping? Has the OBR ever made an assessment of the cost benefit of extending tax-free shopping to EU visitors, or assessed the Treasury's forecast for that element?

Tom Josephs: No, we have not. What we did in this EFO was review the costing that was made back in 2020 of the Government's decision to abolish VAT-free shopping for non-EU visitors only. We have not looked at anything more widely.

Q70 Stephen Hammond: My point to you, Mr Josephs, is whether it is therefore reasonable to extrapolate from 2020 data about what the outcome might be of stopping tax-free shopping for non-EU visitors, and extending that to EU visitors in 2024?

Tom Josephs: We have not looked at that wider potential policy because it has never been confirmed Government policy; under our remit we are therefore not permitted to look at that policy. We have reviewed the 2020 policy in a lot of depth. At the time, that policy was estimated to raise around £500 million a year of revenue for the Government. We have looked at all the underpinning assumptions on that and updated them. We have also reviewed all of the evidence that we could find on travel data and tourist spending since then. There is nothing in that review to suggest that the original costing was not central and reasonable.

Q71 Stephen Hammond: No, but my point is that HMT is saying that it is basing the forecast for EU visitor behaviour on your forecast and analysis of non-EU visitor behaviour. I am not suggesting those forecasts were wrong in anyway, but I am suggesting to you that, because they are two different markets, it is clearly difficult to extrapolate what you have said



HOUSE OF COMMONS

about one into the other. That is because of behavioural differences, and the very different type of people they are in terms of likely spending.

Tom Josephs: As part of reviewing the 2020 costing, we looked at trends in both EU and non-EU visitors. There is nothing in that data that we could see that would suggest the original costing needed a material adjustment.

Q72 Stephen Hammond: I accept that entirely, but it is not only a question of whether that costing was right. I am suggesting that, because of the very different type of market that you are then trying to apply that analysis to, it is very difficult.

Tom Josephs: It is the case that most of the data suggests that it is non-EU visitors who globally tend to use those sorts of schemes. But as I say, we have not looked at the wider costings.

Q73 Stephen Hammond: Based on your assumptions, the original analysis from HMT back in 2020 was that there would be no fall in spending from ending tax-free shopping. Yet what you have seen in one of your later analyses or assessments was that two months after that decision was made and in the period thereafter, there was a fall of somewhere between 20% and 24% of shopping from that group. Is that a number you recognise?

Tom Josephs: I am not sure exactly what that number is. What we have looked at is the impact of the measure on the number of non-EU people who may be deterred from coming to the UK because they are no longer able to get those refunds. All the analysis suggests to us that the original estimate we made, though clearly very uncertain, of around 30,000 people being deterred still looks reasonable, and there is nothing in the data on the number of visitors since the policy that would lead us to think that it was wholly way off. We have made some adjustments in terms of the impact of the fact that those people are not coming on wider tourist spending, and we have factored that into the costing, when it was not in the original costing. That is a wider loss of tax revenue from the fact that that set of people do not come to the UK and spend more broadly on their holiday. That loss of revenue is relatively small and does not change the overall yield that is generated from the measure.

Q74 Stephen Hammond: Can I ask what you mean by “relatively small”? It was around £500 million, wasn’t it? That is the number I have seen.

Tom Josephs: Five hundred million was the overall revenue generated by the abolition of VAT-free shopping. Within that is an offset from the fact that some visitors are deterred from coming to the UK and spending more widely. I think that is around £10 million to £15 million, so it is not huge relative to the overall yield from the measure.

Q75 Stephen Hammond: One last question. Would it be sensible for HMT to commission you to do a revision or full review of the forecasting in this area—notwithstanding that you think the numbers are still broadly correct but in terms of the proportions?

Tom Josephs: That is a decision for the Treasury, but as I say, we cannot cost policies that are not announced Government policy, and that wider policy has never been announced Government policy.

- Q76 **Chair:** So that I understand, what you have published on page 71 onwards of your economic and financial outlook is the piece of work that the Chancellor commissioned on tax-free shopping, and it is done, as far as you are concerned?

Stephen Hammond: In 2020 though.

Tom Josephs: We have published that material in the report. We have also published the longer notes. We released those yesterday. That is the totality of the work that we are doing, which is work we decided to do ourselves. We decided ourselves to review that costing on the basis of the fact that we recognise it is an uncertain one.

