HOUSE OF COMMONS

Treasury Committee

Oral evidence: Budget 2024, HC 625

Tuesday 12 March 2024

Ordered by the House of Commons to be published on 12 March 2024.

Watch the meeting

Members present: Harriett Baldwin (Chair); Mr John Baron; Dr Thérèse Coffey; Dame Angela Eagle; Drew Hendry; Danny Kruger; Dame Siobhain McDonagh; Anne Marie Morris.

Questions 115-213

Witnesses

I: Paul Johnson, Director, Institute for Fiscal Studies; Yael Selfin, Vice Chair and Chief Economist, KPMG UK; Torsten Bell, Chief Executive, Resolution Foundation, and Prof. Arun Advani, Professor of Economics, University of Warwick.

Examination of witnesses

Witnesses: Paul Johnson, Yael Selfin, Torsten Bell and Prof. Arun Advani.

Q115 **Chair:** Welcome to the second of the three sessions we are holding as a Committee to scrutinise last week's Budget from the Chancellor. We heard from the Office for Budget Responsibility this morning, and we are hearing from the Chancellor tomorrow. This afternoon we have a great panel of witnesses, and I shall start by asking them to introduce themselves.

Prof. Arun Advani: I am Arun Advani from the University of Warwick.

Paul Johnson: I am Paul Johnson from the Institute for Fiscal Studies.

Yael Selfin: I am Yael Selfin, chief economist at KPMG.

Torsten Bell: I am Torsten Bell from the Resolution Foundation.

Q116 **Chair:** Thank you very much. Professor, we have you here because we understand that you are an expert on the tax system. My first question is more on the macro side of things. We heard from the Office for Budget Responsibility this morning, so I will start by asking each of the three economists where you differ the most from the forecasts that the Office for Budget Responsibility has put out.

Paul Johnson: I don't think I have a particular answer to that in terms of forecasts. We do not do our own macroeconomic forecasts. On the fiscal forecast, because they have been forced to assume unlikely things like fuel duty rising and spending being held very tight, I expect that their fiscal forecasts are more optimistic than is a central expectation. That is not down to a difference about macroeconomic outcomes, though.

Q117 **Chair:** Your main difference is that you think that tax will be a bit lower and spending will be a bit higher—is that your main point of difference from what has been published by the OBR?

Paul Johnson: Yes, and the bigger of those will be spending probably. As I say, I think that their forecasts are not a central expectation, but that is not their fault; that is because that is what they have to do.

Q118 **Chair:** When we heard from the OBR this morning, they said that public sector productivity is key, that public sector productivity is still lower than it was in 2019, and that if we were to get public sector productivity back up to that level it would be worth billions and billions in productivity from the public sector. Do you agree with that assessment?

Paul Johnson: It will certainly be good to get it there. We know that health productivity, for example, is not where it needs to be, but you actually need to get it there just to start getting the waiting lists down, so of course it is better to have higher productivity than lower, but I do not think that that will massively reduce the pressure for spending.

It is worth saying about the macro forecasts that one thing they continue to do is to say that they think that economy-wide productivity will grow halfway between where it was pre-financial crisis and since. You could argue that that is quite optimistic. On the public sector productivity element yes, we need it, and yes, it would help, but I am less convinced that that would make the scale of cashable savings such that we really kept to the numbers that are published.

Q119 **Chair:** We will have further questions on the NHS productivity plan this afternoon but, Yael, as a private sector economist, where did your forecasts differ most from those of the Office for Budget Responsibility?

Yael Selfin: Our forecasts of inflation are broadly in line with those of the OBR; where we differ is on GDP growth forecasts. That is partly because their input of the Q4 numbers and the revision to the data were not taken into account in the current forecast, whereas we had the ability to incorporate that, but the bulk of it is really because our expectation for productivity growth is lower than the OBR's.

Q120 **Chair:** You are you are above the Bank of England but below the Office for Budget Responsibility on productivity growth.

Yael Selfin: To give an example, our forecasts at the moment are for GDP growth of 0.1% in 2024, 0.9% in 2025 and 1% in 2026, versus 0.8%, 1.9% and 2% for the OBR latest forecast.

Chair: Torsten?

Torsten Bell: I do not have loads to add. I think those are highlighting the key areas where the OBR looks a bit out of whack. The productivity forecast is basically assuming the economy gets growing again in a way that it did not over the last pre-pandemic decade. I definitely hope that that is true, but the gap between the Bank of England's and the OBR's growth forecasts is probably the largest it has been, definitely in a sustained fashion; it is a very large gap. The Bank of England is incredibly pessimistic—hopefully, again, far too pessimistic—and the OBR far more optimistic than anyone else in the private sector forecasted.

Q121 **Chair:** And the productivity assumptions?

Torsten Bell: Most of that is driven by productivity assumptions. Some of it is about when people have updated their population stats, but mainly it is about productivity differences—definitely between the Bank of England and the OBR it is.

Q122 **Chair:** Okay. I will ask the same question about inflation, because again there was quite a meaningful difference between what the OBR was forecasting—below 2% by the end of the year—and the Bank of England's forecast, which has it falling but then rising again to 3% by the end of the year. What is driving that difference? We would like to hear your views, as well as your organisation's.

Torsten Bell: There is quite a lot of uncertainty, so I think that either forecast is reasonable. Personally, I prefer the Office for Budget Responsibility's forecast as a more likely scenario, but we should say that they are very uncertain. The Bank of England's forecast is, to some degree, fitting a story, which is that interest rates are not going to come down as fast as markets expect, and because they are not and because of what they have put in, they have to have inflation bouncing back up again.

On the substance, what matters is what you think is going to happen to the stickiness of wage growth. If you look at what is actually happening in the data, we have different things pointing in different directions. We have a very high level of nominal wage growth in today's labour force survey—you will have seen it is roughly around 6%. If you look at the shorter-term wage growth numbers, we have quite a fast slowing going on, but again that is within AWE, and that does not quite match up with what we are being told by firms—

Chair: Is that average weekly earnings?

Torsten Bell: Yes, but they are seeing that they are falling very fast. There has been hardly any growth in private sector pay in the average weekly earnings since the summer. Now, for companies in other necks of the woods, if you look at what the Bank of England's agents are reporting, for example, they are saying that they are still expecting to pay 5% this year. If that is what happens, you have a problem and the Bank of England forecast maybe looks more plausible; but as I say, AWE shows it falling to below 3% in terms of the shorter-term pay growth. Let's hope that that is what actually happens.

Yael Selfin: To add to that, there is one element of the output gap, which is essentially the excess capacity that is still available in the economy, wherein the OBR is expecting fairly significant slack—much more than the Bank of England and more than we expect at the moment—and that means that inflation could go further down below the Bank of England target, by more than what the Bank of England or we expect in the medium term. That is partially driven by the assumption of stronger productivity that is building that additional capacity in the economy.

Q123 **Chair:** Paul, you have described the Chancellor's fiscal rule as "bizarre". What would you think would be a better fiscal rule?

Paul Johnson: No fiscal rule is perfect and I should say that the one thing that the current fiscal rule has done is constrain how much he has been able to do this time round. That is positive. In a world in which he was not constrained at all, he might have done more to provide pre-election giveaways, but he was constrained by his fiscal rule. Of course, it is bizarre because it is just about debt coming down in the fifth year of the forecast period.

I think there are two ways you could go. One is to have a more qualitative rule, where the Chancellor says, "My aim is to get debt down into the medium term," and then each time you get the OBR to say whether it thinks that is happening and whether it thinks the direction of policy is consistent with that qualitative rule. There is quite a lot to be said for something like that. Obviously, you could not do that if you did not have an independent OBR, but with an independent OBR you can do something along those lines.

Otherwise, you are always in the game, as it were, of having specific numerical rules where something of the form that we have had in the past, which is less forward-looking—not looking at where things are going in five years but maybe looking three years ahead—and is looking still at getting debt falling between now and the end of that period or at that point. The problem at the moment is the current fiscal rule is just about the loosest we have had. Any rule of that numerical kind that you put in its place would be even more constraining than the one we have, because debt is actually rising over the next three or four years and with pretty much any other rule, you would have had less flexibility than you have at the moment.

Q124 **Chair:** Indeed, but what I am hearing there is that the Institute for Fiscal Studies is not campaigning for a particular different fiscal rule.

Paul Johnson: Not a specific one. As I say, I think there is quite a lot to be said for moving to something more qualitative.

Q125 **Chair:** Would that reassure the financial markets, do you think, Yael? It sounds slightly hazy and grey, and this time the bond markets were stable after this Budget.

Yael Selfin: Yes, but I agree with Paul that it is really much more about the substance and the overall credibility of the spending plans and the future further along the horizon. Therefore, the rules themselves are less of the issue; it is more—

Q126 **Chair:** —the credibility of the thinking that has got them to that forecast. In that context, are you not suggesting any change to the fiscal rule either?

Yael Selfin: I agree with Paul that these are not the ideal rules. I think there could be others that would give the Chancellor more room to look at the longer-term horizon and really address some of the key issues that we have in the UK economy, like boosting productivity. Trying to prioritise the implication of spending in the longer term, and what would boost longer-term prospects for the UK economy, is really important. I am not sure whether the current set is the best for that.

Q127 **Chair:** Torsten, all Chancellors are always likely to want to have some version of the fiscal rules that we have. Can you envisage any fiscal rule that would ever bring debt down to the kind of levels that we saw before the pandemic, as a percentage of the economy?

Torsten Bell: It is not really a fiscal rule but a fiscal policy that brings debt down, and I think we should really distinguish between those. There is a lot of discussion about rules, but really we care about what the actual fiscal policy is and what we actually do. In the end, that is what markets care about—whether your policy is credible. You remember that Prime Ministers Liz Truss and Rishi Sunak both had the same fiscal rule, but the markets believed one and not the other. The reason is that fiscal policy is what matters, not the fiscal rule.

In the short term, under either of the main parties, we are not going to bring debt down at all, let alone bring it down to where it was before the pandemic or certainly where it was before the financial crisis. Yes, the forecasts show a fall in debt between two years at the back end of the period, but first, partly for the reasons that Paul was laying out—that there is some optimism bias in the assumptions in those forecasts—you are not going to have debt falling, and secondly, because stuff happens. Even if you did have it falling in that individual year, we know that a recession turns up roughly once every 10 years. It costs you enough in terms of a share of GDP added to your debt stock that your debt will not be on a downward trajectory with this current fiscal policy.

All else being equal, there is a bit of a weird thing at the moment. Lots of people are criticising the fiscal rule, but really what they mean is that fiscal policy is too tight. If you watched commentators ahead of the Chancellor's appearance on Laura Kuenssberg's show, they were all saying, "We don't like this rule. It's too constraining." The truth is that we have a very loose fiscal policy and, exactly as Paul said, debt is not falling. It is not falling even on the basis of these forecasts really, and it definitely is not once you take into account that the world gets messy. That was a long answer, but no—not on the current fiscal policies that you are talking about.

In terms of the actual fiscal rules themselves, the five-year focus is definitely silly. Whatever you think about anything else in the rules, in normal times, if you think that the goal is to have debt falling—I will come on in a second to whether it should be debt falling—you need a rule that basically requires you to have debt falling in every year outside of a recession and the recovery from not recession, not just five years out, because that is a rule to never have debt falling.

Secondly, the fact that the consensus in British politics is that we should focus fiscal rules in ways that do not take any account of the difference between investment and current spending is causing us big problems. That is why, whenever a downturn happens or just bad news happens, we cut public sector investment. That is what is going on right now. That is definitely bad for the country in the long run, and we are definitely moving into a phase where we have to be investing more rather than less. Net zero on its own would be enough to require that, but so would lots of other things. Lots of other people in some parts of British politics would like a lot more investment spending on defence—the bombs are capital spending and the nukes that we are building are capital spending. You are going to need more capital spending in the future.

