



Economic Affairs Committee

Corrected oral evidence: Sustainability of the UK's national debt

Tuesday 12 March 2024

3 pm

[Watch the meeting](#)

Members present: Lord Bridges of Headley (The Chair); Lord Blackwell; Lord Burns; Lord Davies of Brixton; Lord Griffiths of Fforestfach; Lord Lamont of Lerwick; Lord Layard; Baroness Liddell of Coatdyke; Lord Londesborough; Lord Razzall; Lord Rooker; Lord Turnbull; Lord Verjee; Baroness Wolf of Dulwich.

Evidence Session No. 9

Heard in Public

Questions 212 - 236

Witnesses

I: Bim Afolami MP, Economic Secretary to the Treasury; Ruth Curtice, Director for Fiscal Group, HM Treasury.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.
2. Any public use of, or reference to, the contents should make clear that neither Members nor witnesses have had the opportunity to correct the record. If in doubt as to the propriety of using the transcript, please contact the Clerk of the Committee.
3. Members and witnesses are asked to send corrections to the Clerk of the Committee within 14 days of receipt.

Examination of witnesses

Bim Afolami MP and Ruth Curtice.

Q212 The Chair: Good afternoon, and welcome to this session of the Economic Affairs Committee. I am delighted to welcome Bim Afolami. Could you both introduce yourselves for the record, please?

Bim Afolami: I am Economic Secretary to the Treasury and City Minister.

Ruth Curtice: I am director of the Fiscal Group in the Treasury.

The Chair: We have quite a large number of questions to rattle through in the next hour and a quarter. I will start with a very simple one to you, Minister. Can I assume that you agree with the outlook forecast that the Government will hit their debt target in five years' time?

Bim Afolami: Yes.

Q213 The Chair: Given that, I am assuming that you also agree with the assumptions that underpin that forecast about fuel duty rising, cuts in public spending and tax take rising to near record highs.

Bim Afolami: That is not quite accurate, my Lord. Let me explain what I mean by that. Take public spending, which you mentioned. We have been very clear that public spending, in the next spending review period, will increase by 1% a year in real terms, i.e. above inflation. In that regard, we are clear.

For those who criticise that, and I think the director of the Office for Budget Responsibility has had some interesting things to say about this entire process, I say simply that the spending review period being done on a three-year basis and the debt forecast period—indeed, the assumptions you are talking about—on a five-year basis are reasonable bases looking forward. We have been very clear about the overall spending pattern for public spending. As I say, it is 1% above inflation every year increased.

The Chair: When it says that it assumes that fuel duty will rise by 5p in March 2025, what is your view on that assumption? I am just trying to understand the lie of the land.

Bim Afolami: Look, I would love to speak about this all day. I talked about public spending; let me talk about fuel duty. Every single year when it comes to the Budget, as the Chancellor has just done in this Budget, the Chancellor makes a decision on that. This year he chose to not raise fuel duty in line with the assumption of the previous year. When it comes to the next Budget in March 2025, after the election, that Chancellor—if it is the current one or another one—will have to make that judgment. It is not for me to determine that into the future, unless I am the Chancellor at that point. I am not making a prediction.

The Chair: I am just trying to square a circle in my mind. You are saying

that you agree with the outcome of the forecast that the Government will hit the fiscal rule as regards debt, but are you saying that you do not agree with the assumptions that underpin that forecast? I am just trying to square this in my mind.

Bim Afolami: Let me try again. When it came to public spending, I was very clear about our overall position and that is set out in the OBR forecast and the Red Book. When it came to the fuel duty increase, I did not say I agreed or disagreed with it; I said that it is up to every single Chancellor every year in the Budget to decide what to do about fuel duty.

The Chair: What about tax?

Bim Afolami: What about tax?

Q214 **Lord Griffiths of Fforestfach:** Could I just interrupt? I take the point you make but, for the last 15 years, you have said that you would raise fuel duty and you never have. Whatever you say to me now, that is an empirical track record that personally I think is shocking.

Bim Afolami: My Lord, how I would respond to you is as follows: I did not personally promise anything 15 years ago. However, in relation to fuel duty specifically, if any Chancellor of the day chooses not to meet any particular assumption that underpins a forecast, then that Chancellor has to find alternative sources of revenue to replace the fuel duty revenue. I am not making a prediction; I am just saying that that will happen as Budgets go from year to year. If that were to be the case and a Chancellor were to choose not to raise fuel duty, they would have to find the equivalent amount of money in order to make the assumption credible. I think that is a reasonable position.

The Chair: We are trying to look at how sustainable our national debt is. I struggle to see how you can accept the outcome of the OBR without accepting its assumptions.

Let us try another assumption. It says that the fiscal forecast is conditioned on the tax-to-GDP ratio increasing by a further 1.1 percentage points from its current level to close to a post-war high of 37.1% of GDP. Two-thirds of that increase comes from freezes to personal tax allowances. Are you also saying that that is something that may or may not happen?

Bim Afolami: Without being too philosophical about it, anything may or may not happen. What I would say in relation to tax is that the tax burden, though a relevant consideration for everybody on the committee—indeed, the country—to think about, I would argue, gently, that what is more relevant is the actual take-home pay for individuals, real household incomes, because that is actually what people receive. That also underpins the question of how fast your economy is growing. Obviously we are trying to grow the economy to the point where people's real living standards are improving.

I do not want to go down all the things we are doing, but this is very important around the tax burden. I know where you are going with this, my Lord. What is very important around the tax burden is first that we have the lowest tax burden out of European countries in the G7.

The Chair: I am sorry; we are pushed for time. We are getting into debt sustainability.

Bim Afolami: Sorry; I was getting carried away.

The Chair: No, it is perfectly understandable that you wanted to make that point, but I am trying to get into debt sustainability and to understand how sustainable our debt is. It seems that the Government are saying that debt will be falling in the fifth year of the forecast, but they disagree with the assumptions upon which it is falling. That then makes me wonder how sustainable our debt is, because if you are not agreeing that you will see taxes rising or spending falling, I cannot quite understand how these figures all add up.

Bim Afolami: You are putting words in my mouth. I did not say I disagreed with the tax point that you made or that I disagreed with fuel duty. To the extent that I thought it would be possible to change any of those assumptions, I said that one would have to find alternative sources of revenue to fill that gap.