- Q77 **Chair:** And you are not doing any further work on this topic, so that concludes the work the Chancellor asked you to do on this subject?

Richard Hughes: This is probably the most rigorous re-costing of any policy measure we have ever done.

- Q78 **Danny Kruger:** I have a question or two on non-doms, and then I will talk about the high-income child benefit child. The last question will be about forecasting.

It does seem much simpler and fairer to base taxation on residency, but I understand that your assessment is that there is very high uncertainty—I think you said that—about being able to accurately evaluate the effects on revenue from this change. I would like to understand a bit more about the uncertainty. I do not know if you saw the tweet from Gemma Tetlow at the Institute for Government asking the Treasury to explain how they are estimating the likely revenue when they say that they evaluate the tax base of foreign income and gains from HMRC administrative data, but by definition non-doms are not captured in HMRC. Can you help us on that one? More generally, what are your concerns about the unpredictability of the reform?

Tom Josephs: There are three main uncertainties that relate to the amount of revenue that will be received from those individuals who are now no longer eligible for the four-year exemption period. The first uncertainty relates to Gemma's point around the amount of overseas income and gains that those people have. There is a certain amount of information on that, which HMRC has not only from its own UK sources but from agreements it has with other jurisdictions around sharing information. It is clearly an area of uncertainty.

There is also the judgment on the extent to which those individuals may decide to leave the UK as a result of the higher tax burden that they face. We have made an assumption that around 10% to 20% of those individuals will leave the country. That is based on both external analysis of the impact of tax on location, which tends to find a surprisingly small relation between those two things, and on evidence from the last time this

regime was reformed in 2017. From that, it again looks as though migration was relatively low, but this is a different reform. It kicks in earlier.

- Q79 **Danny Kruger:** There were far more protections in the 2017 reform. Would you say it is effectively going to cancel itself out?

Tom Josephs: There were significant protections in 2017. There are also significant transitional protections in this set of reforms, which is one of the reasons why we have assumed that migration will be at that level of 10% to 20%, but clearly there is a lot of uncertainty about that. The final uncertainty is around the degree to which those people will undertake tax planning to essentially reduce their liabilities. Again, looking at the evidence from 2017, it seems as though that took place less than was expected. We have an assumption of around 30% lower yield as a result of that.

- Q80 **Danny Kruger:** Okay; so rich people are not quite as mobile as some people have predicted. That seems plausible on the basis of previous experience. The other factor, which may be contained within your 10% to 20% estimate, is the future effect on people who might have come to be a resident or a domiciled resident in the UK. Have you tried to calculate the dynamic future effects of the policy?

Tom Josephs: The four-year regime in the new set-up is actually more generous than under the previous regime. There is potentially some risk that more people might be incentivised to come to the UK to take advantage of that. That would increase yield from their earnings while they are in the UK. We did not make an adjustment for that due to evidence that suggests that tax is not a huge driver of location decisions but also due to the fact that that period is four years whereas previously there was a less generous regime but it lasted for longer. Those two factors might broadly balance out.

- Q81 **Danny Kruger:** Lastly on this, what about the consultation on inheritance tax and the implications for that? Do you have any advice for the Government?

Tom Josephs: We have not looked at that at all because, as you say, the Government are still consulting on that so we do not have any—

- Q82 **Danny Kruger:** Have you been involved in that consultation?

Tom Josephs: Not in the consultation but once the Government decide what they want to do, then we will assess and cost the impact of that.

- Q83 **Danny Kruger:** I have a question on the child benefit charge, which is also for you, Tom. It is very welcome, in my view, that we have raised the threshold. In terms of forecasting and estimating an effect, can you give us a sense of why you think there will be a 10,000 person, or full-time equivalent, addition to the labour force from this change?

Tom Josephs: Sure—David might want to say a bit more about the labour market response. Essentially, as you have said, the taper range has risen



HOUSE OF COMMONS

and therefore the people who benefit from that will see a reduction in their marginal tax rate. In the same way, as we assess the impact of the NICs cut, we assume that that increases the incentive to work for a set of people within that group, which is roughly 10,000 FTE.

Q84 **Danny Kruger:** It also makes life a bit easier for single-earner families, doesn't it? There might be an added incentive not to work.

Tom Josephs: In what sense do you mean it makes it easier?