The fiscal rules are driving us to a perverse outcome. I do not think that the Chancellor thinks that is a good thing, but it is just where politics and the fiscal rules have taken us. Fixing that is not totally straightforward, so we should definitely get rid of the rule that we do not talk about anymore, because it never binds. We should not have an overall borrowing target but a current budget balance target that only looks at current spending versus current taxation, and I think that is generally accepted. That is not making a difference to the fiscal policy at the moment because it is not the rule that is biting.

On debt it is harder. I think all reasonable people should probably think that we should get rid of that borrowing target and replace it with a current budget target. Debt is more complicated. In a perfect world, you would prefer to have a net worth target than a net debt, which takes into account the value of assets that the public sector holds. That is harder to do in practice because of the valuation of those assets, and indeed of your liabilities—public sector pensions is a case in point.

You would have to do that carefully. I would probably be looking at both debt and net worth to come to a rounded view of what is happening to the public sector balance sheet, but that is where you would look to move towards.

Q128 **Chair:** Did you want to add something here, Professor Advani?

Prof. Arun Advani: Torsten picked up the two points I was going to make. I agree with everything Paul said, in that I prefer a qualitative test to a quantitative one. The OBR standing up and saying, "This is how likely we think it is to look consistent with whatever our overall strategy is," is better than having a tick-box exercise, which would lead any Chancellor to want to game it directly to get just under the target.

If we are going to have a fiscal target, the first of the two things—both of which Torsten picked up—is making sure that it is a target that covers all the years rather than just the fifth year, because the downside of the current rule is that we can increase debt every single year as long as we have it declining in that fifth year and it looks okay. That is clearly not consistent with what any of us would think was the goal behind that kind of rule.

The second thing is that we should not think that investment is free and can be done unlimitedly and separately, but we probably should not have it directly in the same target. We should think about it separately, because, exactly as Torsten said, the current system encourages Chancellors, when it comes to the crunch, to say, "All right, I will cut the capital spend so that I can afford a bit more of the current spend," and that will happen year after year.

If we are going to make sure that there is scope for investment, and if the point of the rule is to encourage good policy and good long-term thinking, we need to make sure we have some way to think about that investment separately from the current spend directly, rather than as something that can just be hidden away together, with all the money getting moved over into current spend every time we get to a crunch.

Q129 **Drew Hendry:** I want to talk about departmental spending plans and the impact on public services. Perhaps I could start with Paul and Torsten. We had Richard Hughes from the OBR in, who previously told the Lords Finance Committee, on the fiscal forecast: "Some people have referred to that as a work of fiction. That is probably generous, given that someone has bothered to write a work of fiction, whereas the Government have not even bothered to write down their departmental spending plans". He stuck by those comments this morning. Is there sufficient clarity on the Government's future departmental spending plans at this fiscal event?

Paul Johnson: There isn't clarity. The Chancellor was very clear that we are not going to get a spending review until after the election. That is a shame, because it means there is nothing for any of the parties to base what they are saying on. It is easy to say that spending will rise by 1% a year after the election, if you are giving no sense of where that spending will be.

As you will have seen, calculations by us, the OBR and others show pretty clearly that, if you take seriously some quite conservative assumptions about what is going to happen to Defence and Health spending and so on, that will mean cuts across the rest of public services—especially when you take account of that on a per-person basis, because of course the population is growing here.

Q130 **Drew Hendry:** I want to come back and concentrate on that issue in a second, but could the Government give any more clarity, given that the spending review has not been undertaken?

Paul Johnson: They could do a spending review before the election.

Q131 **Drew Hendry:** Should they?

Paul Johnson: In normal times, we would expect a spending review in the summer-autumn, kicking in from April 2025. Given the uncertainty around an election, you might think that is a slightly odd thing to do, but Departments will want to know what they are expecting to spend from April 2025. If we do not have an election until the very end of this year, and then a spending review, that will give them very little chance to prepare.

More important is the point about transparency and accountability. My sense is that both main parties will probably hide behind the fact that there is nothing saying what will happen to the Justice budget or the local government budget, and so on, so that the difficult trade-offs are not really discussed.

Of course, that is in the context of the Institute for Government work, which you will have seen, showing that virtually all public services are doing worse than they were in 2019, when they were doing worse than they were in 2010, for instance, as well as the fact that the areas that are likely to grow—Defence, Health and so on—and the ones that are not going to grow, or that are at risk, are exactly the ones that had significant cuts in the 2010s.

Q132 **Drew Hendry:** As I say, I want to come on to that again, but I am hearing from you that they should have, and they haven't, and that that is an issue.

Paul Johnson: I would very much like them to indicate at least how they would make the sums add up. They have given us the total, so what is their proposal for meeting that envelope? That could be a formal spending review, or it could be something that comes out in a manifesto, for example. However, in the interests of transparency, given that we have these total numbers, there is a strong case for us to be told how the Government intend to make the individual bits add up to the total.

Q133 **Drew Hendry:** Torsten?

Torsten Bell: I agree with all that. In terms of democracy, you obviously would like to know more. In terms of administering the public sector, it is definitely deeply suboptimal that we will not even get a one-year spending review for '25-'26. Say, for example, that we have a late October election: that means that whoever is the Chancellor after the election must deliver a spending review basically within a matter of five or six weeks.

You really need to have done it by the first week of December, because you do not need to give just Departments their budget: you must do the spending review and give Departments their budgets, and they then need time to do, for example, the local government settlement and the schools settlement. Otherwise, if we leave it later than that, we are at serious risk of running into the start of the financial year without having given schools and councils budgets. If you do that kind of thing, you cannot be surprised when you get bad value for money. Those actions are concrete.

I agree with Paul on the high and mighty transparency of democracy—I like democracy to be well-informed, and you should all go and inform it—but for the people running public services right now, not doing at least a one-year spending review, if we are having an election in the autumn, is a very bad thing indeed.

Q134 **Drew Hendry:** Let's drill down on that and what Paul said a second ago. The OBR has stated, "Meeting these and other commitments on schools, childcare, and overseas aid spending would imply a real cut in all other departments' budgets of 2.3 per cent a year from 2025-26." What particular Departments, in your view, are likely to be the big losers here?

Torsten Bell: The ones they are talking about are the likes of the Ministry of Justice—you will have seen it announced yesterday that prisoners are being let out of jail early to ensure that we can manage a prison estate that has not had the investment it needs. Local government is the other big one.

Q135 **Drew Hendry:** How bad is it for local government?

Torsten Bell: We will not be able to deliver a 13% cut to local government spending power in the next Parliament. We are all talking about the tax rises that have been announced in recent years, but one that does not get discussed, because it is not formally set by the Treasury, is obviously council tax. That is going up by 5% basically every year for ever in these forecasts. Why is that happening? Have you all met your potholes? You cannot do a focus group on any topic right now around the country, even if it has nothing to do with public services, without people raising the potholes.

Q136 **Danny Kruger:** Really?

Torsten Bell: Yes. Just as a little side story, potholes are usually brought up as a symbol of the public sector not being able to deliver at all. They are undermining people's faith that anything can get done, and that is a real worry.

Paul Johnson: I agree. There are other things that can give. For example, the OBR's numbers are predicated on some pretty horrific expectations on spending on disability benefits. We are talking about public service spending here, not welfare spending, so you could reduce the rate at which you increase the state pension.

You could find—although it is not easy—some way of controlling the various parts of the welfare budget, which gives you more room for manoeuvre, but in the public services budget it is exactly as I said: those areas that had the biggest cuts in the 2010s, which were the unprotected areas, would again be the unprotected areas under these scenarios. The backlogs in the justice system are huge, and it is clear that local authorities are struggling.

Again, with local authorities, you could just say from the centre that they have less in the way of expectations or the legal minimum requirements they have for getting special educational needs kids to school, or you could reduce the standard of social care. Those are options, but they are options that would have really bad social consequences. In local government, I think something like two thirds of their budget is going on social care of one kind or another and supporting children in that way.

Q137 **Drew Hendry:** Just to underline that, who do you see as the big losers in this?

Paul Johnson: Let me put it this way: I do not think that this is what will happen. That is not my central expectation. Whoever wins the next election, it is most unlikely that they will be imposing 10% to 15% cuts across those services. It is much more likely that we will either borrow more or tax and spend more, or we will get lucky with growth. I genuinely would be surprised—to go back to my very first answer, because it is the law, as it were, the OBR must put that as its central forecast, but it is not my central forecast of what will actually happen.

Q138 **Drew Hendry:** Let me move on to a specific issue. The Government have announced an additional £2.5 billion of day-to-day funding, as they put it, for the NHS in England. They have described it as "protecting funding levels in real terms and supporting the NHS to continue to improve performance and reduce waiting times." Have the Government done enough to put waiting lists on a long-term downwards trajectory?

Paul Johnson: The £2.5 billion is just enough to stop spending falling between this year and next. That is because spending was topped up this year. It is being topped up now ahead of time for 2024-25 and will almost certainly be topped up again. There is an interesting game-theoretical question about whether that is a sensible way of doing things, because if you offered them more, they would still come back for top-ups later on. It is an illustration of the kind of not-very-sensible way that we fund various parts of the NHS. In terms of getting waiting lists down, we know that another £1 billion has been moved from capital to current spending this year. Alongside all of the last decade, that is one of the reasons we are struggling with waiting lists.

Bits of the longest waiting lists are coming down. On some reasonable assumptions, waiting lists should start to turn the corner over the next few years, but work that my colleagues have done suggests that, on reasonable assumptions, waiting lists will still be higher at the end of the next Parliament than they were pre-covid.

Q139 **Drew Hendry:** Just on covid, can the increase in waiting times be solely explained by the pandemic?

Paul Johnson: I don't think anyone really knows what has created all of this. As far as I can tell, that includes NHS England. There are a number of elements and hypotheses, including that lack of capital I referred to, and the fact that, while there are a lot more staff, they are on average less senior than they used to be. There are clearly problems getting people out into the social care system. There are still some people in hospital with covid, with all the isolation and so on that that requires. There is some evidence that people are going in with worse health than they used to.

There is also evidence that GPs are less likely to refer people to hospital, because they know that the waiting lists are higher and hospitals are struggling.

There are also bits of the waiting lists that are not even part of the headline waiting lists, such as the length of wait for cancer treatment. I was shocked when I realised just recently, on the basis of my colleagues' work, that there has been a remarkable reduction in the number of people with urgent cancer referrals who are actually being treated within two months of their referral, even after they have been diagnosed as having cancer. There are problems right across the piece. The amount of resource is now such that things will start to move in the right direction, but all the evidence indicates that they will move pretty slowly in the right direction.

Q140 **Dame Siobhain McDonagh:** I don't know why I am telling you guys this, because I think you know all that I am going to say to you, but 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 they were at its start. The Conservative Government between 2015 and 2017 has the second-worst record on living standards over the course of a Parliament, with a modest improvement of £260. What have the Government got wrong that has led to the slowing in improvement, and now fall, in living standards?

Torsten Bell: The biggest answer is that it is really good to avoid pandemics and being in Europe during an energy crisis where gas prices in Europe have obviously gone up considerably. Those are the big things, which you may or may not think the Government have control over. Within that, household budgets are also being squeezed by taxes rising; some of those intentionally by policy, and some of those because of wider changes in the economy going on over that phase.

In terms of what is happening in the very short term, the answer is that the figures you read out are certainly right; this is the first Parliament on record where we should expect to see living standards at a lower level at the end than at the beginning. All I would say to balance that is that it is not quite as suicidally depressing as it was in the autumn. The OBR is at least projecting some income growth next year, rather than further falls, which is welcome. But yes, the numbers are still terrible.

In terms of whose income is probably growing next year, our projections are that middle and higher-income households should be seeing some income growth next year, because wage growth is now happening in real terms. For poorer households, because the cost of living payments are being brought to an end, with the last payment being made in February—a policy choice, but an understandable one—poorer households will probably have lower incomes next financial year than they had this year. That is a serious situation because we are already seeing those households struggling. Food bank usage is up by 30% over the last few years. It is a very difficult situation that people are going to be wrestling with this year.