Q215 **Baroness Liddell of Coatdyke:** The OBR has told us that long-term debt sustainability requires action over the next Parliament, which is the next five years. What are your thoughts on that?

Bim Afolami: I agree with the fundamental point that it will require action, not just in the next Parliament, but the Parliament after that, the Parliament after that and successive Parliaments, because this is a long-term challenge. What are my thoughts on how to do that? The fundamental way to do that is to deal with the numerator and the denominator of the question, in growing the economy to make sure that you need to borrow less over time and making sure that we get better outcomes for public services to ensure that you do not have to bake in huge increases every year.

We are working on both of those. I am not saying that that work is complete or that future Parliaments and Governments will not have ideas as to how to do those things more effectively. What I am saying is that the core question is the growth of the economy and public spending. We have to focus on both of those questions in every single Parliament.

Baroness Liddell of Coatdyke: I do not disagree with you on that but how do you get there? That is the most difficult question.

Bim Afolami: We have started. I was going to say that we have had all these growth measures and I was going to list them, but there are over 120 in the last six months from both the Autumn Statement and the Budget, so I will not list them all. That is a huge amount of growth measures. Do not just take my word for it; the OBR itself has said that, if

you combine the spring Budget of 2023, the Autumn Statement 2023 and the spring Budget this year, together they add up to an increase of 0.7% growth on what otherwise would have been the case. Of course you could say we should try to increase it by 1% or 1.5% or 2%, but I am saying that we have done a huge amount. For the record, that is the highest amount that the OBR has ever scored. This Chancellor is very focused on this. On the growth side, that is what we are doing.

In relation to public services, the work that we are doing on productivity and improving the productivity of public services is quite fundamentally different to professed productivity improvements in the past. In the past, there has always been a tendency of Governments to say, "We will do efficiency drives and cut X amount every year from government departments". Although efficiency drives have their place, what is transformational about this productivity plan is that it actually requires investment. We are investing to improve outputs in public services. By doing that in all sorts of practical ways, whether by using artificial intelligence, new technology or investing to help children with special needs—all these things—taken together with economic growth, we will get on top of our debt position.

Q216 Baroness Liddell of Coatdyke: Does cutting national insurance at the present juncture promote medium to long-term debt sustainability?

Bim Afolami: It promotes it in so far as it is improving—or increasing, rather—the growth of the economy by increasing the labour supply by about 100,000 over the forecast period. Of course, as you know, there are two ways of improving your economy: labour and capital. That is quite a significant increase to your labour supply. That is one way it improves it. Secondly, it improves it by giving people more of their hard-earned money, which will give them more opportunities to spend that money over time. That of course is a core way in which economies grow.

Baroness Liddell of Coatdyke: There is an election looming and it is going to be—

Bim Afolami: Really? The thought had not crossed my mind, my Lady.

Baroness Liddell of Coatdyke: Well, you might be in a state of shock then. With an election looming, has talk of fiscal headroom against the backdrop of rising debt risk jeopardised the Government's credibility in promoting debt sustainability?

Bim Afolami: I do not think so. I do not agree with that premise, but of course the thing about elections is that the public gets to decide. That is my view, but it does not have to be anybody else's.

Baroness Liddell of Coatdyke: You do not really have an answer for that one.

Bim Afolami: I said I do not believe it has.

Baroness Liddell of Coatdyke: Do you agree with this morning's

Financial Times, which said that the next Government should begin a rethink of how the country runs its fiscal processes altogether?

Bim Afolami: I have not read the piece, so forgive me. Off the top of my head, from what you have said, we should always be looking to improve our processes. Innovations happen from time to time. Indeed, the Office for Budget Responsibility was an innovation in and of itself. When people have good ideas as to how to improve the fiscal sustainability of the country, we should always consider them.

Q217 Baroness Liddell of Coatdyke: Should the OBR be better resourced?

Bim Afolami: Forgive me; I do not know how well resourced it is, but it does produce very good work in relatively short order, so it does not strike me that it is inadequately resourced.

Q218 Lord Griffiths of Fforestfach: Minister, regardless of party politics, my background is as an economist, and this review concerns the issue of debt sustainability. I think everyone feels that, when you are getting close to something like 100%, it is a serious issue. In addition to that, in the Chancellor's speech on the Budget, if you look at the figures he gave for the ratio of debt to GDP over the next five years, they are higher at the end of the period than they are now.

In addition to that, you see all the demands, from mental illness through to defence. People want money spent on improving services, welfare and defence. Against this background, we have these fiscal rules. The OBR is an independent body, after all—it is specifically not party political—and it has been highly critical of them. If you put all this together, how much confidence do you have in saying that we know we have a problem, we know the answer to it and we are on that path to delivering an answer?

Bim Afolami: Lord Griffiths, that is a fascinating question. Let me try to do it justice with my answer. To take the fiscal rules first, I have thought about this quite a lot and, if you compare us to other countries, our fiscal rule stands up pretty well. Let me take a comparison. First, the United States does not have a fiscal rule. The European Union obviously a bit more complicated because it has member states, but it does have a fiscal rule. If I recall, its debt fiscal rule is something like 60% GDP. I do not have all the figures in front of me but I think most European countries are way above that. In fact, all the European countries in the G7 are above our level to GDP. I make that point not to criticise them—I do not want to lose any friends in the European Union—but simply to make the point that having a rule in and of itself does not necessarily make one chaste in this regard. I think that our fiscal rule stands up reasonably well and, indeed, is voted on at the beginning of the Parliament.

The first part of your question is, ultimately, if I were to summarise it—and correct me if this is wrong—rising demand and how on earth we will pay for it all on the track of debt that we appear to be on. It is a very difficult challenge. Everybody in this room knows that and any economist who looks at the books knows that, but it was also a difficult challenge in the time of one of my favourite former Prime Ministers, Harold Macmillan.

If anybody has enough time—and Members of the House of Lords are all working until very late, voting until the early hours, so you probably do not—look at his memoirs, five volumes if I recall. He talks about the debt challenges that that Government had, and this is when he was Chancellor and when he was Prime Minister. The debt-to-GDP ratios that they were dealing with were not out of kilter with where we are looking today. Then you fast forward 20, 30 or 40 years after that and the debt came down as a percentage of GDP. If you had asked Harold Macmillan what was going to happen in 30 years' time that would mean that the debt would fall, he probably would not have been able to give you a precise answer.