Q85 **Danny Kruger:** It is particularly the calculation on a household basis. The principle that now a single-earner family is not worse off being taxed at the £60,000 level than a two-earner family just below that level.

Tom Josephs: The Government have suggested that they are going to consult on moving to a household basis for child benefit.

Danny Kruger: They have said that they are going to do it from 2026 actually.

Tom Josephs: But again we have not estimated the impact of that, because it was not a firm announcement that they made.

Q86 **Danny Kruger:** I understood that it was fairly firm—that they are going to calculate it on a household basis from 2026, which is obviously a couple of years out. I want to come on to that. So you have not looked precisely at the potential effects of a calculation on a household basis?

Tom Josephs: No.

Q87 **Danny Kruger:** Okay. You do look at the effect on what you call "family formation, stability or breakdown", and you say, "There is no impact for those families or individuals whose incomes are above £80,000". I am interested in how you calculate impact on "family formation, stability or breakdown"—I am very interested in this topic. It feels like a very uneconomic, un-quantitative subject to look at, but a very important one.

Tom Josephs: I do not think we have done any analysis on family formation.

Danny Kruger: Sorry, I might be quoting from the Treasury papers actually. That was an HMRC quote, but I would be interested to know how they do it. You are saying that you have not yet looked at the effect of this change to a household basis, but has the OBR looked at that as a possible reform more widely for tax policy? Some of us have been arguing for some time for the Treasury to consider household income, rather than individual income, which is of course a way in which many other European countries do their tax analysis. Is that something that the OBR has looked at?

Richard Hughes: The last time it was changed was some time in the 1970s. It is not something that we have looked at because it is not a policy—

Q88 **Danny Kruger:** It was Nigel Lawson's good work in the 1980s. Would you



HOUSE OF COMMONS

expect to be looking at this in the light of the Government's commitment to change the basis of child benefit?

Tom Josephs: We would be interested in the fiscal consequences of making that change and potentially or primarily the impact on labour supply.

Danny Kruger: Thank you. Do I have time for another question?

Chair: On the same topic?

Danny Kruger: No, on a different topic.

Chair: Fire away.

- Q89 **Danny Kruger:** Thank you—I will be very quick. It goes back to the question about forecasting. I am tempted to ask a facile question about who is going to be chairman of the Fed and the Bank in five years' time, and on what basis you think that you can make a satisfactory estimate of GDP. I was struck by what you were saying about the sensitivity of the forecast interest rate rises. Monetary policy is completely unknowable—next year, let alone this year.

We had Charlie Bean and a bunch of other economists in last month, and they were raising concerns about the dependence of UK fiscal policy on OBR forecasts. Do you worry about the extent to which your role in the Chancellor's work is so dominant and influential? You were explaining earlier that the Bank has been getting predictions more right than you in some respects. We have talked about migration, which you have underestimated. You have complained about the Government's own spending plans being very opaque. There are so many unknowables, even if the Government were being far more up front about how they were going to organise spending. Do you sometimes lie awake at night thinking that you have too much power and not enough knowledge?

Richard Hughes: My colleagues should definitely offer their reflections as people who also have to make these judgments. Our only power is to produce a forecast, and we produce a forecast because the Chancellor has a fiscal target that falls due in five years' time, and you need some basis on which to judge whether Government policy is on track to deliver that. The Chancellor is in charge of a trillion pounds-worth of revenue and a trillion pounds-worth of spending. He decides what he wants to do with that.

- Q90 **Danny Kruger:** Do you think he puts too much weight on your forecasts?

Richard Hughes: What puts weight on our forecasts is the fact that Chancellors leave themselves very little margin for manoeuvre against their own fiscal targets, the ones they set for themselves. That means that whether they are meeting them or missing them becomes very sensitive to everything in that forecast—because they leave themselves tiny margins for manoeuvre against the targets they set for themselves. That is what makes their decisions sensitive to our forecasts. It is because they set themselves their own fiscal objectives and leave themselves very little

margin for manoeuvre, relative to huge risks around anybody's forecast—not just ours but anyone else's.

One thing we try to draw attention to as much as we can, including in the context of this Committee, is the uncertainty around our forecasts. We always do lots of scenarios around the key judgments in there, around interest rates, around migration—around anything that we think is a key source of uncertainty around the outlook. We also produce once a year a whole report on fiscal risks and sustainability, which tries to draw attention to all the things that are not in our central forecast but which ought to be the focus of policymakers. We rely on your Committee to draw attention to those factors as well.