Yael Selfin: I will add that we have had a relatively healthy labour market, in the sense that unemployment is still relatively low. That is partly guaranteeing that wage growth remains relatively strong. We are expecting wage growth to moderate a little bit but remain well above inflation. Therefore, people are gradually recovering their real purchasing power over time. That will improve.

We still expect the higher interest rates to feed into higher mortgage costs over the next couple of years, so we will have tightness there. But generally, in the medium term what is driving it, again, goes back to productivity. We need strong productivity. We need stronger productivity in order to be able to benefit from higher living standards.

Paul Johnson: I do not have a lot to add, but there are two things I will say. The national insurance cut in January and April is big, and it will mean that the tax bill for middle to higher-middle income earners will be significantly down—quite a big boost to living standards for that group, which very significantly offsets the increase in income tax as a result of the freezing of allowances and thresholds. That will be a boost for that group.

In terms of the period, there is a sense that the beginning of the Parliament happened to coincide with just before the pandemic hit. If you had had a Parliament from, say, 2008 to 2013, you would have had a bigger fall over that period—it just happened that we did not have a Parliament over that period. I don't think that in either case it is likely that Government policy would have made a great big difference. To be clear, the fall is not just because of who happened to be in Government at the time; at least a large part of it is because it happened to be a bad time.

Torsten Bell: One thing that is worth reflecting on is that there are things we control and things we do not. Generally, the last few years have been really difficult for most European economies. The bit where the UK looks exceptional is the longer-term period—from 2010 to now—where growth per capita, which is what matters, and productivity growth are much weaker than other countries. Productivity growth is about half the level in the UK over those 14 years than across the advanced economies.

Q141 **Chair:** Can you clarify whether that started in 2010 or with the financial crisis?

Torsten Bell: No, the slowdown in productivity growth probably starts even slightly before the financial crisis, but the financial crisis is the cause for the start of the slowdown. Normally, you have a big crash and then you have faster growth in the recovery phase, if anything, because you have taken the big output hit during the 2008-2009 phase.

Instead, what we have seen is basically next to no productivity growth, and that is where the UK looks exceptional. I would rather be us than Germany right now, in lots of ways, whereas I would rather have been Germany looking across the whole 15-year period.

Q142 **Dame Siobhain McDonagh:** That brings me to my next question. In comparison to Australia, Canada, France, Germany and the Netherlands, typical households in the UK are £8,300 worse off. What is it that those countries have got right? I appreciate that it may be their energy supply and policy. What makes them so much more prosperous than the UK, and what is it that this Government have got wrong that means we are falling so far behind?

Torsten Bell: That is a Resolution Foundation statistic you are reading out. It is a typical-income household, so there are two things going on behind that. First is the size of the pie—the GDP per capita that is being shared out, and how unequal they are. The five countries you raise are all more equal than Britain, so the middle-income groups receive a bigger share of the living standards pot being shared out in those countries.

Secondly, those countries either started richer than us or have grown faster than us over those 15 years, or both—in fact, in most cases it is both. Those two things together give you higher living standards for the middle class in those other countries.

Yael Selfin: I just want to add one more point about living standards, looking potentially at other metrics. When you look at surveys, people appreciate not just the money they get, but other things such as the quality of health, including mental health. That is potentially one of the other things we should measure when we talk about living standards and how we compare with other countries. I'm sure Torsten will be able to share some statistics.

Torsten Bell: I promise not to.

Dame Siobhain McDonagh: Any other comments?

Paul Johnson: I agree. We are less productive than those countries, for the sorts of reason we have discussed.

Torsten Bell: I happen to have been looking at it today, so I will also highlight that housing is a catastrophe.

Dame Siobhain McDonagh: Don't say any more—that's my next question.

Torsten Bell: All right, I won't say any more.

Paul Johnson: I think we will all agree with you there.

Prof. Arun Advani: I definitely agree that the way to think about the productivity problem is not over the last Parliament, but going back to the financial crisis. However, you can even divide that into two phases. The immediate post-crisis period was a period in which most countries struggled; their productivity did not bounce back in the way we would expect after other recessions.

In a way, the more striking phase is from the middle of the last decade, when we continued to have bad productivity growth and not to have wage progression in the way that other countries started to see. There are a lot of things that you can point to, but one that economists often point to is Brexit. One part of that is that leaving the EU has genuinely made us poorer, but more important than whether we are in or out is the tremendous policy uncertainty we had over the whole period. We had five or six years in which we did not quite know what was happening and there was no decision. That makes it very hard for private sector investment to take place.

We have talked about public sector investment being pretty poor over that period, because Governments have wanted to constrain spending and have pushed the money—when they had it—towards current spend, but the private sector has also not invested. A big part of that is that without certainty over what the policy looks like, it is very hard to make a decision. Whether you think in or out is better, not deciding and not being sure what the deal looks like for a long period was certainly worse for the UK, because for that long period nobody could quite be sure what to do.

Then we got to the end of that period and we had some certainty—exactly when the pandemic started, so that is another period in which it has been pretty hard for companies to be organised in planning for the future. The question now is what will happen going forward: the OBR has done its best estimate and we have spoken already about what other predictions for productivity might look like.

Q143 **Dame Siobhain McDonagh:** One of the surprises to me, as an MP in south-west London, was that the Chancellor had so little to say about housing, because it is certainly the biggest social problem I come across. More than 1 million households are expected this year to come to the end of their cheaper mortgage deals, leading to an average increase of £1,800. Previously, mortgage holders on average had £61 left after paying for essentials, but after those mortgage changes they are likely to find themselves in debt by about £100 a month.

It is even worse if you are dependent on the private rental or social housing sectors. I had a couple come to my advice surgery last Friday who will imminently be homeless. The man has an income of £40,000 a year, and there was not a shared ownership project, even at the smallest proportion he could buy, that he had enough money for. We now have 550 families in temporary accommodation. We are used to being down at 100. The council cannot cope and the families cannot cope, and we are putting them in accommodation that costs the taxpayer a fortune and that you would not let your pet live in. Why did the Chancellor have nothing to say?

Torsten Bell: There are a number of different things going on within that. We talk about the housing crisis or housing problem, but there are obviously a number of different problems going on. Certainly, the levels of homelessness that we are seeing—broadly defined to include not just street sleeping but temporary accommodation—are all at absolutely terrible levels.

In so far as policy has a part to play in that, which it does, there is good and bad news. The bad news, I am afraid, is that lots of that was predictable, because that is what happens if you freeze the local housing allowance and leave large numbers of families unable to afford their rent over the course of the last few years. The good news, which the Chancellor announced in the autumn statement—so he has had something to say on housing—is that he is reconnecting the local housing allowance to the 30th percentile of local rents. That comes in in a few weeks' time and is a very significant increase in people's rent support, including in south-west London, so it should start to help.

We are in a silly world now where we all know that we have to let the LHA rise with rent levels, but we pretend for three years that we can leave it frozen to keep the public finance numbers in the forecast looking okay, and then homelessness starts to build and we reconnect it temporarily. That is not a good system to be in. That is at the bottom end of the housing market; obviously at the top end the mortgage increase is the thing that is really driving concern.

Stepping back from both of those, the underlying problem is that in Britain housing is too expensive. If you look at the cost of housing for those who face housing costs, relative to the amount of housing you get, we are definitely the most expensive place to buy housing in the OECD. I was looking at something yesterday that is absolutely staggering: the size of the home per adult that you get in the UK—not London, but the UK as a whole—is now less than in New York. That is mad. That is what happens when we do not build enough houses.

Danny Kruger: Say again?

Torsten Bell: The amount of floor space per person in the UK as a whole—obviously in London it is less than New York, because you do not have tower blocks everywhere—is now lower than the New York metropolitan area; not Manhattan, but the New York metropolitan area. We now have less floor space than the Japanese, who famously love tight floor spaces, and that in the end—

Danny Kruger: Do you know what the population of the New York metropolitan area is?

Torsten Bell: I cannot remember off the top of my head, but I can definitely write to you with that, because it is going in a book. It is terrible and it is terrifying, and the only reason we are getting away with it is that 35% of Britons now own their home outright, so they do not face housing costs. But if you face housing costs, Britain is a disaster.

Chair: I feel we could do a whole inquiry on this.

Torsten Bell: Even more, we could build some houses as well as an inquiry. That would be nice.

Chair: I think 2.5 million or something have been built.

Q144 **Dame Angela Eagle:** Yes, that is true. There are 12,000 people on the housing waiting list in Wirral, where my constituency is, and 30,000 houses in the social sector. You can imagine the pressure that everybody is under with those kinds of figures as housing rises up the political agenda and the Chancellor says very little about it.

I wanted to ask about growth, but before we get there, could you say what impact the plan to abolish employee and self-employed national insurance contributions would have on pensioner taxation if it were funded through an increase in income tax?

Paul Johnson: If it would cost £40 billion-odd to cut national insurance contributions, that would require—

Q145 **Dame Angela Eagle:** Is that just for employees?

Paul Johnson: Just for employees, yes.

Q146 **Dame Angela Eagle:** If you are going to get rid of it, presumably you would also get rid of employer national insurance contributions?

Paul Johnson: That would cost you £200 billion or something; I do not think anyone is contemplating that. It is important to be clear that when anyone talks about getting rid of national insurance, they are talking about only the employee bit, because the employer bit is three or four times as big as the employee bit now. If you think it costs you 40-something billion pounds, that is something like 6p on income tax, if you were to pay for it like that.

I think that would be a better world than the world we are in. A world in which we are equalising the tax rate, apart from the employer bit, on earned income and other income would strike me as being an appropriate place. We would think it was a very strange world where we started off with the same rate of tax on all income and then suddenly started increasing it on earned income and decreasing it on other income.

For me, that would be the right thing to do. Yes, it would mean a redistribution from, on average, people over pension age to those under pension age.

Q147 **Dame Angela Eagle:** Were you surprised to hear it suddenly floated almost as an afterthought in the Budget?

Paul Johnson: I think it is one of many things that was said in the Budget that I do not think is going to happen. I do not think that there is any prospect of it happening in the foreseeable future.

Chair: It was not said in the Budget specifically, was it?

Dame Angela Eagle: But it was said by the Chancellor in his interviews post Budget. It was also said by the Prime Minister in his interviews post Budget, so we presumably have to take it seriously.

Torsten Bell: Well, it is not going to happen on any plausible timeline. Would it be a better world? Yes, it would be a better world—not if you are a landlord or a pensioner, but generally that would be a better tax system to have. It would make a pretty significant difference to the quality of the tax system, so it is not small fry.

Q148 **Dame Angela Eagle:** Do you think income tax should have to go up to pay for it?

Prof. Arun Advani: It would be an income tax cut of 2p for workers. It would be an income tax increase of 6p on every pound if you are a pensioner or landlord.

Torsten Bell: Those are two reasons why it is not going to happen. There are others.

Prof. Arun Advani: It would be a 6p increase for people who have incomes that are not covered by national insurance to pick up for those who have incomes that are covered by it. In the context of the idea being to abolish this and pay for it by increases in income tax, it is just a straightforward redistribution towards people who get their income from work, and away from people who get their income either from wealth or from pensions that would have been saved up from work. It is a straightforward redistribution between those groups, and then the question is "Do you want that?"

There are two questions to ask about that. One is "What are your political preferences?" We have nothing to say about that, or I certainly do not. The other is "What do we think it does for incentives to work and those kinds of thing in that context?" That is for the same rationale that cutting national insurance contributions, as the Chancellor has done, is something that might be supportive towards the labour market, because it encourages people to work; it encourages employers to hire people. The continued further 2p cut is effectively what you are getting. It is another 2p compared with the 4p we have already had, but the trade-off is that you are charging landlords and pensioners more. It would be a big change to do all at once, but it is something that could be done if someone wanted to do it.

Q149 **Dame Angela Eagle:** Torsten, how much of the so-called tax cuts that were announced have been paid for or financed by borrowing?