This is a very long-winded way of me explaining that all we can do is focus on the two core things: the first is growing our economy as fast as we can, and I think we need to continue to do more on that. By the way, I am not saying everything we are doing is done. There is a lot more to do on that; I completely agree. The second is making sure that the demand for public services and the outputs more generally in how the service is run are done as effectively as possible. That is all that you can do.

The Chair: The *Financial Times* had a very interesting editorial this morning, which points to two core flaws in the Chancellor's debt rule. "First, it does not encourage long-term thinking"—I am quoting from it—and, "Second, the five-year window is rolling, which means the chancellor can meet it by pencilling in backloaded spending cuts or tax rises that never happen". Can you be clear about what your view is on those two critiques or criticisms?

Bim Afolami: I will take the second one first. It is theoretically possible to do that if you have a five-year rolling target, but I have already explained how we are not doing that. It is also possible to meet the targets by not doing that. In relation to your first point—what was it? Forgive me.

The Chair: The first point is that it does not encourage long-term thinking.

Bim Afolami: I am happy for Ms Curtice to come in on this point, as a long-term official in the Treasury, but I see that the fiscal events that we have—we have two a year and used to have one a year—are good mechanisms for forcing economic decision-making. They are good mechanisms for forcing the whole of the Government and, frankly, the whole country to think about the economy.

Broadly speaking, whether you take this Chancellor, whether you take, for example, Gordon Brown when he was Chancellor or Nigel Lawson—just to take a few Chancellors—they tend to run in thematic ways. If you think about the Chancellor's spring Budget in 2023, the Autumn Statement and this Budget, he is not lurching from thing to thing. It is broad, long-term focus on business investment, long-term focus on tax cuts for individuals and long-term focuses on rewarding work. These things tend to happen in quite a strategic way. Although it is theoretically

possible that every fiscal event sees lurches in policy from one way to the other, I do not think that that has been the case most of the time.

Ruth Curtice: I will add a couple of points on fiscal rules. The rules have taken a lot of heat recently from people—I think that *FT* editorial sort of argues for both—as they might both be constraining spending too much or be too loose and should come forward. I think the rules are quite difficult to set and to meet right now, because the fundamentals are quite hard. Perhaps we need to talk more about the fundamentals as well as the rules.

It is necessary now within the OBR's five-year forecast for debt to stabilise to run a primary surplus. You need to run a surplus of 1.3% in the final year of the forecast just to get debt to stabilise. If we were to look from 2010 to 2019, you could have run a deficit of just over -2% in order for debt to stabilise. One of the reasons that the fiscal rule of debt falling is getting such attention is because it is very hard to achieve that at the moment. None the less, within the forecasts, the Government are.

The second point I want to add is that one of the other criticisms of the rules is that they are a bit too narrow and do not look at everything that is relevant to debt sustainability. It is undoubtedly not possible to do that within a single metric, but the *Charter for Budget Responsibility* requires us to look at other measures to assess wider evidence. We do that very actively. We also have an aim in the charter to strengthen measures like public sector net worth, which takes account of wider measures of assets and liabilities, and that strengthens through the forecast at a faster rate than debt.

Q219 Lord Davies of Brixton: There is a level of disbelief about all this. I do not think any interested outside observer takes the fiscal rules seriously. They are not regarded as serious politics. You need to have them, you need to promote them, but I do not think anyone is impressed who does not have a direct involvement in what is happening. The *FT* is only the tip of the iceberg. It is a fundamental problem: you are basing policy on the difference between two very large and very uncertain figures, so you are left with a figure that is extremely uncertain. Is this form of fiscal rule serious politics? Obviously you have to say yes.

Bim Afolami: Let me address this very directly. In this Parliament, a lot has happened: the global pandemic, the war in Ukraine and a series of Prime Ministers. At an early point in the Parliament when certain Chancellors ended up getting the wrong side of the market, so to speak, that was noticed hugely. What you have seen with this Chancellor and this Prime Minister is a huge amount of confidence in the people who buy British Government debt in them. That is what you have seen.

That is partly perhaps an individual judgment. I suppose I would say that, would I not? But it is maybe partly an individual judgment in them as people, but it is also partly a judgment on the gilt market's assessment of the fiscal rules, the broader sustainability of the British Government and the strategy to be in an overall position to grow the

economy and bring debt down. The market is very interested in what the British Government do and how they deal with debt. The market is saying that at the moment we are meeting our fiscal rule and that it is broadly happy with that, judging by the response of the market to the Budget and to this Prime Minister and Chancellor being in office.

Lord Davies of Brixton: Is it really that the markets are impressed by the fiscal rule?

Bim Afolami: The fiscal rule is part of the overall framework that shows international investors how the British Government will fiscally manage their position over the coming years. The fiscal rule is an integral part of that framework. I am not saying that it is the only thing, but it is a key part of that overall framework and the market is now showing its confidence in the Government.

The Chair: Let us move on to talk about migration and the dependency ratio.

Q220 **Lord Rooker:** The OBR's long-term projection for rising debt is based on a steady increase in dependency ratio from the mid-2040s onwards. How can the Government's policies on immigration be squared with the need to mitigate this rise?

Bim Afolami: That is a very important question and the answer is quite straightforward. It is our policy to bring migration down from the levels where they were last year—I think somewhere in the region of 740,000, something like that. It is our policy to bring that down and bring that down on a sustainable basis. First, it is worth saying that the OBR can see that the Government, once applying their policies on migration, will bring it down. How you deal with your conundrum is by improving the economic potential for every migrant that you do take, so making sure that your policy focuses on ensuring that every person that you take contributes as much to the economy as possible. The corollary of that is also true: you are trying to dissuade people from coming or not accepting people who do not benefit the economy in the same way, because it is not the total number in and of itself that is the most important thing; it is the economic potential and value that each of those migrants brings. That is how we need to focus.