- Q91 **Anne Marie Morris:** Can we move to property taxes? It was your view that the cut to the top rate of CGT would lead to a permanent increase in people selling properties. Could you explain why? Part 1, in a way, is: why will just that cut in the top rate make an impact now? But why will the impact then become permanent?

Tom Josephs: I can start on this one; David may want to add to this. You are right: the cut in top-rate CGT on property has, we assume, both a short-term and a medium-term impact on transactions. We assume that it is likely to bring forward some property sales, on the basis that some owners may have been holding on to their property because of the tax cost of selling, and the reduction in the CGT rate will incentivise them to sell those properties. In our forecast, you essentially have an increase in transactions in the short term—over the next couple of years. We also assume that that effect tapers off, but you are left with a medium-term small increase in transactions, essentially on the basis that the reduction in CGT has increased the cost-benefit—the tax benefits of investing in property.

It is also the case that part of the reason why we have a positive yield from this measure, despite the fact that the CGT rate falls, is that it incentivises, we assume, these additional transactions, from which you get CGT revenue but also stamp duty revenue. Quite a big part of the fact that you get that additional yield is the stamp duty.

- Q92 **Anne Marie Morris:** Before we get on to the amount of tax raised—because that has a high level of uncertainty and is a separate question—I am still unclear as to what you think is driving this move to sell? Specifically, is it to do with the changes in the furnished holiday letting relief—its removal? Do you think that it is to do with people's concerns about the renters reform legislation? Is it to do with the multiple dwellings relief, which has gone? What is it specifically that now is making people think—I suspect that it is not just going to be driven by this relatively small change in tax rate, so what is it that's driving it? I am still a little confused as to why—what is it that is going to make the impact permanent? I am still not entirely convinced, from what I have heard, that there is a reason why it should stay permanently.



HOUSE OF COMMONS

Tom Josephs: The big driver is the change in capital gains tax—the reduction from 28% to 24%. We did also look at the impact of the other two measures that you have mentioned, on multiple dwellings relief and furnished holiday letting. We think they may have a small impact on transactions, but the big driver, we think—as you say, it is definitely an uncertain judgment; there are risks either side of it—is the fact that this CGT cut will essentially incentivise people to release properties they might have been holding, because the tax cost of doing so is now lower. It will also incentivise people to enter that market, because, again, the tax cost of doing so is lower.

- Q93 **Anne Marie Morris:** Can you quantify that? It seems extraordinary. You say that this tax drop will incentivise and then you give an amount by which it will incentivise. What is the underpinning for that thinking?

Tom Josephs: It is a relatively small impact on transactions. Overall, transactions are around a million; it is maybe a bit lower this year, because the property market has been weaker—around 800,000, I think. We are talking of an impact of about 10,000 transactions a year. This is small compared with the overall market. However, we do think that that incentive is created.

- Q94 **Anne Marie Morris:** Yet you say there is a high level of uncertainty as to the amount of revenue that will be raised.

Tom Josephs: But that is either side. We think there is both upside and downside risk around it. We have tried to take a central judgment on that. I don't know whether David wants to add anything on the property market.

Professor Miles: Just the point about the cost of the tax bill you pay when you get out. If you bought some buy-to-let properties quite a long time ago, you might be sitting on a few hundred thousand pounds of capital gains. If you had £250,000 of capital gains, when that rate comes down, your capital gains tax bill is going to be, say, £10,000 less than it would have been. We think that is quite difficult to be confident about, in a way. It might tip some people over into thinking, "Actually, I've been looking to get out of buy to let. I will do it now. I am £10,000 better off than I would have been the day before the Budget."

- Q95 **Anne Marie Morris:** When you looked at the furnished holiday let removal, how were you able to assess how many holiday lets are out there? As far as I understand it, there is no central register. How many of them currently benefit from that particular relief? To benefit, you have to be prepared to have the property available for 210 days, which many people doing Airbnb would not be prepared to do. How can you assess what the impact of that removal reduction will actually be?

Tom Josephs: HMRC does have a lot of information on this. We made the assumption that that measure would not impact on property transactions to any material degree. Essentially, we think that measure really changes the incentives around use of properties, rather than actually holding and owning a property.