Torsten Bell: There are a number of different ways of thinking about that. If we look across the five years of the forecast as a whole, we are talking about tax cuts of about £65 billion. That is the cumulative figure, in terms of how much they mean in extra borrowing if nothing else was done. Of that, he has brought back in about a third through raising other taxes. That is non-doms, which I am sure we are coming on to, a slightly extended windfall tax on the oil and gas companies, and a few others. You are at about two thirds borrowing, one third tax rises. Those are the decisions.

Running the other way, the Office for Budget Responsibility has given him slightly lower borrowing pre-measures than he had back in the autumn. That is making it show up as no change to borrowing overall in the forecast. But in terms of what the decisions have done, the decisions are roughly two thirds borrowing, one third tax rises. It is more tax rise-heavy if you are just looking at the final year, but one of the things we are trying to encourage you to do is not just look at 2028-29 as the measure for everything, because otherwise you could borrow for everything and just fund it in the final year, and that is exactly the problem we are trying to get away from. That is why I am giving you the figures in a cumulative forecast over the five years.

Paul Johnson: Another way of thinking about that is that we have a definite up-front £10 billion tax cut that is sort of half paid for by an indefinite, uncertain, five-year-ahead tax increase. There really is a lot more uncertainty about what you will get from non-doms, the energy profits levy and so on than there is about what the national insurance will cost.

Dame Angela Eagle: Or indeed how quickly the vape tax will be up and running.

Paul Johnson: Indeed.

Q150 **Dame Angela Eagle:** On growth, at the moment we are in a shallow recession. You were talking earlier about the productivity issues and some of the problems with the UK as an outlier following the financial crisis. Why do you think we have diverged from the other advanced economies that are similar to ours? Is it this combination of the uncertainty over Brexit and the lack of knowledge about precisely what trading would be like, or are there some deeper issues as well that you think we ought to be trying to address?

Torsten Bell: If you are making us say one thing, which might make it a quicker answer, the thing that makes the UK stand out is just low investment. We have very low public sector investment—not quite as bad today as it has been for lots of other phases since the 1970s. The 1990s were an absolute catastrophe. The 2000s were not that much better, and lots of the topping up that did happen happened, obviously, via PFI schemes and the rest. The level of increase planned when Boris Johnson was in No. 10 and Rishi Sunak was in No. 11 was actually quite chunky. It was taking us back to investment levels that we had not sustained since the 1970s, but they have not been sustained this time either, so we are coming back down to about 1.7% of GDP. That is in the public sector.

In the public sector, the only G7 economy that comes close to making us look okay is Germany, and anyone who has used German transport or German energy systems will know that there are reasons why that is causing exactly the same problems in Germany as it is causing here. By the way, that is also because Germany is another country that has a very debt-focused rule. It happens to be in the constitution, but the same process is happening, which is that a purely debt-focused rule is driving down investment levels to cope with day-to-day pressures.

In the private sector, no other country comes close to making us look normal. The Germans have very high private sector investment and very low public sector investment. Nobody comes close to how low our levels of private sector investment are. If you do that for a year or two, it is fine. The capital stock is a very large thing; it takes a very long time for changes to feed through. We have now done it for decades. To your question, Chair, this started before the financial crisis. Private sector investment was coming down in the early 2000s, even when the politics was really stable. That is what I would caution on. The easy thing for economists, the CBI or business leaders who do not want to say, "This is the problem," is to say, "It is the uncertainty and the change that is the problem."

Those things do not help. We definitely had a very large one in the case of Brexit, but it is not just that. Even when there was very stable politics and very stable economics, the private sector in Britain was not investing anywhere near what you were seeing in other countries. That is what is underlying here, in so far as the thing we can do something about as opposed to wishing a financial crisis had not happened in a country with a large financial sector—it is a bit late for that. Investment is the thing we should be focusing on—public and private.

Q151 **Dame Angela Eagle:** We have full expensing. People are trying to focus on that, but it is still not really making a difference.

Torsten Bell: You say we are focusing on it. The tax improvements we have made over the last six months are good, but remember that lots of the kind of investment that happens in Britain will not be covered by full expensing. It is only building stuff and buying machines that we are talking about, really.

Secondly, firms are responding to lots of other things, like how active their ownership are. You have got to be looking at those kinds of things. It is not about finance per se, which is what everyone talks about in terms of these pension funds, but it is in terms of who owns British firms and how much pressure they are placing on managers to actually have a long-term plan for growth.

The thing that makes Britain stand out is that our executive teams have very little pressure from their owners because they are very diffuse, in the sense that they are foreign or they are being held via DC pension funds, which are in no way big enough to be active shareholders, and they are probably almost all holding it indirectly via tracker funds anyway. Compare that with the 1990s, where you had very large DB pension funds owning large portions of British capital, and then compare it with European countries that maybe do not have that block ownership that we normally see in the United States, for example. They have workers on their boards who are providing another form of pressure on managers to have a long-term plan for investment. If you look at the academic literature on that, it shows you that when you have workers engaged on boards, you do not get what people worry about, which is wages being higher; what you get is higher investment and higher productivity. You need some pressure on owners.

Q152 **Dame Angela Eagle:** It seems to me that there are several structural issues that have come together to put us in the least favourable position. The structures that we have—the corporate structures, the ownership of them, the lack of worker representation, Brexit uncertainty, a general disinclination to invest that goes back to the ’70s—have all come roaring into presence to create a circumstance in which we are now looking at rates of trend growth that are chronically smaller than they were even in the past.

Torsten Bell: Yes, and that is what we have got to get out of. That is why wages are £14,000 lower today than they would have been if they had kept growing at their pre-2008 level: because in the long run, if we do not invest, we are not going to be growing this economy.

Dame Angela Eagle: Yael, did you want to say something?

Yael Selfin: Yes. First, I think it is quite possible that we are out of the recession by now. It was a relatively shallow recession in the second half of last year. We need to put that in perspective.

Also, when we compare GDP growth performance for the UK with the other G7 countries, we have actually not done that badly, with the potential exception of the US. The US has done particularly well. There are a number of elements that are different. One is that it was not subject to the impact of the higher gas prices that we faced in Europe in particular. Obviously the situation is slightly different when you look at growth of GDP per capita, where we have been a little bit weaker—

Q153 **Dame Angela Eagle:** Seven quarters of negative growth in GDP per capita, isn’t it?

Yael Selfin: Yes, absolutely, and relative performance there is a little bit weak. Especially since 2019, other countries have done better than us, but generally, in terms of international comparisons, we are not that bad.

When you look at business investment, and private sector investment in particular, one thing it is very important to mention is what we call market size, and the expectation of the growth of the market for businesses. One of the key elements, apart from the expectation for the growth of the economy, is the expectation of how much they can export from the UK to other markets. The trade relationships are really important here.

Q154 **Dame Angela Eagle:** Is that for services or goods? We have had a 15% reduction in trade volumes.

Yael Selfin: It is definitely across the board. We have had more problems with goods since Brexit than services, and we have seen a stronger performance of service sector exports, but generally it is across the board. It is one of the things that will determine future business investment decisions.

Apart from that, I want to stress that uncertainty and longer-term uncertainty is extremely important. Changes in Government policy, especially things like climate change policies or investment priorities, are really important because businesses will look at a 10-year horizon at least when they make long-term or important business plans and investment decisions.

Q155 **Dr Coffey:** We may have covered some of this ground already. This question is to do with national insurance. People have only seen two parts of their pay packets improved by the cut in national insurance, and there is more to come. The OBR and the Chancellor both suggested that there will be nearly 100,000 more employees in our economy as a consequence of that. What is your view?

Paul Johnson: I think they said that there would be the equivalent of that in extra hours.

Dr Coffey: Yes.

Paul Johnson: That is plausible, but uncertain. It is also worth saying that the OBR thinks that freezing the tax thresholds is going to reduce the number of hours, so there are offsetting effects.

The key thing is that, in a qualitative sense, reducing national insurance contributions, if you are going to use the tax system, is not a bad way of increasing labour supply, but it is not going to be massive and it is offset by other increases in tax elsewhere. The 100,000 number is probably the best you can come up with, but I would treat it with a considerable degree of uncertainty in terms of where we will actually end up.

Q156 **Dr Coffey:** Apologies if you have covered some of this already, Mr Bell. Your comments about pensioners have been well advertised, but I am conscious that the Resolution Foundation has historically pushed for more intergenerational fairness. Could you give me a sense of the Resolution Foundation's perspective on earned income being taxed less and the equivalent of nearly 100,000 extra employees?

Torsten Bell: We are producing some more work on that today, which should be going out while we are here. I can run you through what it says: the Budget does not make much difference to pensioners because we are cutting a tax they do not pay.

If we look at all the tax rises and tax cuts in this Parliament as a whole, we see the facts you are mentioning, which show that pensioners do badly because they pay the tax rises but do not get the tax cuts—the 8 million taxpaying pensioners £1,000 worse off. To provide some wider context to that and what the fair thing to do overall is, our basic view is that if you are going to cut taxes, the Chancellor has done it in the right way, on this generational basis and on fairness versus different kinds of income.

One way of thinking about that, as the publication we have just released shows, is that if you look at all the policy changes taken since 2010 in the round—the tax rises recently, but also the pension changes taken over the last 10 years before that—pensioners overall are about £1,000 better off because of the policy changes, including the recent tax rises. That is because the triple lock provides such a boost to the average pensioner that it outweighs the loss from the current tax rises. The only pensioner group that loses if you look at the whole period since 2010 is richer pensioners, because for them the tax rises are so large that they outweigh the gains from the triple lock.

Overall, pensioners are better off and the richest pensioners are worse off. That provides a good reason why the Chancellor has focused tax cuts on working-age households. As well as the reasons we like as economists, which are that it is generally a better thing to do for incentives and for horizontal fairness between different kinds of income, the history is that that policy has actually benefited pensioners overall.

Q157 **Dr Coffey:** Bearing in mind the fact that next month there will be an 8.5% uplift in pensions.

Torsten Bell: That is exactly what the numbers are showing.

Q158 **Dr Coffey:** There has been a significant increase in the number of working pensioners, who of course do not pay national insurance contributions—their employers do, but they do not pay themselves. Is there any kind of assessment on whether we might anticipate more people coming back into the working environment over that classic pensionable age?

Torsten Bell: In general, there is a longer-term trend of having more working pensioners. Pensioners are now no more likely to be in poverty than the rest of the population, probably for the first time in history. That is not normal. In history, pensioners have been very poor, but they are now less likely to be in poverty than the rest of the population.

We all focus on the triple lock, but one of the reasons why is that large private pension income is doing a lot of the work, and so are large amounts of earned income compared with what we used to see. That is making a big difference to their living standards. It is obviously a good thing in general for the size of the economy and all the rest, so long as people want to work more over that phase. It is generally a good thing.

Q159 **Dr Coffey:** I want to ask about the merger. You have both tax and NI on earned income. In my part of the world, in a more coastal environment, people often work weekly in the hospitality industry, so they pay more in effect than they would do if it was done annually or monthly. I can see quite a lot of benefits in that.

Several Chancellors in the past have looked at merging NI and income tax, but it has never happened. I can give you my own theory for that, but do you anticipate why it has proven so difficult? It is a bit like trying to change business rates; that has pretty much never happened either, despite how many people have looked at it.

Torsten Bell: Or council tax, or inheritance tax.

Prof. Arun Advani: I guess the obvious answer is that it makes it very obvious how much tax we are charging people. That is going to be a painful thing to announce, even if it is the same amount of tax for a lot of people.

The other part is, as we said earlier, if you were to merge the two things, assuming you want to raise the same amount from the new income tax as you do from income tax and national insurance contributions, they would be some very sizeable increases if you were fully merging the systems.

A few minutes ago, we said that it would be a 6p increase for pensioners if you just did employee NICs. If you did employer NICs as well, you would be seeing very sizeable increases for pensioners and for landlords. That is something we should be aware of, at least.

Q160 **Dr Coffey:** NICs have also been the way people have built up their eligibility for benefits and pensions, so there would be a different route on that.

Torsten Bell: There are already people who don't pay national insurance who we credit into the system, so if the only barrier was whether we could find ways of crediting people into their state pension, we could overcome that. The bigger barriers are the scale of the change and some very hefty losers from the change. But as we saying earlier, the direction of travel is a good one.