We have made quite a lot of progress in this. I lose track of the number of visas we have. We have the global mobility visa, the high potential visa and I think something called the scale-up visa—all sorts of things designed to grow the economy, designed to bring in people who will help grow the economy for the long term of this country. We need to bring down the numbers of migrants who are not as likely to do that as some of the people who I have mentioned. That is the direction of policy.

Lord Rooker: A lot who do come in of course send billions of pounds out of the country so it is not all a gain, is it? If immigration were reduced to—I say tens of thousands because that is what a lot of Ministers have said—tens of thousands, what would this mean for debt sustainability?

Bim Afolami: It is not a phrase that I have used, so I do not want to tie myself to it.

Lord Rooker: No, you have not. Home Office Ministers certainly have said tens of thousands.

Bim Afolami: Home Office Ministers say lots of things, as you will know.

Baroness Liddell of Coatdyke: Are you disagreeing with your colleagues?

Bim Afolami: No, I am not disagreeing with my colleagues. The point that I am trying to make is that bringing down the numbers of migrants is a balance, in terms of who you are accepting, the numbers and making sure that that is compatible with what you see as the growth of the economy. These things are balanced with time. One thing that is worth saying, which does not get covered enough in this debate, is that we are talking about net migration numbers and you can control only half of that equation. It depends on how many people are emigrating from the UK at any given point. There is a degree of uncertainty about that.

What you can do, however, is to make sure that everybody you bring into the country—I have already outlined the sort of visas that we have in place—are as economically valuable, the best and brightest from all over the world, as you can possibly manage. If you do that, you can grow your economy in a sustainable way and you will need fewer of them.

Q221 **Lord Rooker:** Looking at the demographics we have, it is true that we have an ageing population, but we have flatlined life expectancy for the last 15 years. People are not living longer, in that sense, but we certainly have an ageing population. How do the Government plan to mitigate the risks of an increase in health and social care spending, because the consequences of that are enormous?

Bim Afolami: The challenge of an ageing population is one of the central challenges of our time. In particular, on the point that you have already made, it is not just the ageing per se, but how healthy people are in the latter period of their life and the costs that that imposes on the NHS. It is not my brief, so forgive me if I am not completely au fait with the detail as to every aspect of how the Department of Health is doing this. But I know from numerous conversations with the Chief Secretary to the Treasury about what we are doing on health investment and NHS productivity, that, broadly speaking, the direction of travel is to try to reduce demand for the NHS in all sorts of practical ways, but also to make sure that we are getting more bang for our buck, so to speak.

I am not saying that that challenge is met. Indeed, it is worth pointing out that there is not a developed country in the world that does not have an ageing population. Forgive me; I cannot think of one. Maybe there is one, but almost every developed country in the world has an ageing population and rising health spending, so this is a challenge not just of the UK but of the industrialised world. But I think that this country is on track to meet that challenge if we continue along the process of reducing

demand in the NHS, investing more to get better productivity and growing our economy, which grows our revenues as well.

Q222 Lord Rooker: This is my last point. It is interesting that you raised that in your answer. That specific issue was raised last week, I think, or the week before. We asked the witness who made a claim about countries looking after their ageing population, and he could name countries where they had planned spending on dementia and the impact of the ageing population. I think it was Mr Jessop. He said Hong Kong and Singapore are two examples that come to mind. They have intervened successfully, apparently. Is there anything that we could learn from them?

Bim Afolami: I am sure we can. I am not an expert in this area of policy—forgive me—but I have always been a huge advocate for looking at other countries and seeing how they do things. Ultimately, whatever country in the world we are in, we all breathe the same air and we are all human beings. We should look at other countries; of course we should do that.

Q223 The Chair: Minister, I will quickly bring you back to immigration for a very quick question. Is it not the case that the Government cannot afford to bring down migration? The ONS projection is for 350,000 and the OBR is saying that if it were 200,000 lower underlying debt would rise by up to 3.1% of GDP. You cannot bring it down to 100,000 or so without having quite a bad impact on debt sustainability.

Bim Afolami: Without repeating my point about the quality in economic terms of the people who you are bringing in—I made that point already—the key thing here is a balance. As I have said, it is a balance. I do not think anybody anywhere is suggesting that we should take absolutely nobody, unless I am missing something.

Lord Griffiths of Fforestfach: Mr Anderson is.

Bim Afolami: He says lots of things. I will leave him to speak for himself; he is quite keen on it. Barely anybody is proposing that we take absolutely nobody. At the same time, nobody is proposing that we take absolutely anybody from anywhere in the world who wants to come here. All we are debating here is the level and it is my assessment that the level will have to be dependent on a balance of things, the nature of your society and integration, but critically economics.

The Chair: "Critically economics" is very interesting. Do you think that 315,000 and the ONS figure are therefore acceptable figures from the economic position?

Bim Afolami: It is not just the economic position because you also have to bear the societal aspects of this in mind. You cannot just take one aspect of a judgment.

The Chair: It might be lower or it might be higher.

Bim Afolami: Of course it could be, whatever the judgment is when you take things in the round. The problem with this debate, if you will forgive me, is that people end up getting fixated on specific numbers and it is very difficult to assess everything that will happen in the future. If we had said five years ago that there would be a war in the Ukraine that would lead to hundreds of thousands of people coming to this country, people may have found that far-fetched.

The Chair: I am just trying to get a sense of where you are with the OBR figures.

Q224 **Lord Layard:** On ageing, of course the state pension age and what it is are very important from the point of view of the Budget. Are you thinking about advancing the date at which the state pension age goes up to 68? I think it is 2044 at the moment, which seems a very long way ahead.

Bim Afolami: It does. I have not had any conversations on that and it is not my understanding that we are thinking of doing that in this Parliament.

Q225 **Baroness Wolf of Dulwich:** Minister, I will switch from migration to net zero, bearing in mind that we are still talking about debt sustainability. This will be very expensive and the expense has, as I am sure everybody is aware, become increasingly live as a political issue, to some extent in this country but even more clearly in other developed countries. What is your view of the risk that this transition poses for the future of our debt levels and sustainability? This may also be a question for Ms Curtice. I would be very interested to know how the Treasury is thinking about them and its view of how far policy can mitigate them. I would like some concrete thoughts rather than, "Of course it will spawn all sorts of green jobs and magic productivity increases".