Q96 Anne Marie Morris: Okay. When the original furnished holiday let relief was introduced, it was in part to try to stop the debate over whether somebody was doing this as a “trade” or not. Way back when, the Office of Tax Simplification said, “If we simplify and streamline these two situations—the long-term let for residential and the short-term holiday let—you would need to introduce something to deal with that distinction.” There will be a number in the tourism business who have these sorts of properties for whom losing this relief will be quite significant, particularly if they cannot convert them into residential properties; in some parts of the country, people have often been able to convert only on the basis that it would be available for holiday lets—particularly farmers who have converted old outhouses and so on. Do you have a view as to what ought to be done if the Chancellor does go ahead with this, as set out in the Budget, to deal with the challenge of what is a trade and what is not?

Tom Josephs: It is not really for us to give policy advice to the Chancellor on that sort of thing, I am afraid.

Q97 Anne Marie Morris: But it will impact the revenue take, won’t it?

Tom Josephs: We have assessed the policy to end the relief as announced by the Chancellor, but we have not looked in detail at particular options around how you would do that, I am afraid.

Anne Marie Morris: All right. Thank you.

Chair: Thank you, Anne Marie. Siobhan, did you want to ask some more questions?

Q98 Dame Siobhain McDonagh: Yes, about the current tax burden. At the 2019 election, the then Prime Minister campaigned on a manifesto pledge not to increase taxes. Since then, the Government have introduced 25 tax rises. Households will be paying £3,900 more in tax at the end of this Parliament compared with at the start—the greatest tax-rising Parliament since the second world war. Personal taxes are going up, with threshold freezes exceeding the value of national insurance rate cuts. I do not know why I am telling you—I appreciate that you probably know that better than me. It is £41 billion versus £21 billion. Do you think that the Chancellor might be incorrect when he describes this as a “tax-cutting Budget”?

Tom Josephs: It is the case that in this Budget, the Chancellor’s measures reduce tax. That was also the case at the previous event in November—both had quite significant tax cuts. Stepping back and looking at the tax to GDP ratio more broadly, it is set to rise in our forecast. We estimate that compared with pre-covid, the tax to GDP ratio will rise by about 4% of GDP by 2028-29. Much of that has already happened, actually; there has been around a 3% increase from pre-covid to this year. Our forecast is of a further 1% GDP increase to the end of the forecast period. That is our forecast, so it is uncertain, and there is risk around that for the reasons we have discussed in this meeting.

David's point is also important. That increase in the tax to GDP ratio is required, alongside the Government's plans for spending, to ensure that debt is stable and just falling at the end of the forecast, and therefore meets the Government's fiscal rules and puts the public finances on what you would see as a minimum required to ensure fiscal sustainability.

- Q99 **Dame Siobhain McDonagh:** But we are seeing people entering the higher rate of tax for whom it was never intended—police officers, teachers and senior nurses who, in spite of the national insurance cut, will see their tax take increase.

Tom Josephs: It is the case that quite a significant chunk of the increase in the tax to GDP ratio, as you say, is driven by the personal tax threshold freezes, combined with what we have seen in terms of high inflation and high earnings, meaning that more people are pushed into those higher tax brackets. The Chancellor's announcements on the cuts in NICs at the macro level offset broadly about half of that impact.

- Q100 **Dame Siobhain McDonagh:** In order to pay for the Chancellor's changes to national insurance, I understand that the Government will have to cut day-to-day spending by about 13% to £19 billion. That is three quarters of the size of the cuts we had to endure during the austerity period. Do we know how those cuts will be delivered when public services are already finding things very difficult, such as with the wait times in our courts or the precarious financial situation of lots of local authorities? Do we have any idea of what is getting cut first?

Richard Hughes: We do not, for the reasons that we discussed earlier. The Government's detailed departmental spending plans run out next March, and after that, we are given just two numbers to put into our forecast: one for total current and one for total capital spending. But there is no breakdown by Government Department or major public service.

- Q101 **Dame Siobhain McDonagh:** When would you expect that we will know more about how those cuts will fall? When would be the normal time to find out?

Richard Hughes: It has varied over time. What we understand from the Treasury is that the next spending review, which would be the process of allocating that envelope out between Departments, will not happen until after the general election.

- Q102 **Dame Siobhain McDonagh:** In local authorities, it is much more defined and specific. You must have your budget ready by the last week in February, and you must be able to send your council tax bills out, but there is not that formula for Governments.