The other thing is that I didn't take it that the policy is to abolish national insurance, but if it is, I am sure the Chancellor will tell you that tomorrow. I took it to mean that the direction of travel is that it would be desirable to rebalance from national insurance towards income tax. If that is the position, that is a very good thing to have as a stated policy. It is quite similar to my stated policy that public services should get a bit better over time. I don't know how I am going to do it or anything; I am just saying that I would like it to happen over time, but that is no bad thing.

For example, if you did want a change like this to actually happen, you would probably need a degree of cross-party consensus over a period of Parliaments. What you want is an agreement to say, "Whenever we're going to increase tax, we will increase income tax, and whenever we have space to cut a tax, we will cut national insurance, because over time that will get us to a system that is actually the desired point." That would be a triumph, so I look forward to that happening in 50 years.

Paul Johnson: It is worth saying that until November, exactly the opposite policy is being followed by all parties.

Torsten Bell: Exactly—so if we manage the reverse, that is great.

Paul Johnson: I think it is the first ever cut in national insurance. Don't forget it was only two or three years ago that it was announced that national insurance would go up by a penny and a half or a penny and a quarter. This is part of the instability of tax policy that has been so damaging over such a long time.

Q161 **Dr Coffey:** I recall that that was supposed to be linked directly to the increase in money going to the NHS.

Paul Johnson: Indeed, but I do not think the NHS has been cut as a result of that not happening.

Dr Coffey: No, no, I understand. I think I have covered the questions I wanted to ask on NI. I have some others for later.

Q162 **Chair:** My understanding of national insurance is that it is a regressive tax. Would you all agree with that?

Torsten Bell: It depends on what you mean by regressive. Do you mean across the household income?

Q163 **Chair:** As a percentage of your income, if you are on a low income, you actually pay a higher tax rate than if you are on a higher income, because it is 2%.

Torsten Bell: First, the marginal rate paid by higher earners is lower than the marginal rate paid by lower earners. Obviously, in terms of thinking through the regress in the system, you definitely want to think about it in combination with income tax, where that is not the case. Secondly, across households, national insurance, like income tax, is progressive in the sense that it is the middle and the top who pay the bulk as a percentage of their earnings and their income.

Q164 **Chair:** Income tax is more progressive than national insurance. Can I say that? Would that be a safe statement to utter?

Torsten Bell: Yes.

Q165 **Danny Kruger:** I think most of my questions are for Arun, but I might just run down the row first for a quick response. First, on the high-income child benefit charge. Torsten, do you have any immediate reaction to the raising of the threshold? I want to come on to the question of the prospect of the household assessment in a second, but do you think raising the threshold was the right thing to do? What do you think of scrapping the charge altogether and whether that would be neater and better? I will ask the same question to each of you.

Torsten Bell: Raising the threshold is definitely an improvement. The existence of the threshold and this way of means-testing child benefit is a very bad place for us to have ended up. There are reasons why we ended up there, but it is definitely a bad place for us to end up, and raising it helps in the sense that far fewer people are affected. There is quite a big, chunky amount of people taken out of the charge and that is a very good thing. In the long run, yes, we should be looking to get rid of this charge, full stop. It is not a good way to run a tax or a benefit system and it is definitely not a good way to interact a tax and a benefit system.

Q166 **Danny Kruger:** Do you think it would be possible just not to award child benefit to certain households, though, which would be the simplest thing to do? Take it out of the tax system and just do not give rich people the benefit.

Torsten Bell: There are lots of ways you can try to do that. At the moment, the Chancellor has suggested that he wants to move to household means-testing within the tax system. That is quite complicated. It is more doable than it was a decade ago, but it is quite complicated and it is still sub-optimal, to a degree.

Broadly, the system that has a means-tested level of child support within universal credit and then a universal system of child benefit outside that, I think, is not a bad system to have had, and so moving back to that at some point is the way we will remove a lot of the worst high marginal tax rates—but that costs money.

Q167 **Danny Kruger:** Yael, do you have a view?

Yael Selfin: I think it is definitely a good move, but it should also be aligned with a provision of more and better childcare so that you can bring more people and especially women into the workforce.

Q168 **Danny Kruger:** Yes, okay. But you would be content to see the charge scrapped altogether, or do you just approve of the raising of the threshold?

Yael Selfin: Given that we have very limited room for public spending, we do want to ration it to some degree.

Q169 **Danny Kruger:** Paul?

Paul Johnson: I do not have a great deal to add; I broadly agree with what has been said. We are in this bizarre position where we have universal credit and we have a second means test on child benefit. Part of the problem is that the threshold was not indexed in line with inflation or anything else from the moment it was brought in. This is a good example of why it would be much more sensible, if you bring something in, to then index the limit rather than leaving it flat in cash terms, which is what has happened.

We have ended up in this bizarre world where you could get universal credit and have your child benefit taxed away at the same time, which was just—I do not think that can now happen, or at least only in very exceptional circumstances. We got ourselves into a heck of a muddle. We moved some of the things around to make it slightly less of an effect, but it is still a muddle.

Q170 **Danny Kruger:** I would love to explore that more, but okay. Thank you very much. Arun, your views, but also particularly on this question of household assessment. Do you think that is practical? Do you think HMRC will be able to do it satisfactorily? Are we just introducing more complexity into the system?

Prof. Arun Advani: I certainly agree on the points we have had already in terms of the value of moving it. In terms of moving towards a household system, the obvious point is that we already have a household system for the benefits system. It is certainly adding complexity to put that within the tax system.

If the point is that we want to deliver something that is means-tested and done at the household level, we can do that already. It would not be HMRC that would traditionally deliver that; it would be DWP. That would seem the most natural way to do it.

If we particularly wanted HMRC to do it, we can do that. One obvious difficulty in the current way we administer it—it will continue to be hard if we keep a threshold of around £60,000 rather than above £100,000—is that typically if you are only an employee, you do not have to file anything to HMRC. You only have to file if you are either above £100,000 or have income not from direct employment and if you have enough of it—so if you have a small amount of savings income, you do not declare it, but you do if you are over £1,000. Those are the only people who have to file.

Q171 **Chair:** Can I clarify something for the record? I thought the filing threshold had gone up to £150,000 from £100,000. Am I not right on that?

Torsten Bell: It hadn't last year, but it could have changed this year.

Prof. Arun Advani: It might have just changed.

Q172 **Chair:** I think it was announced in autumn for next year.

Prof. Arun Advani: Then even more so—if you get to £150,000, there will be even more people. We are saying that we do not particularly want them to file pieces of paper or online forms if they only have one source of income and it is employment income from one place. It does seem to add unnecessary complexity to say, "But you need to put in some declaration so that you can have child benefit withdrawal", rather than just to say, "Okay, if this is something we want to withdraw, and we can do that already within a different system that is designed to do that."

Q173 **Danny Kruger:** So, as you say, the benefits system and tax credits are administered on a household basis. I am instinctively in support of the principle of a household system; I am just very conscious of the complexity. Also, we do not mean a household as a married household. We just mean people who are in a partnership. Are there going to be all sorts of difficulties in terms of HMRC suddenly having to involve itself in prying into people's relationships? Do we have anything to learn from the benefits system to ensure that that system will work?

Dame Siobhain McDonagh: It was an initiative by Mrs Thatcher, wasn't it?

Danny Kruger: I am not objecting to individual taxation.

Torsten Bell: In principle, I was just going to agree with Margaret Thatcher. Generally, I would prefer to leave taxation at the individual level for a whole host of reasons—you have raised one of them—but the marginal incentives to work are also significantly effective for second earners if we move to a household-level system. I have to say, in general it may also help you reduce poverty in some ways, because you end up with lower taxation for some poorer households in that route. But on balance I would leave it at the individual level.

Q174 **Danny Kruger:** Not forgetting that Nigel Lawson also intended to have transferrable allowances between married couples. He never quite did that.

Prof. Arun Advani: Currently, HMRC does not do anything to try to link members of a couple. There is no reason for them to do so, so we have not got any way in which we can currently do that. Apart from the complexity of trying to design the system, there would also be a whole new administrative project in trying to link the couples.

Even at the moment where you can say, "I need to have it withdrawn", they do not directly try to link all those cases and cross-check them in a systematic way. It would definitely create new work that we would have do on the administration of the tax system if we were then saying that we want within the tax system to go back to something where there is at least a partial household.

Q175 **Danny Kruger:** I only have a few more minutes, so I will come straight to you, Arun, about non-doms. We had the OBR in this morning. They have described as having very high uncertainty their forecasts on what the receipts would be from this change. Their expectation is that 10% to 20% of current people qualifying as non-dom would leave the country. They admit that it is very difficult to predict this.

The last change did not produce much change in the way that people seemed to behave. Do you think we can rely on that forecast? Do you have a sense of what the likely effect of the change will be?

Prof. Arun Advani: First, I 100% agree that there is a lot of uncertainty here. There is a lot of uncertainty first of all in the static estimate of how much money non-doms have abroad. It is worth pointing out that we currently choose not only not to tax these people, but not to collect data on what they even have. That would not be true in other countries, where even when you give someone a tax break you often collect information about it.

It is worth us thinking about that in terms of the design of the new system. We should think about what information we want to have from people who are new arrivers, even if they are not yet having to pay tax on that. That will be really important in how we think about administering the system when they start having to pay tax on that foreign income and us being able to ask whether that income is new or old. That is one thing.

Then there is the uncertainty around migration. Looking at the last reform, which took place in 2017, we think that the effect of that reform was to decrease the amount of money that people had, after tax, by about 20%. The impact of that was to increase the number of people who left the UK, relative to what we would have expected anyway, by about 6%. That is roughly what we see as a benchmark, and that is on a base of people already having a roughly 5% to 6% probability of leaving, even when they have been here for 15 years. When you look at people who are here for much shorter periods of time, they have much higher probabilities of leaving just anyway. People who have been here for only the last couple of years—this kind of group—typically have a probability of leaving of around 20%.

So you should expect a lot of mobility. We should therefore expect that that mobility will go up even further. You should certainly expect that there will be migration as a response to this. I think that the overall number that they have come to, in terms of the total revenue that they think will be raised, is pretty close to what we thought as well. They have got there a slightly different way, but we ended up in pretty much the same place.

Q176 **Danny Kruger:** Okay, that is good to know. So you basically broadly agree; thank you.

For my last question, I will come to you, Paul, if I may, on a very general point. I was struck by what you were saying earlier, predicting that there would be no major cuts in public spending in the next Parliament, whoever is in government, just given the state of things. You suggested, therefore, that the consequence will be either higher taxes or higher borrowing to fund current spending, or just a hope for growth. You didn't mention reform and the option for demand reduction within the model that we have.

What is your experience and your expectation of what might be done in the public sector in order to improve? In a sense, it is about productivity, but it is also simply about the way in which we deliver services to reduce the overall demand on the taxpayer—by shifting spending upstream, being more preventive, and being more intelligent about the way we actually spend. Do you hold out much hope for the reform programme to actually help to balance the books, rather than us just cutting services or increasing spending?

Paul Johnson: I think that there are different aspects of that. I mentioned welfare and disability payments, for example, and I would hope that a Government will look very hard at how they are delivered and whether there are ways of making savings there, although it has to be said that previous efforts have not been terribly successful, for all sorts of reasons. So there is there is one issue there.

Then, you look at the big public services; we know that part of the reason that the health service is struggling with productivity, for example, is actually a lack of investment in, frankly, just half-decent IT systems—rather than about using world-leading AI or what have you—and that is creating problems. So the positive bit here is that we know that there is quite low-hanging fruit in some of these big areas, and we really ought to be focusing on some of that low-hanging fruit.

Then, there are things like moving to student loans, which saved quite a lot of public money by sort of moving things into the private arena. We might want to at least ask ourselves whether there is scope for that anywhere else. It is not very obvious to me that there is, and it will be quite a big public, political decision to do that in any aspect of health or in any other aspect of education, for example, but that is the sort of place that one might want to look.