Bim Afolami: You took my answer away then, Lady Wolf. This is how I see this question: there are three aspects. First, this is something that not just this Government but almost all Governments across the world have committed to. We are not an island in this respect. We are tackling this challenge at the same time, broadly speaking, as everybody else.

The second thing is that it is highly uncertain how we will achieve it because it relies, in part, on changes to individuals' behaviour and technology. I am talking about the 2050 target now. It is about not so much about technology being invented afresh, but being commercial in some respects.

Thirdly, it will clearly involve public spending of some degree that otherwise may not have been spent. I think those three things are true. On the third, to focus on it specifically before I bring in Ms Curtice, I do not necessarily think it needs to be a doomsday scenario for the fiscal position because, to some degree, it will be spending that would otherwise have been made in a different area of the economy that is now going to net zero. Let me give you an example. In the Autumn Statement the Chancellor brought forward the full expensing regime, the capital allowances 100% regime, which is designed to promote more business

investment. Fifty years ago, if a Chancellor had done that, it would not have gone on green, because that was not part of the debate or the public issues of that time.

Today I suspect quite a lot of it will go on greening the economy, on investments to make businesses or parts of infrastructure more ready for the net zero challenge. That is not extra spending; it is displacement spending. I think that that is more likely to happen: we find ways of improving the economy by investing in increasingly green ways, rather than what otherwise would have been done, which is less green. That is what I think mostly happens, but I am not naive enough to think that it will not require some extra public spending, at some point, or maybe public subsidies to do certain things. I am not saying that that will not be required, but I think that it will be quite a small minority in comparison with the former.

Ruth Curtice: I can add on the fiscal effects of the transition to net zero. The OBR has characterised those as significant but not exceptional. In the Treasury we would agree with that. As the Minister said on levels of public spending, the OBR estimated that it might need to be about £10 billion a year and that it might be absorbable within the existing public sector investment assumption that it makes over the long term. Obviously that will be a choice for a future Government.

There are two other effects that we think about. One is the loss of revenue from emissions-related taxes, which are about 1.2% of GDP, by the end of the forecast. On the other hand, during the period of transition, there may be receipts gained from what is currently the emissions trading scheme. Those are the direct fiscal costs.

As you say, there will then be much wider effects, both the wider effects on the economy from whether or not there are higher levels of investment to support the transition and what that does to productivity—relative to the past and to what it otherwise would have been—but perhaps also costs in making the transition to a somewhat warmer environment with more weather events, which are separate from the ones that I mentioned.

Baroness Wolf of Dulwich: It is your judgment that the amount of investment required and the loss of tax revenue that will follow, including obviously from fuel duty, is manageable. It is not something that you see as, for example, comparable in its doomsday potential to the impact of demographics.

Ruth Curtice: I quoted the OBR and we take its long-term projections very seriously. The demographic effects within its long-term forecasts are more significant than the net-zero ones.

Q226 **Lord Blackwell:** Minister, I very much take your caveat from Macmillan about long-term forecasts, but there are some inevitable trends that we have to take account of. As Lord Rooker was saying, look at the OBR's demographic projections and the implications of that for spending.

Dependency ratios are going from one and a half people in work to one not in work at the moment to more like one in work for every one not in work, and there are increasing costs of pensions and healthcare on an ageing population. Its numbers may be spuriously accurate but, projecting that forward, it ends up with spending at 67% of GDP in 50 years' time, assuming other areas of government spending are held in reasonable restraint.

Stepping outside the short-term aspects and the political aspects of the short term, as a nation, regardless of who is in government, we have a real challenge to face in that we cannot carry on sustaining levels of expenditure growing faster than GDP. That 67% of GDP spent by the Government, if not balanced by taxes, would mean an explosion in debt. I think you would agree with me that 67% taxation would not be very desirable. Is there not a fundamental challenge here that nobody is talking about of how we, as societies, restructure our provision of healthcare and ageing?

Bim Afolami: There is that fundamental challenge. I share your view. We say that no one talks about it, but I try to talk about it as much as I can. Well, I try to talk about everything as much as I can, but in particular this question. I often say that we cannot have a situation where the economy grows at, say, 1.5% a year and public spending grows at 2% or 3% a year carrying on ad infinitum. A 12 year-old would understand that that is not a sustainable position.

Here is the thing: you mentioned the dependency ratio, which is an absolutely critical aspect to this. It ties in with what we were saying about migration with Lord Rooker and with Lord Bridges as well. This area of policy has not had enough attention over the last 15 to 20 years. Our replacement rate is falling. It is now, I think, around 1.5, 1.6. You broadly need 2.1 to have a population that stays the same. Frankly, our replacement rate is lower than many of our competitors, although most developed countries feel that theirs is too low. We have to have a serious conversation about how we support—in a reasonable, non-coercive way—people who want to have larger families having them or having children at all.

That is a critical part of the debate that we are having today, because if that dependency ratio improves from that perspective, it helps with the broader economic issue. It means that you do not have the same migration pressures and the debates that we were having. It is a good thing that we should support people who want to have more children, but feel that they cannot because they cannot afford it, they cannot get the childcare or their work is not flexible enough—all the reasons that we all appreciate. I think it is a good thing if we can support them more.

That is one of reasons why I was very pleased in this Budget—I know it is a small thing but it matters—by the child benefit changes that the Chancellor forecast in terms of changing the household assessment for child benefit; and, secondly, in the short term, increasing the high benefit charge level from £50,000 to £60,000, tapering off to £80,000. It may

have been missed by a lot of people because the newspapers like to argue about normal political things but, in my own constituency, that will have a huge impact for many middle-earning people, many middle-earning families, maybe supporting them to have another child. Supporting families is something that is underappreciated in economic debate more broadly. It is something that needs to be talked about more and, if we could do that, many of the problems that we are talking about from a structural perspective will get a bit better.

Lord Blackwell: This needs to be quite radical, does it not, to have a significant impact? Some 25 years ago, the Conservative manifesto promised transferable allowances for households. Is the Treasury considering that?