Richard Hughes: They have statutory deadlines as well as responsibilities to consult. How the Treasury plan to handle that is a question for them.

- Q103 **Dame Siobhain McDonagh:** As a result of this Budget, all 18 million tax-paying pensioners will see their taxes increase. Basic rate pensioners will be around £700 worse off, and on average pensioners will lose out by £1,000, or £8 billion as a collective hit. Do you recognise those figures,



HOUSE OF COMMONS

and do you think that they are accurate?

Richard Hughes: They paint a partial picture of what the sum total of fiscal policy means for pensioners. It is also important to bear in mind that pensioners have had a triple-locked state pension, which means that they have had full inflation protection on their state pension throughout the big rise in inflation over the past few years, when people of working age and earning income from salary have seen their real earnings eroded. It is important to not just look at the specific measures announced in the Budget about taxation without taking into account the relative protection that pensioners have had from the big rise in inflation via the triple lock.

Q104 **Dame Siobhain McDonagh:** But do you think the figures are correct?

Richard Hughes: I confess that I have not looked at them in detail, but as I said, when you look at the net impact of all fiscal policy on different groups, it is important to bear in mind what they are getting in terms of pension as well as what might be taken out of that in tax.

Professor Miles: I think the force of your questions is clear, but what it reveals is that there are simply no easy ways of achieving something that is essential to achieve, which is debt sustainability. The Government are trying to stop the stock of debt simply rising relative to GDP. I don't think that there is a costless, easy and pleasant way of doing that. It is about doing it by a combination of taxes going up relative to GDP, and they will be paid by households because, ultimately, households are the only people who pay tax.

It is also about doing it by having a very tight spending plan for the next five years. It isn't clear exactly where the cuts are going to fall, but it is going to be very tight. Real spending per person in the UK will be flat; it won't be rising for the next five years. I don't think there is some easy way of doing what is essential, which is to stop the debt to GDP ratio continuing to go up and up.

Q105 **Chair:** Would it be accurate to say that just as the tax burden has been at a high for a significant period of time, public spending during this Parliament, because of the pandemic and the energy crisis, has been at a record high as well?

Richard Hughes: Correct, and three things have pushed it up in particular. Departmental spending is higher post-pandemic than it was before. Welfare bills are higher, partly because of the issues around inactivity that we have been talking about. In particular, interest costs are higher because there is a larger stock of debt and much higher interest rates than we saw in the pre-pandemic period. All that puts a burden on the spending side of the Budget, which needs to be accommodated and is driving the fiscal adjustment that we are talking about.

Chair: Thank you. I think a few other colleagues have extra questions. Thérèse, did you want to ask some more?

Q106 **Dr Coffey:** Yes, please. In your economic outlook, you say that living standards are expected to recover more quickly than you forecast just a



HOUSE OF COMMONS

few months ago, growing by around 1% on average a year over the forecast. I am conscious of an increase in the tax burden and the increase in spending. In chart 4.2 in your forecast, you show that more than half the increases in the tax burden didn't come from policy decisions. Does that mean they have been the result of changes in the economy and what we have been through rather than an active choice of Government?

Tom Josephs: Yes, that is right. A lot of that reflects essentially a more tax-rich economy coming out of covid and in the post-covid period. Quite a lot of that seems to be driven by higher income tax and NICs. That looks like it reflects stronger earnings growth towards the top end of the earnings distribution, which therefore generates higher receipts.

Similarly, on corporation tax, we seem to have seen higher tax-paying sectors doing better and generating more profits, and therefore more corporation tax. VAT, the final big tax stream, has also been quite strong. Part of the reason seems to be that there has been a fall in the tax gap, which is the difference between the theoretical amount of VAT out there and the amount that HMRC actually collects. So HMRC is collecting more of the potential VAT, which is pushing up the tax to GDP ratio as well.

Q107 **Dr Coffey:** I guess that measures like getting Amazon and other retailers to report that in a more proactive way than they have in the past are one way to try to tackle avoidance or evasion.

Tom Josephs: Yes. We have done some analysis of this in the report, and we think that quite a lot of that fall in the VAT tax gap is due to HMRC measures to tackle it. It is also probably a bit to do with the declining use of cash in the economy.