Then, there are aspects of rationing where we might want to think quite hard. One of the problems very clearly facing local authorities is that demand for their services, and particularly some of the very expensive services, has gone up a lot in recent years. We might want to understand better than I think we do why that is and whether there are ways of managing that that do not simply involve just meeting the demand as it occurs. Although at the moment, again, there is some informal rationing there—essentially, people have to appeal against decisions, and then get almost 100% success if they do, for example—that is not a very efficient way of running things.

So I think that there is a series of options along those lines, and we probably need to take all of them quite seriously if we really want to manage the overall size of the state.

Danny Kruger: All right. There are other questions, but I have run out of time.

Chair: We may have more time, but I am going to let John ask some questions first.

Q177 **Mr Baron:** Thanks, Chair. I will just turn to forecasting, if I may, which is a constant theme, as some of you know, in our line of questioning in sessions like this. That is partly driven by the fact that forecasts have been somewhat awry—certainly the dispersion in the accuracy has been somewhat more noticeable—in recent times. We all know Galbraith's quip about making astrologers look useful.

However, that is a slightly academic point until it affects policy. The OBR notes in box 3.1 in the "Economic and fiscal outlook"—and this has been noted elsewhere—that fiscal policy has been volatile in response to forecast revisions. What is to blame? Is it that the forecasts were too volatile, or is it that policy is too closely tied to the forecast?

Torsten Bell: That is a great question; that discussion is missing from lots of the newspaper-based coverage of "What do we think about what is driving fiscal policy?", so it is really good.

In terms of what we see, there has been a volatile set of forecasts; debt interest forecasts, in particular, have been very volatile in the recent past. Obviously, if you go back a few more years, it is the actual levels of spending that are very volatile, whether it is Liz Truss having to announce a huge energy support package or the pandemic spending itself. You have a mix of both.

However, the reason more recently, particularly over the discussions of the last two fiscal events, and the thing that is making policy sensitive to fiscal forecasts, is the policy choice to have basically next to no headroom versus a fiscal rule, particularly if the fiscal rule is a long way out and is a hard binary target, going back to our previous conversation. The headroom in this Budget forecast is about one third of the average headroom that Governments and Chancellors have held since 2010, so it is basically zero or rounding to zero. If you have that kind of low headroom, you will end up with the forecast having far too much effect on your policy choices, because—

Q178 **Mr Baron:** With respect, Torsten, that perhaps answers the first bit, but it does not answer on the effect. I will bring in anyone else who wishes to answer this. Is policy too closely tied to the forecast?

Torsten Bell: The policy is being tied to the forecast because of the policy choice to have so little headroom at the end of each fiscal event. If you left yourself with £40 billion-worth of headroom, the fact that you have lost £15 billion of it would mean that you would just say, "Okay, I will leave it at £25 billion this time and recoup it later." That is exactly what is driving this slightly silly conversation where you have people saying, "I have lost £3 billion off my forecast, and that is somehow affecting my policy choices," which is an insane way to run a Budget.

Q179 **Mr Baron:** I would agree. Are there any other comments from anybody?

Paul Johnson: Another part of the problem is that the response to changing forecasts is asymmetric, in the sense that when the forecasts get worse, Chancellors tend to say, "Let's just change our fiscal rules or use up whatever headroom, not tighten fiscal policy." When they get better, they loosen fiscal policy. Actually, given the current methodology, if we have another fiscal event in the autumn, the forecast horizon gets pushed forward another year. If you pencil in another year of tight spending, you probably open up a bit more headroom and the Chancellor can then use that headroom. We have become far too tied to that for very similar reasons to—

Q180 **Mr Baron:** Far too tied, because the finances are tight. I get that, but is it not worrying that we have different forecasts for different parts of the machinery of government? Let us take the Bank of England. On inflation, for example, it suggests that it will rebound to 3%-plus by the end of the year. You—I say "you", meaning the OBR—have just nearly halved your inflation forecast. We have the Bank of England at 3%-plus and the OBR, I think I am right in saying, at about 1% or 1.5% by Q4, or certainly below 2%. That is quite a big number, but it is dwarfed when you look at the difference in growth forecasts. I think I am right in saying, but correct me if I am wrong, that the OBR is coming in 3% ahead of the Bank of England next year, roughly—I say "roughly", but it is still a big figure if it is 2.8%, 3% or 3.2%. These are big figures. You therefore have these different forecasts potentially moving fiscal and monetary policy in opposite directions. That is a nonsense, isn't it?

Torsten Bell: Yes, although concretely, in these particular circumstances, that is a reason why it was probably not a good idea to put in a load of tax cuts right now, because the OBR is at the most optimistic end of the market. The critique of the OBR is that it is so pessimistic and stopping adventurous policy changes taking place, but both historically over the whole 15 years of the OBR's life and particularly right now, the OBR is at the more optimistic end, relative either to what actually happens on growth or to other forecasters. I think that the Bank of England comparison is very telling, as you say. If we ended up with the Bank of England's productivity outturn actually happening, we are a long, long way from debt falling, and you need to do tax rises not to deal with your public services problem, but because you will not get debt falling on those numbers.

Q181 **Mr Baron:** Thank you for that, Torsten; that is appreciated. May I just bring in those who have not spoken yet? Are we not leaving ourselves open to the sort of scenario where, because the OBR believes that growth is going to be far ahead of Bank of England estimates, you have the OBR, in a way, encouraging growth, yet monetary policy is unduly restrictive because of the Bank's particular view? We need fiscal and monetary policy to be, not joined at the hip, but certainly working in conjunction if we are to get the best out of them. It does not feel that way, courtesy of the forecasts of the respective organisations. Am I being uncharitable?

Yael Selfin: One of the problems is that the mandates of both institutions are a little bit restricted. The OBR, for example, have to take Government current policy as the basis for their forecasts, and we have already heard that some of that is unlikely to happen—for example, the fuel charge. Therefore, apart from the productivity assumptions, some of the assumptions they are being asked to use are probably less realistic; as a private, independent forecaster, I would not take those assumptions.

To some degree, we have a similar issue with the Bank of England: quite a lot of the metrics they use—for example, the interest rate and foreign exchange assumptions—are based on market expectations. It is not necessarily what an independent forecast would have. That constrains a little bit the forecasts you get as a result. The assumptions are different because of the construction of that framework.

Q182 **Mr Baron:** Professor Advani, do you have anything to add?

Prof. Arun Advani: I want to come back on the point about how much it constrains policy. I agree with what Torsten said—that by leaving essentially no headroom, we have to move around, effectively, with wherever the headroom looks as though it is going to be. We seem to have decided that we want to leave nothing, so we move with the forecast.

There is a separate point, though. Although the OBR have consistently, recently, been at the optimistic end of market forecasts, if there were a set of forecasts out there where the OBR were looking at the pessimistic end, a Chancellor could, if they felt so minded, say, "Look, we don't want to spook the markets, so we're not going to go way off base, but here's what the markets look like and here's the forecasts. The OBR look pessimistic to me. I'm going to go for something that looks as if I have negative headroom according to this measure, but I'm accepting that and

I'm telling you all why: it's because I can see that everyone else thinks that things are going to go well, and I think the OBR are too pessimistic." There is always scope for doing that, and a Chancellor, if they had a credible story, could choose to go and do that.

Q183 **Mr Baron:** Do you think there is scope for, not merging, but looking to one official source of forecasting—perhaps introducing some greater latitude on ranges? We all know forecasting is hardly a science, but why not try to bring some—how can I put it?—not conformity, but joined-up thinking on monetary and fiscal policy? From recollection, I cannot remember a time when the forecasts have been so different between the two, and we have a real chance here of policies moving in opposite directions at a time when we need better co-ordination between the two policy areas. Why not, somehow, bring about a merger of the institutional forecasting capability?

Paul Johnson: I think the first step would be to ask them, as I think they should, to get together and publish something that says, "Here, in some detail, is why we have come to these different conclusions." That would be incredibly useful in terms of transparency. The Bank is obviously undergoing a review of its forecasts with Ben Bernanke, and I hope they come up with something that suggests that they are more transparent and show more possible scenarios.

It would be helpful, as a first step, to do as the OBR does now, looking back at its forecasts and saying, "How did we do against them?". You could get the Bank to do that as well, and you could get the Bank and the OBR—on an annual basis, or with some regularity—to work together to explain the differences and explain their models in ways that are relatively clear to non-specialists, including me, about how they do it. I think that would be a good start.

Q184 **Mr Baron:** So you think better liaison between the two?

Paul Johnson: As step one, certainly.

Mr Baron: Certainly as a step one. Anybody else?

Yael Selfin: I think the key is to use scenarios here. As you rightly say, we are unlikely to get an accurate forecast, especially at a time when volatility is very high. Therefore, being able to deploy different scenarios and understanding the implications for public finances and spending is very important.

Q185 **Mr Baron:** I have a final question for you. The OBR's forecasting track record is volatile, to say the least. For example, in Q4 they have almost halved their inflation forecast from 2.8% to 1.4%. That is a big move. What is your assessment of their forecasting capability? There is volatility across the piece, but looking to the OBR actually affecting fiscal policy in many respects, what is going wrong?

Yael Selfin: My perception, based from a very high level and not being very hands-on involved, would be that they do an excellent job looking at the fine details of potential assumptions and looking at a very granular level at a lot of different aspects of the forecast. But there are certain things—like, for example, their assumption on productivity and future productivity—where that is potentially very high-level and could be worked at more, and it is a crucial assumption, really, to drive the longer-term forecasts.

Q186 **Anne Marie Morris:** Professor Advani, can we move to property taxation? The Chancellor maintains that the changes he made to capital gains tax—reducing the top rate by 2%—will, effectively, generate more tax revenue rather than less and enable more first-time buyers to get on the housing ladder. Do you feel that that is a justified statement to have made? Do you think that is the likely consequence?

Prof. Arun Advani: I think there are two parts to that. First, he said that his cut from a 28% capital gains tax rate to 24% for owners of additional properties would raise money. He said it would unleash the inner Laffer curve that the OBR had finally found.

On that point, what is driving that in large part is the bringing forward of disposals. The view is that people will sell houses more quickly if the tax rate is lower; they are more willing to just part with them. There is this idea of a lock-in effect: if the tax rate is high and I have brought a property, I will have to pay a big tax on the gain that is there, so I might be less willing to part with that property to go and buy the next one, to swap over and to have a different home that I want to own.

Q187 **Anne Marie Morris:** How realistic is that as an idea, given that people tend to take a view of property that, in the long term, it goes up?

Prof. Arun Advani: I think the answer is that it is quite hard to know how much it will bring forward people's disposals and whether people will sell more quickly. To the extent that they do sell more quickly, there will not be additional revenue raised from capital gains tax, because it will still be the case that somebody else will have the property instead.

In the end, when you look at the figures, what is driving the fact that there is increased revenue from this reform is that there will be more stamp duty being paid. Despite that, it is still clear that, by the fifth year of the forecast, these two things have basically netted out. The gain number is starting to turn; on the capital gains tax, we are getting no additional revenue, and it looks like we are going to go towards being negative after that, the reason being that, at that point, all that matters is that we have a lower tax rate than we had before, so we are getting less money from capital gains tax.

Q188 **Anne Marie Morris:** Is this going to release first-time buyer houses?

Prof. Arun Advani: There is no reason to expect that it is going to create more ability for first-time buyers to buy these houses, because this just makes these houses more attractive for landlords. So I do not see any reason why it would make it easier for first-time buyers at all.

Torsten Bell: Unless it was going to happen anyway, and it would speed it up. If you think of other reasons, like significant other increases in taxation on second homes, which the Government have put in place over the last 15 years, and if you think we are in a phase of moving from slightly lower additional property ownership to slightly higher first-time buyer ownership, this could speed it up, to be fair to the Chancellor. But if it is raising zero money at the end—

Paul Johnson: Of course, that then creates more pressure on the rental market. It is worth saying that, if you look at the OBR document, it has one number saying it raises money and one number saying it costs money, depending on which bit of the document you look at, but there are very small differences at the end.