Bim Afolami: I cannot say that I have had that discussion with anybody, but I think that, as I hope I made clear in my previous answer, broadly speaking, supporting families and households—and I mean families of every description, just for the record—is a positive thing. Not just in economic terms, but it is positive socially as well, because it is very difficult to see how we could manage with an ageing population over the long run, while maintaining the public services that we want and growing the economy sufficiently, unless we change that dependency ratio to some degree.

Lord Blackwell: The other side of the equation is growing the economy faster, as you said, bringing down that ratio of spending to GDP. If you took that level as where we might end up, you would need to grow the economy, every year, something like 1% a year faster than the OBR projections to keep government spending down at a reasonable 40% or so of GDP. If we had the objective of adding 1% a year to the growth rate, which would be phenomenal compared to our record, how are we going to get that kind of productivity?

Bim Afolami: There are so many aspects to productivity in the wider economy. I have talked about business investments, so will not repeat all of that. One area is a dog yet to bark but, if you speak to anybody who works in technology, any venture capitalist or investor, they will tell you about the potential for artificial intelligence to improve productivity. I had some people in my office recently from top professional services firms and I asked them the question very directly. These are the sorts of firms that I used to work for and I am even hearing how, in the space of 10 years, the use of technology improves the output for these firms. You look forward—this is before the artificial intelligence bug had bitten—five, 10 or 15 years, and there are lots of economists who are very optimistic about the potential for artificial intelligence to improve productivity and the outputs for the economy. I tend to be of that view as well.

Q227 Lord Blackwell: Given our economy is 80% services, it is productivity in services that is critical. A lot of government measures tend to focus on capital investment and things to do with manufacturing and productive industries. Could the Government do more to improve investment in software and do more productivity-raising investment in the service

industries?

Bim Afolami: We could, and let me give you an example of something that we did over the last couple of years that I was very pleased by. I went to see the now Prime Minister when he was Chancellor to talk about the economy and various things. I thought I was being terribly keen and clever when I was talking to him about a speech that Andy Haldane had made. I think it was called "Hub No Spokes". It was when he was at the Bank of England. It was an absolutely brilliant speech and exposition of the economic difficulties of the country and the need for improved productivity. I thought I was being terribly clever, but of course the Prime Minister had already read the speech, and he pulled it out of his bag and had a marked-up copy of all the different aspects of it.

He then started talking to me about what became the Help to Grow scheme. The Help to Grow scheme was broadly designed to improve the management skills of small and medium-sized business owners. To declare an interest, my wife runs a small-to-medium-sized family business and she did it as well, so I heard about it from the coalface as well as from Government. I think it was a success. We should be doing many more things like that because, if you are talking about improving productivity and services, you are right; it will not be by capital spend. It is not manufacturing, but improving the quality of management, improving the inputs for people and improving education. Those are the things that can improve productivity, as well as, as Andy Haldane makes very clear in that speech, improving the adoption of new technologies, particularly for companies in that long tail that he describes.

Q228 Lord Londesborough: Staying with the subject of productivity, the OBR, in its March forecast, cites productivity as the single most important and uncertain forecast, particularly in relation to the public sector, where the crucial assumption is a 1% gain in productivity for each year of this forecast period. We look back and there has been a 6% drop in public sector productivity since the pandemic, since 2019. I am struggling to see how we mind that gap. That is a major turnaround from -6% to +1%. I have not seen a lot of detail apart from NHS software investment, which will probably take three to five years to bear any fruit.

Bim Afolami: Yes, I think that is a fair challenge. I know that the Chief Secretary is working at pace to try to give as much of that detail as possible going forward. We thought we would start with the NHS, but that is a very fair challenge on the detail.

To address the point directly about the 6% fall in productivity since the pandemic, that is correct and that is why it is so urgent. I happen to think that the pandemic presented such a unique, once-in-a-century, level of stress and strain on many key public services—most notably the NHS, but not solely the NHS—that it was a unique period. I do not forecast that it will continue falling in anything like the same way, but we need to address that. That is why we have the productivity plan and, I repeat, we are not just making old-fashioned efficiency savings, but investing more to get better outputs. I think that that is the critical

difference between this productivity plan and previous ones that I have seen.

Q229 Lord Turnbull: Just as an aside, earlier in my career I was told by John Biffen that 1958 was a major turning point for the worse in the British economy when Macmillan did not back his Chancellor, Thorneycroft, and he resigned, heralding 18 months of weak government thereafter.

I want to go back to the beginning. The Chair raised the question about total expenditure that is supposed to grow at 1% in real terms. The IFS calculated that, if you take the protected programmes—health, the triple lock and defence—and then look at what is left, they have to contract by about 3% a year. None of these services is starting from a point of equilibrium; there are backlogs all over the place. There are roads, potholes, school buildings, waiting lists for housing, courts, asylum processing and so on. The question is whether it is plausible to expect that the numbers that are needed to make these figures add up will ever be implemented.

Bim Afolami: I will answer very carefully to a former Cabinet Secretary and former Permanent Secretary to the Treasury. Obviously you know your onions. The way I view it is this: the only thing that you can reasonably ask any Chancellor to do is to give the headline number as to how much spending will go up or go down in the next spending review period. We have done that. We said that it is a percentage point above inflation. We have also talked about our productivity plan and all sorts of other things I have said, how we need to grow the economy and all the rest of it.

After the election and the spending review occurs—whoever does that—they will have to work out how to apportion that spending. It is not reasonable at this juncture to ask this Government and this Parliament to make a full Budget for the next spending review period. The figures you mentioned sound difficult in some respects, but ultimately it will be up to the next Chancellor and the next Parliament to make decisions about how to apportion that. The only thing I would say is that, if you look between 2010 and 2015, if I recall, spending in real terms went down by about 1% for that Parliament. We are proposing going up by 1%.

This is not completely revolutionary at all. It is more spending in real terms than we saw only 10 years ago. However, ultimately it will be up to the next Parliament and the next Chancellor how to apportion that.

Lord Davies of Brixton: I am struggling with this. You are starting with a broad overall financial target for spending. Would it not be better to start with a rational assessment of what has to be done, then work from that towards a reasonable level of public expenditure, or is that too naive?

Bim Afolami: That would be very difficult. The way that we have always done things—one could argue that we should do things completely differently, but this is the way that we have always done them—is to say what we think the growth rate of the economy could be, how we think we

can improve that, what we think we can afford, how much we can afford to borrow, what the will markets accept and what inflation will be. Then we get to where we get to. We then have to think about how that is allocated in terms of public spending, taxes and the rest. I do not think that that is an unreasonable way of doing a budget going forward.