Q108 **Dr Coffey:** In the Budget speech, the Chancellor frequently talked about how lower taxes lead to higher growth. In forecasting a historically high tax burden, I cannot see that the OBR is significantly reducing its underlying forecast for economic growth. Could you suggest why the OBR's economic model does not agree with the Chancellor on that particular economic projection?

Richard Hughes: In our forecast, we do take account of the effect of frozen thresholds and greater fiscal drag on the labour supply, and that offsets around 100,000 of what would have otherwise been a bigger rise in the labour supply over our forecast. We do have a drag on hours worked and output as a result of a rising tax burden from the rise in thresholds.

Q109 **Dr Coffey:** Briefly, can I go back to things like productivity? You talked about the digital story, and the answer you gave to our Chairman, Harriett, was that if we had gone back to pre-pandemic levels of productivity, we would be talking about a difference of tens of billions of pounds.

From your perspective in doing some of your analysis, what is the key difference? If I can share a story with the Committee from the short time I was at Health, NHS Digital refused to give information to NHS England, which I then got out of them, handed to NHS and that accelerated the



HOUSE OF COMMONS

merger. But it was all designed to improve understanding of productivity and similar. What changes would you like to see in that regard in terms of their productivity improvement?

Richard Hughes: Both the health service and the UK in general are a low-investment economy by international standards. In our models of how we model growth in the private sector, building up a capital stock increases capital per worker and, in the long run, output per worker. The same can also be true in the public sector. If people are working with better IT systems and better equipment, it can make them more effective in their jobs in the way that David described. In addition to having one of the least capital-intensive private sectors, we in the UK also have one of the least capital-intensive public sectors. The health sector is no exception, if you look at things like diagnostic equipment and the size of the health estate.

Professor Miles: The optimistic thing about artificial intelligence is that it is very cheap. A lot of it is free. It is not like industrialisation in the 19th century, when we had to build steelworks and shipbuilding yards. This stuff is very cheap.

Q110 **Dr Coffey:** May I take you to pages 126 and 127 of your outlook document? You talk about net migration, and it seems to suggest that you are making different assumptions on how spending on public services reacts to levels of net migration. Is that the first time that you have started to suggest that net migration could have a cost, rather than growth? I am just trying to understand that better.

I am also looking at the end of footnote "a", which states that "our forecasts will capture the cost of any immigrants from previous cohorts who now claim welfare because their claims will be included in the outturn data". Could you give us a sense of how many immigrants from previous cohorts you believe are now claiming welfare? If you haven't got it today, it would be helpful if you could share it.

Tom Josephs: No, I don't think I could give you a number today, but that is something we could maybe come back to you on. Essentially, the point is that in our forecast, we assume that new migrants will not add to welfare, because they are generally not allowed to claim welfare.

Q111 **Dr Coffey:** There is a five-year—

Tom Josephs: But there will be a stock of migrants who have been here for longer than five years. A proportion of them may have started to claim and therefore will be in DWP's caseload. We start the forecasts from that caseload and grow it from there, so they will be in the baseline. But we could maybe come back to you on the numbers.

Dr Coffey: That would be really helpful—thank you.

Q112 **Chair:** Do any other colleagues wish to ask further questions? No? I will wrap up with a couple of final questions. Richard, you said how incredibly important this Committee's scrutiny of your forecasts is, and we have had a very wide-ranging discussion today, but is there any particular topic we



HOUSE OF COMMONS

should have been drilling down into more?

Richard Hughes: One thing we would really encourage you to do—because we have talked so much about uncertainty and risk, as well as all the points that David was making about long-term sustainability being one of the biggest issues that will confront any Government when making fiscal policy—is have a session on our fiscal risks and sustainability report this summer. That will go into some of those questions, including around the health service and the outlook for migration and their implications not just in our five-year forecast, but looking 50 years ahead at longer-term trends. That would be really useful because it would help us to shed some light on issues that do not show up very much in our five-year outlook but show up a lot more when you look 50 years ahead.

Q113 **Chair:** Thank you; that is noted. You had to do a forecast for a November fiscal event and then had very little time before you had to do a forecast for a 6 March fiscal event. Have you been given any indication, other than that report you just alluded to, that you will have to do anything at any time in the future?

Richard Hughes: Not as yet, but we stand ready to do as asked.

Q114 **Chair:** With the normal 10 weeks' notice.

Richard Hughes: Indeed.

Chair: If there are no further questions from colleagues, this has been a very interesting session. Thank you very much for your time.