The other crucial thing to say is that, in terms of rental property, even after this cut it will remain significantly the most heavily taxed major asset that there is—it is still a really highly taxed asset to hold.

Q189 **Anne Marie Morris:** You are right. Looking at a specific change—abolishing the furnished holiday let relief—do you think that that will have the impact that the Chancellor predicts? His prediction is that if you level the playing field, more people will go into long-term domestic rented, if you like. But is that realistic following what has been an escape from that market by a number because of the proposed renters reform changes? Do we think that there is maybe an unintended consequence? Many of these are small cottages, or whatever, or farmers who have tried to diversify. They are in the middle of absolutely nowhere, and they could not get planning permission to make them residential, so you are actually going to put a great big hole into the tourism industry. That is the last thing that coastal communities like mine could do with.

Prof. Arun Advani: To go back to the earlier conversation we had about housing, in a way some of this is a discussion predicated on how much we can use changes to the tax system to affect where people are living. We can do some of that, but at a more fundamental level, whatever we have done in terms of houses we have built, the pressure on building accommodation is still very strong. If we do not do more of that bit, while we can use the tax system to change how much is used for holidays and for private renting versus people being able to buy houses, the core problem here is that housing and accommodation is really expensive in the UK. That will continue to be the case, whichever way round we fiddle the tax system.

All the tax changes we are mostly making—except for in this case—are changing the form in which people are able to have access to that. As Torsten said, it might be that you are able to speed up people moving between renting and ownership. Certainly in this case, if you make furnished holiday lets more expensive, you will presumably encourage, in some cases, some kind of accommodation—it could alternatively be long-term lets—but, as you say, there will be cases where it is not really accommodation of the sort that people want to use for a long-term let. Presumably, it will then either go out of market or people will have to rent it at a higher price, and say, "This is what we are offering it at," and you will have slightly fewer people taking it up.

Q190 **Anne Marie Morris:** Okay, but do you see that that might have an impact on the tourism industry?

Prof. Arun Advani: Going back to the comment on forecasting, this is a pretty hard one to work out. I don't know whether anyone has any particular numbers on the scale.

Paul Johnson: There are not huge number of these things. My number is 127,000 of these things in the entire stock, which is really quite small. This is not going to make a dramatic difference; it will make a difference in very specific areas, clearly. This is all about moving arbitrary boundaries, so we are going to start treating these lettings more like housing and less like businesses. There is now going to be a kind of boundary between furnished holiday lettings and bed and breakfasts, for example, where there will be completely different tax regimes, and people will try to claim that they offer a little bit of extra service, and that their property should therefore be treated like a bed and breakfast rather than like housing. Because we treat everything to do with rental housing, lettings or whatever much more harshly in the tax system than any other business, you are creating this gap between whatever counts as a business and what counts as housing.

Q191 **Anne Marie Morris:** When the Office of Tax looked at this, and it talked about levelling the playing field and getting rid of this particular relief, it was concerned that effectively you had two groups: those which were businesses and those which were, if you like, just a one-off property. The concern was that if we did not find a way of distinguishing between the two, we would just land up with a load of tribunals where individuals running, for example, five to 10 individual holiday lets would say, "We are a trade and therefore we should have a different tax regime." The OTS made a particular proposal. Do you think that when the Chancellor looks at—on the assumption he does—implementing this change, he needs to add something rather than just making the two equal? Rather than just abolishing it, does he need to find a way to enable businesses to actually be businesses? Torsten, do you have any views on that?

Torsten Bell: I have not read that Office of Tax Simplification report, so I do not want to comment on that. Paul's point is basically right, which is that you have full-on second homes, full-on businesses letting out properties permanently where the owner never has any intention of going near it, and then you have stuff in the middle. The Chancellor is trying to put the stuff in the middle more towards the second homes category. I think this is pretty small fry for the economy overall, or even for these markets overall. The general picture is that we are moving to more punitive treatment of any second or other additional property ownership, because we are looking for ways to change the distribution of who owns our insufficient housing stock. That is what we are doing. Overall, I am perfectly happy to do that, given the imperfect situation we find ourselves in, but the better situation is to build ourselves enough housing that these trade-offs are far less binding, particularly in certain areas.

On what the Chair said earlier, we have done a better job in some ways of building more houses over recent years. The problem is that we have a very large backlog. We don't need to just keep in line with our population; we need to build significantly above the rate of population growth, because that is what countries do as they get richer. For some reason, we are trying to buck the trend of richer countries consuming more housing, and it is causing us mayhem left, right and centre.

Q192 **Anne Marie Morris:** Thank you, Torsten. I have one final question for you, Yael. Given what we see, I think Torsten is saying that it is a political decision in a way. Effectively, the decision has been made: we want to try to maximise the opportunity for people at least to have one home rather than two. Ultimately, that is the position, but there will be these unintended consequences. While Torsten says that they are small in number, they can have an impact if you happen to have a coastal or rural community, as I do—something like 27% of these are in my constituency apparently. Consequently, for them, it is going to have quite an impact because a number of them simply cannot convert it to residential, for one reason or another. Do you think there will be any justification, given what Torsten said, for the Chancellor to intervene in some way to alleviate that particular issue and try to do something along the lines of what the Office of Tax Simplification suggested?

Yael Selfin: Looking at it from a higher level, I would say that the issue we have with housing at the moment is that we do not have enough housing where we want agglomerations—places like London, where we have workers we want to be here because it is more productive. We also potentially have some stock of housing in certain places that is not fully utilised—it is partially let, or is not being used completely and could be used better by another group. Anything that tries to make the whole thing more efficient by building where we need housing, and by better using the stock that we have, is better as far as I am concerned. Doing it within the tax system is not easy, and I think the main problem is things like stamp duty bringing in too much money and being politically difficult to change. I think stamp duty is probably not the right tax because it discourages people from moving to where they can be more productive and potentially get better jobs. The whole taxing of the housing stock is probably wrong generally. We want to encourage an efficient use of the housing stock and the building of more housing where it is needed.

Chair: That is very interesting, and we on this Committee lament the passing of the Office of Tax Simplification. I think a few colleagues have some further quickfire questions, starting with an exemplar from Siobhain.

Q193 **Dame Siobhain McDonagh:** By 2027, 63,250 nurses, 141,827 teachers and 60,680 police officers will have to pay 40% of their earnings to income tax, because of the Chancellor's decision to freeze income tax thresholds. In the '90s, almost no nurses, and just 5% to 6% of teachers, paid higher-rate tax. Do you think it is fair for a police sergeant, a senior nurse or a deputy headteacher to pay that amount of money in tax? Is that who the upper tax threshold was meant for?

Paul Johnson: That is not who it was meant for originally. If you go back to the early 1990s, when independent taxation was introduced, the top rate was for the small number in the top percentage of earners, and I think we are going to be in a position where something like a fifth of earners are paying it. Actually, over the £100,000 mark, where you start paying 60%, has become the new top rate. You have a similar fraction of people paying 60%, or 45% as you had 30-odd years ago, paying 40%. What we have had, actually, is a structural change to the income tax system, which has been brought in gradually. It has been turbo-charged by the recent freezes, but it has been going on for a long time. Where we had a sort of single-rate tax system with a thing on the top, we now have two rates and a thing on the top—or a weird thing with 60% and 45%. We have, without announcing it, fundamentally changed the structure of our income tax system.

Chair: I do not think we need an answer from everyone. Do you have another question, Siobhan?

Q194 **Dame Siobhain McDonagh:** In 2019, the then Prime Minister campaigned on a manifesto pledge not to increase taxes. Since then, the Conversative Government have introduced 25 tax rises. The current Chancellor has claimed that this is a "tax-cutting Budget", but personal taxes are going up, with threshold freezes exceeding the value of national insurance rate cuts by £20 billion. Households will be paying £3,900 more per household in tax at the end of Parliament compared with the start—the greatest tax-raising Parliament since the second world war. Is the Chancellor being dishonest when he says that it is a "tax-cutting Budget"?

Torsten Bell: It is a tax-cutting budget. It is a tax-rising Parliament and a tax-rising phase we are living through—not, actually, as everyone keeps saying, because of the pandemic, which was expensive and needs paying back, but because debt interest costs are significantly up and that is what is—

Q195 **Chair:** Has it been a Parliament of high public spending, would you day?

Torsten Bell: It has definitely been a Parliament of higher public spending than we are used to, yes.

Paul Johnson: It is also worth saying that the reason this tax has risen as a fraction of national income is mostly not to do with specific choices the Chancellor has made. In one sense, he has been a really lucky Chancellor; he has got loads of additional money in, because we have just happened to have very tax-rich growth.

Torsten Bell: The corporation tax take—what is coming in the door at the moment—is phenomenal.

Q196 **Dame Siobhain McDonagh:** Just very quickly, in order to pay for the Chancellor's changes in national insurance, the Government will have to cut day-to-day spending, as we have discussed, by about 13%, or £19 billion. That is three quarters of the size of the cuts we had to endure during austerity. How are these cuts going to be delivered when public services are already on their knees?

Torsten Bell: We touched on this a bit earlier. I think that is quite a good way of phrasing it, which is one thing we have not really discussed much: can we afford these tax cuts? In the end, what was the actual fiscal policy judgment in the Budget? It is that we can afford some chunky tax cuts, assuming that we are not motivated purely by the election, which I am sure we are not. Can we afford them or not?

There are two proof points that the answer is probably no, we cannot afford them. One is what you have just read out, which is that public service plans will not be sustainable, so we are hoping we get lucky. It would be better to get lucky and then have the tax cut, rather than pencilling in the tax cut and then hoping we get lucky. That shows it is not affordable.

The second thing is that the fiscal policy of both main parties is that they would like to see debt declining. As you mentioned at the beginning, Chair, in future we would like debt to head back down to levels that we saw in the past rather than the rise we have seen, and we are just not going to on these forecasts. In a world where you are not getting the debt decline you say you want and you have pencilled in public spending cuts that I think most people agree cannot be delivered, you cannot afford the tax cuts you have just announced.

Q197 **Dr Coffey:** When our Chairman asked the OBR earlier what it would generate if we returned to pre-pandemic levels of public sector productivity, the suggestion was tens of billions of pounds. In terms of trying to improve public sector productivity and productivity more generally, what are one or two main policies that you would encourage the Government to really press in trying to make that change?

Yael Selfin: This is really important, because it cannot just be about spending. Planning long term, really assessing what needs to be done, not chopping and changing, and going through consistent plans is also very important here, because we will have a shortage of money. We need to do the best with whatever investment money we have, so we need a good procurement system and long-term planning of what is needed before you start with anything on the ground.

Q198 **Dr Coffey:** I don't know whether anybody else wants to add a little bit more on that. It was suggested earlier that things like IT or artificial intelligence could have a significant role. Is technology going to be enough? You talk about longer-term planning; I guess the Government would point to a 10-year plan for workforce, or whatever—there's never been one of those before. Any other thoughts?

Paul Johnson: If you are talking about public service productivity, of course, the health service is more than 40%. A focus on that is really important. I spent a year on the Times Health Commission, and two or three things really struck home very hard from doing that. One is that far from cutting-edge or AI technology, as I think I said earlier, they just need half-decent technology, rather than computers that take half an hour to turn on, information systems that do not talk to each other and so on. There needs to be an absolute focus on the basics of having IT systems that work.

Secondly, the stories of just the poor management of people are astonishing. Again, that has to be quite a big drag on productivity. It is not as exciting as AI and new technology, but the fundamental management of some of these things strikes me as being vital.

Then there are things where you can use AI. If you are doing diagnostics, you do not need two consultants or radiologists to look at it: an AI plus a radiologist is probably more accurate and certainly cheaper. There are things that that you can do, but it is really hard to do this with big things from the centre. This is about making it work—as Yael was saying, making the procurement work, making the management work and getting the basics of the IT right. I am definitely not the right person to ask about how you do that, because that is really hard.