The Chair: I am going to bring in Lord Burns, another gentleman who knows his onions.

Bim Afolami: They are all here.

Q230 **Lord Burns:** There has been a lot of attention given to the increase in the ratio of taxes to GDP in recent years. It is now getting towards the highest point in the post-war period. We all understand the reasons why it has happened, and you have mentioned the pandemic, the slow growth of the economy and the pressure on public services, but do you have a view on whether we are reaching the point at which the overall tax rate has a detrimental impact on growth?

Bim Afolami: It is a fascinating question. I know it is one that economists have debated ad infinitum for decades, so I doubt I will be able to solve it here. But the Chancellor's view, which is one that I share, is that if you look at lower-taxed economies, you see economies in the Far East, America and Canada. America and Canada in particular have lower tax burdens than the UK does although, I repeat, we are still below compared to the rest of Europe. Those economies tend to grow faster. We want to be in the fast-growing pack, not in the slow-growing pack.

Lord Burns: Is there scope for changing the balance of taxes between different taxes to improve the growth rate—whether it is to do with average taxes against marginal taxes or whether it is to do with particular kinds of taxes—which you think have more impact on growth than other taxes?

Bim Afolami: Of course there is scope to do this. Let me give you an example of something that I have long thought about, which I am very glad that we did. We cut the higher rate of capital gains tax from 28% to 24%. As the Chancellor said, Richard Hughes has found his inner Arthur Laffer by scoring that as increasing the amount of tax take to the Exchequer. I am not saying that for can do that for every tax, but there are taxes that could be changed, that might unblock an area of the economy. There are taxes where we think we can do things like that. That is a very good example of where cutting a tax can increase the amount for the Exchequer and increase economic growth. We should be looking for those all the time.

Lord Burns: The other approach, which was one that Andrew and I lived through in the 1980s, was the Nigel Lawson approach. That tried to expand the tax base and keep marginal tax rates down. I do not see much attention given to these ideas at the moment; are they out of fashion?

Bim Afolami: I have Nigel Lawson's memoirs on my table in my office, and they are very good memoirs—although they are very long—as many of you are in them. The fascinating thing about them is that they are very bite-sized chapters, so you can read them quite easily. You can dip into different sections. I went and dipped in the other day when Lord Nigel Lawson was talking about tax rates. I think it was the famous 1988 or 1989 Budget where he cut tax rates; the Labour Party got very stressed about it in the House of Commons and the House almost had to be suspended.

The reason why I mention this is that broadening that base is something that has happened over the last few years, in effect through the fiscal drag that has occurred. There are more people paying tax now than there were a couple of years ago. That is something that has broadened the base of the economy and means that more people are paying tax. It is one of the reasons why tax receipts are up in some respects.

Here is the thing: if we need to broaden that base, we should do so with the lowest possible headline rates that we can. We should also do so by trying to deal with as low national insurance rates as possible by, as the Chancellor has said, cutting that double tax on work. By doing that, we are cutting the right taxes to contribute to growing the economy, not just cutting taxes for the sake of it or for an ideological reason.

Lord Burns: There was some mention earlier about the potential decline in fuel duty with the emergence of electric vehicles. How far has the Treasury gone in thinking about how it is going to replace that?

Bim Afolami: Nobody has talked to me about it. Maybe Ms Curtice may have a view.

Ruth Curtice: We have taken some action. In the Autumn Statement 2022, we applied vehicle excise duty to electric cars, vans and motorbikes. Obviously future decisions will be for future fiscal events, but it is certainly an issue we think about carefully.

Lord Burns: It is quite an enormous hole that is potentially there to emerge, is it not?

Bim Afolami: That is true but, if you went back 40 years and looked at the rates of tax paid on cigarettes today, people would probably think that that was quite strange. Even if you looked at it 10 years ago, you might think that it was quite strange. Then you have vapes, on which we have now put a tax. I am not comparing driving and cigarettes in any other way beyond this: as the challenges change, the taxes end up changing. That is why tax policy is always under review and you end up shifting the way in which you apply taxes with time.

Q231 **Lord Davies of Brixton:** This is a slight change of emphasis. We have talked about debt as if it were a homogenous whole, but it varies in many different ways, interest rates and term. Do you have any issues with debt sustainability that cause you concern?

Bim Afolami: No. I think you have Sir Robert Stheeman on after me, and I am sure you will ask him similar questions in that regard. From my perspective, we have one of the highest maturity rates for our debt compared to any other industrialised nation. It is about 14 and a half years, if I recall, and I think that is broadly a good thing.

We started issuing index-linked debt in the 1980s, and there was a study done comparing whether we had issued just fixed debt or a proportion of index-linked debt, which is what we did, and how expensive that would have been for the country or the Exchequer. We are £158 billion better off since we started issuing index-linked debt as a result of that decision to do so. If you look at the maturity and at the index-linked compared to the fixed, I think we have done the right things, broadly speaking, although we should always keep these things under review and assess them as time goes by.

Lord Davies of Brixton: Another aspect is the suggestion that there is too much reliance on the kindness of strangers—the international aspect of our debt.

Bim Afolami: Again, it is interesting. If you compare us with Japan, for example, Japan issues much more debt to what we would describe as retail investors in Japan than we do. Some people see that we should try to increase the amount of retail participation in our debt. At the Budget, the Chancellor set out what we called the British Savings Bond to encourage more retail investment in debt. We have National Savings & Investments as well. I think there is a place for ordinary people to participate in that, not just overseas investors. Over time that can probably grow and I would like to see that happen.

Q232 **Lord Razzall:** This is a slightly left-field question. Professor Goodhart suggested to us that it might be a good idea for the Bank of England to stop paying interest on commercial bank reserves, as this would present a simple solution to our debt levels. I know the arguments against but would you care to comment?

Bim Afolami: I do not agree. I do not think that that would be a sensible way forward. That is all I have to say about that.

Lord Razzall: The major argument against is that the Bank would lose control over the monetary supply.

Bim Afolami: I am sorry: you said you knew the arguments against; I just did not want to repeat them. I think that is a very radical proposal and I do not think it would be helpful. It affects monetary policy transmission. It would be very disruptive and, for a lot of other reasons, I do not agree.

Lord Razzall: Do you agree?

Ruth Curtice: Certainly.

Bim Afolami: That is the only time when that has happened.

Q233 Lord Layard: Going back to the pattern of spending, do you think there should be more attention in spending reviews and other decisions to the cost-effectiveness of spending in different parts of the Government? I happen to know, for example, that the ratio of benefit to cost in roads averages 3, and in further education and apprenticeship it averages 7. Is that a satisfactory situation or do you think that these sorts of numbers should be much more central when we are thinking about the allocation of money in the next spending review?

Bim Afolami: You make a very reasonable point, but it is important that everything is done in the round. If you want to invest in new further education college, you often may need an improved road to get people there. You have to make sure that you look at these things in the round, but the cost effectiveness is absolutely key.

The point that you make about further education is something that I have long believed; we should invest much more in further education. It should be a much higher priority for the public, the commentariat and Parliament than it is. That sort of investment can have huge improvements in human capital, not just today or in the next Parliament, but for generations.

Q234 Lord Blackwell: Minister, I am conscious that this discussion has been a discussion in two halves, between the short term and the long run. There is a lot of discussion and most of the press and political comment is around the short term—the notion of fiscal headroom between two highly uncertain numbers five years out with a spurious level of precision and a few billion here and there. Obviously the Government need to have some rules, but that does not reflect the other discussion we have had about the long-term challenges we face in the potential huge expansion in demands for government expenditure, the slow growth of the economy, the risk that poses to escalating tax rates or unsustainability of debt. Do you think that politics in this country is failing in its duty to expose and debate that longer-term challenge? Do we all have our heads in the sand?

Bim Afolami: That is a rather difficult question. Frankly, a lot of political debate is risible. I grew up—I am not that old, although I am getting older—reading the *Economist*, the *FT* and all these papers, which in the past definitely, in my view, covered Parliament, parliamentary committees and real debates about real issues. The level of literacy in economic terms was much higher. The broader quality of the political debate on these longer-term, complex issues does irritate or sadden me, because what ends up happening is that, when people try to tackle and think about them, they end up in gotcha questions.

Then people say, “Oh well, that means you must be planning to cut”. When it is an Opposition Member against Conservatives, they accuse them of wanting to—I do not know—destroy the NHS or something. What ends up happening is we do not end up with the debate that we deserve. One of the great things about this committee is that you guys know what

you are talking about and think very seriously about these issues. I just wish there were more forums like this.

Q235 The Chair: Coming back to the issue of debt sustainability, when you look towards the end of the decade and all the issues that we have been talking about, especially the demographic challenge, defence and all the other things, how great a concern do you have about debt sustainability?

Bim Afolami: I am one of life's optimists, and being in politics that is always important, but I am. I would go to two key things. First, the last 10 to 15 years since the financial crisis, in terms of economic growth across the whole of the western world, probably excluding the United States, has been an unusually difficult period. There is a growing awareness of the need to focus on economic growth, not just in this country; we do it in other countries as well. I am optimistic about the next 10 years in economic growth terms. In public spending terms, again, we are having proper debates about productivity and outputs, in comparison with the debate five to 10 years ago, which was simply on how much we were spending.

The Chair: I totally see that. Do you not think we also need a debate—I am thinking several years out now—about what the state does and does not do?

Bim Afolami: Of course we do.

The Chair: That is part of the honesty that we therefore need. I am trying to think about some of these challenges we are facing and the onus on the individual opposed to the state. We may have to increase spending, who spends and how. Do we need that debate on things like social care and other issues, and about what the state does, as well as the issue of productivity?

Bim Afolami: We definitely do. A point that I do not think is covered enough is that, because of what the Government had to do to step in and support individuals and households during the pandemic, we spent over £400 billion. That led to a significant expansion of what the Government were doing. We were literally paying millions of people's wages for months on end, and we all remember when the energy shock came and the Government had to support people with that as well.

The reason why I mention this is simply that we are going through a highly unusual period of time. I think that the focus now will be much more on growth and making sure that the state does manageable things. We just lived through a very unusual time in that regard.

The Chair: In terms of big government, some say that, when they look at the challenges ahead and where we are now, big government is inevitable and that we have to accept that taxes will rise and the state will increase its scope. Would you refute that?

Bim Afolami: It is not inevitable. First, nothing is inevitable. Secondly, it is not affordable. Notwithstanding the points about dependency ratio,

immigration and all the things we have talked about, even with our growth rate getting up to where I would like to see it—somewhere between 2% and 3% regularly every year—you cannot continually expand what is currently running at between 2% and 3% a year. That is not easily achievable arithmetically.

- Q236 **Lord Griffiths of Fforestfach:** Controlling public debt and so on, most people—certainly politicians, I feel—feel that there is a need for an anchor. The two countries in Europe that have done much lower than other countries are Switzerland and Germany. What they said was that, instead of having some complex fiscal rule, they will have a simple rule like a balanced budget. They will spend only what they get in taxation, and will make an allowance for the cycle and for special events, such as Covid, Ukraine and so on. Do you not think that that is something worth looking at in the context of the UK?

Bim Afolami: As I said, I always look at other countries. I would gently say that there are quite a lot of caveats in that, so we can spend only a fixed amount—apart from the economic cycle and special events. That is quite a lot of “aparts”. It sort of sounds like a fiscal rule, because we have a borrowing fiscal rule as well as a debt fiscal rule. It sounds remarkably like a fiscal rule, but I take your point.

If you compare Germany and Switzerland to the UK, apropos of nothing else, they raise a lot more money from their Länder, in Germany, or from the cantons in Switzerland. Their structure of government is fundamentally quite different, so I need to know more about how their accounting works to understand how chaste they are.

The Chair: With that, with one minute to spare, I would like to thank you both very much for coming. I know how time pressure is.

Bim Afolami: Invite me back any time. I do not say that too much, otherwise my officials will be very annoyed.

The Chair: You are going from the fire of here into the frying pan of the Commons to the Budget resolution. Thank you very much for coming; that was a very good session.