Q199 **Dr Coffey:** I told the Committee earlier the story of how NHS Digital would not give information to the NHS leadership. It was just ridiculous. Their merger was accelerated.

Let me go on a little bit further. Unemployment is still exceptionally low. Okay, economic activity is not as high as perhaps we would like, and some of the Chancellor's policies, which we will interrogate tomorrow, are intended to address some of that. If you go back to other aspects of productivity, why do you think there wasn't such a big uptake of the super-deduction, which was probably one of the most generous tax policies ever? We now have full expensing. What is going to make the change on that?

Yael Selfin: I think a big part was the overall climate of uncertainty, and policy uncertainty in particular, which made investment weaker. When you look at what drives investment, it is not always just the cost of it; it is also about understanding the overall projections of the benefits and what the actual environment would be.

Q200 **Dr Coffey:** What sort of uncertainty? There is no doubt that all political parties would like to see more growth, and all political parties would like to see more investment by the private sector, so help me to understand that more.

Yael Selfin: If you look at energy policy, for example, or infrastructure, the fact is that we have changes in transport plans and energy regulations—there are a lot of unknowns for a lot of sectors in the economy that would want to invest when they know what the direction is going to be. Part of the issue is that we have a five-year cycle of Parliament; that does not help in that sense. It is not something we want to potentially change—*[Laughter.]*

Q201 **Dame Angela Eagle:** You are suggesting that we should abolish democracy. I suspect you would get a less productive economy if we abolished democracy. Really, you must not include things like political cycles in uncertainty.

Yael Selfin: I think that within that, as has already been mentioned today, there are certain things on which there is a cross-party consensus on what is good for the country and will be beneficial, and that will give businesses greater certainty in the longer term. There are certain things that are of interest to the whole country, like improving productivity, so you could have a productivity commission that recommended what measures would be beneficial or what kind of investment would make sense in the medium term for the good of the country. That would potentially give businesses more certainty as to where the direction is going to be.

Dame Angela Eagle: But you agree that abolishing elections is not the way to do it.

Yael Selfin: Absolutely not.

Prof. Arun Advani: It is important to say that it is not just about political uncertainty between parties. Over this Parliament, we had an Industrial Strategy Council and we had an industrial strategy, and we abolished it; we created a Skills and Productivity Board during this Parliament and then abolished it after 18 months; and we have changed direction a couple of times on the view over climate change and net zero—

Dame Angela Eagle: Without having elections.

Prof. Arun Advani: Yes. Whatever your views are on any of those things, such as whether we should be doing things about climate change or not, if we pick a direction, at least businesses can say, "Okay, we've decided"—as was announced yesterday—"that we are going more for gas," or, "Okay, we're going to focus on clean energy." I have views on which of those I would rather do, but if we do not decide and commit to it, even within the length of a Parliament, let alone having a cross-party consensus on these things, we are really going to struggle. The lack of certainty, even within a Parliament, is a real constraint.

Q202 **Dr Coffey:** Professor Advani, I don't think you can say there has been a change on achieving net zero by 2050, or indeed any particular change by 2030.

Chair: It is the law.

Prof. Arun Advani: It is the law. Actually, that is an example of a target that we have that we are not particularly on track to meet. Paul will have more to say about the Climate Change Committee, having served on it, but if you look at our progress towards our targets, sure, we have a target for 2050, but what matters is not just what we think we going to do. It is a bit like the five-year-ahead rule that we have for fiscal targets, where currently we are sort of saying, "Well, stuff will happen, but between years 4 and 5—that is when everything's going to happen."

Dr Coffey: No, no, the carbon budget is still on track, including the one by 2030, because a lot has already been done. I can understand why people would say, "You might want to go further and bank what you've already got, and keep to that", but that is not keeping us off that—

Chair: We probably do not have time to go into a long, heated discussion.

Q203 **Dr Coffey:** No, but I do not want people to get the wrong impression. Another aspect is that other economies have far higher unemployment and much higher productivity. Do you recommend that we should do that as a policy?

Prof. Arun Advani: Certainly not.

Q204 **Dr Coffey:** Okay. We talked a lot about housing. I know that the amount spent now through housing allowances is well over £30 billion a year and is predicted to rise. Do you think that the Government should do more radical things on housing—for example, a development corporation for London, because the current Mayor of London is simply not building enough houses?

[Dame Angela Eagle took the Chair]

Torsten Bell: The general thing is that, often, people look at the symptoms of the housing problem, saying, "Can we try to stamp on those?" You raised one of them, which is the increased spend on housing benefit, of which people regularly say, "That's bad. Let's stop spending the money on housing benefit and spend it on building houses tomorrow", missing the point that there is a reason why we are having to spend the money on housing benefit, which is that housing costs have gone up too much and we are having to cope with the consequences.

Yes, we do need to build more houses. On how you do that, there are lots of different things we could do, but the original proposals from Michael Gove on binding targets would have made quite a material difference if, alongside telling councils that they had to accept building targets, you gave them the ability to control that more. Elements of the levelling-up Bill that you have just passed allow councils, in some circumstances, to take land at use value rather than hope value, so that they can actually get on with building some more affordable housing or the infrastructure that you require to do that well. Extending that, basically, to allowing councils, if you are going to force them to build, to be able to control it and do it in that way would make a big, big difference.

As you say, some of our largest urban areas—not just London, but around London—could make a big contribution to that. But we have just had people opposing a planning application to turn a car park next to Cockfosters train station into lots of homes, because apparently the car park was the single most important amenity for the local community. We have people campaigning for a tree in east London, where a mulberry tree cannot be knocked down to build. In the end, if you want the housing situation sorted, people are going to have to stop blocking housing, because they are stuffing the next generation.

Chair: Is that a technical term?

Torsten Bell: That is what we have been doing for decades.

Q205 **Dr Coffey:** There is a combination of factors—people are living longer, so are not necessarily moving out of their homes, and more and more households are forming, as people split up as well. Also, there is the impact of migration—

Torsten Bell: We are not—

Dame Siobhain McDonagh: And we are not building enough houses, which is the most staggering part.

Dr Coffey: Perhaps the Mayor of London should—

Torsten Bell: Interestingly, we are not splitting up at the rate we would probably expect people to split up. Divorce rates are down, and one of the reasons why is, "Good luck paying for your two houses on the salary you were on before." We might expect to see more single households. One of the suppressed households we are seeing is not enough singles turning up in the numbers, because they cannot afford to do it.

Q206 **Dr Coffey:** Correct. May I ask whether Mr Johnson will send me, or the Committee, a note? Earlier, you mentioned the evidence for GPs not referring people for treatment, which is really concerning. Aspects of waiting lists will vary—just getting your next appointment already means that you are automatically on the waiting list—and of course plenty of people are not being treated, but I am concerned to hear that you are saying that GPs are not actually referring people.

Paul Johnson: We simply see that in the fact that the number of referrals has not grown as the number of people turning up at GPs has grown. So this is, again, a simple arithmetic—

Q207 **Dr Coffey:** You are making a correlation, rather than having known evidence—

Paul Johnson: There is a correlation there.

Q208 **Dr Coffey:** Okay. There are the diagnostic centres, but again there is a mixed picture because not all GPs are choosing to refer to diagnostic centres; they are still choosing to refer them to hospitals as well. These are complicated things. I was just checking whether there was some specific evidence out there, but it is a correlation.

Paul Johnson: Yes, it is just looking at the number of referrals.

Chair: Thank you. We have one more question from John.

Mr Baron: May I return to productivity, as a matter of interest? All here, I assume, think that unemployment is a social evil. I certainly do. I think it is corrosive of society, etc, etc. We have an economy that, as Yael suggested, has not done as badly as some people believe in terms of GDP growth, but we have an economy that has nearly record employment and an unemployment rate well below the EU average, say. We know that it is not just about unemployment—it is about how well off people feel in their pockets and standard of living issues as well—but what if I had to choose between low unemployment and slightly higher productivity? I know there is a correlation between the two, and I am not undermining the importance of productivity, but I would choose lower unemployment for all the reasons I have just said. Correct me if I am wrong, and it is a question I do not know the answer to, but if we were, for whatever reason, to allow unemployment to rise, productivity would increase as well, would it not, because you would be measuring those in employment?

Torsten Bell: There is obviously a long literature on the trade-off between unemployment and productivity. In the short run, if you saw a small rise in unemployment would it push up arithmetically the average productivity? The answer is probably yes. Generally, on average, the people exiting the labour market tend to be below average on productivity. I would caution slightly taking that to its longer-term conclusion. That argument tends to run, "I would rather be us than France. We have higher levels of unemployment and much higher productivity." All I would say is that France is not the only country that exists. In the rest of the world, lots of countries manage low levels of unemployment and much higher productivity. That is the world we should be aiming for. There are other reasons why, for example, France has high unemployment. It is not because their productivity is high; it is because they have a two-tier labour market where they basically lock a load of people out of work, as you see in some other southern European countries. I do not think it is because of the high productivity. I agree in the short term, yes, arithmetically that is the relationship.

Paul Johnson: We'd still be worse off on average. If you make people unemployed, we are worse off on average even if the average among those in work is high.

Q209 **Mr Baron:** I completely agree with you. As I said, if I had the choice, I would choose employment over productivity. Although, I realise there is a correlation in the long term with regards to prosperity and unemployment generally.

Yael Selfin: It is all about capital stock. If you have fewer people at work and more machinery, then they will become more productive per person, but that is the short-term bit of it. If you increase the people in the labour force, you will also increase investment in capital stock to accompany that gradually, and productivity should rise as well, provided you have got enough people to sell your products to.

Q210 **Mr Baron:** I firmly believe in the minimum wage rising ahead of inflation for a whole host of reasons. If we are going to have a high or higher-growth, high-wage economy, then that is a stepping-stone in the right direction. There is some evidence to suggest that big business in particular has relied on cheap labour as a substitute for investment. What importance do you attach to that higher growth in minimum wages as one step—it is not going to be the only answer—in encouraging better investment, which in turn should lead to better productivity?

Yael Selfin: I think it is mixed. It will potentially encourage two things: the substitution of labour with machines, and also upskilling people if you have to pay them more and trying to retain them more.

Q211 **Mr Baron:** That is a good thing, isn't it?

Yael Selfin: Exactly. Generally it would be positive, but you need to take into account affordability. Certain sectors—social care is a good example—have limited ability to then push up the cost, and something else gives.

Torsten Bell: This is a big topic. Generally, I broadly agree with the intuition you are flagging, that in the long run a high minimum wage should lead to different business models. If the minimum wage was being enforced, then you would not be seeing hand carwashes charging very low rates because they are obviously underpaying the minimum wage, so you would replace them with machines. That is certainly true. In aggregate, the minimum wage has risen a lot. A full-time worker on the minimum wage today is earning £9,000 a year more than they would if the minimum wage was still at its 1999 level in real terms. So it is a huge increase we have seen, and a very good thing.

On how it boosts productivity, in terms of the evidence we have not seen as much as we would like. We think about it as, "I put up the minimum wage, and the firm that currently employs that worker invests in machinery as well." That will happen to a degree, but the evidence is not strong that loads of that has happened in the UK, because prices have gone up as well.

Q212 **Mr Baron:** I would suggest not just in machinery, but in that person.

Torsten Bell: We haven't seen lots of that, but I think the jury is out. Secondly, there is another way in which it boosts productivity, which you have seen in the German case, where they introduced the minimum wage in 2015 or 2016. It is that you basically move workers out of poor performing, low-investing firms that cannot afford to pay those wages, and they move into faster-growing, higher-investing firms. The evidence does show that has happened, and it is a very good thing. It is another reason why we should not always want to protect the existing firms. We should want to get people out of some of our badly performing firms into good firms. If the badly performing firms close, that is how Britian gets richer in the long run.

Q213 **Chair:** Thank you very much. Before we finish, is there anything else that any of you wishes to say that you have not had the chance to assail us with before you leave?

The witnesses indicated dissent.

Chair: Thank you. That concludes the Committee's evidence session. Thank you to all our witnesses as always. We will reconvene tomorrow afternoon to hear evidence from the Chancellor.