House of Commons

Treasury Committee

Oral evidence: Spring Statement 2025, HC 813

Tuesday 1 April 2025

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Watch the meeting

Members present: Dame Meg Hillier (Chair); Dame Harriett Baldwin; Rachel Blake; Chris Coghlan; Bobby Dean; John Glen; John Grady; Dame Siobhain McDonagh; Lola McEvoy; Dr Jeevun Sandher; Yuan Yang.

Questions 1 - 102

Witnesses

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

Examination of Witnesses

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

Q1 **Chair:** Welcome to the Treasury Committee on Tuesday 1 April 2025. Today, we are starting our investigation into—or examination of—the spring statement made by the Chancellor to the House of Commons last week. This morning, we are delighted to have representatives from the Office for Budget Responsibility in front of us. I am delighted to welcome Richard Hughes, the chair of the Office for Budget Responsibility, who is joined by Professor David Miles and Tom Josephs, both members of the Budget Responsibility Committee. We are keen to hear from the OBR, which of course produced its forecasts last week, which is why the spring statement took place. For those who may be following, the OBR is required to produce two forecasts a year; one is always around the Budget, and the other is at a moment of its choice.

Before we go into the spring statement, though, I have noticed that you are approaching the end of your first five-year term, Mr Hughes; you were appointed for five years, which runs out in six months from this week, on 3 October. Are you planning to seek a second term as chair of the OBR?

Richard Hughes: I wrote to the Chancellor earlier this year to the effect that I would be interested in serving a second and final term, so yes.

Chair: And have you had anything back?

Richard Hughes: Not as yet, but I appreciate that the Chancellor has a lot on her plate at the moment.

Q2 **Chair:** She has had a busy week, indeed. We were actually up at the Darlington campus with the Treasury when we saw a report from Bloomberg listing in detail the elements of the OBR's forecast. It felt that—well, that was a leak, and there has been a leak inquiry by the Treasury. Did you see that as a leak? Was it a leak of your forecast in detail?

Richard Hughes: I read the Bloomberg story at the time. I do not know whether it was a leak of our forecast or whether it was just well-informed speculation. Certainly at the time gilt yields were very high, and we are transparent about the mechanics of our forecasts, so it would not have taken much for a well-informed journalist to have come to the conclusion that much of the headroom was already spoken for by the rise in gilt yields and interest rates.

None the less, I should say that the OBR takes the security of its forecasts very seriously. It is very important for us that our preliminary forecasts are received only by the Government. It is also very important to us that our final forecasts are first received by Parliament, as a Command Paper. The OBR has never leaked in its 15-year history, and when this particular incident happened, I made proportionate inquiries and satisfied myself that the OBR was not the source of the information.

Q3 **Chair:** Then, on the morning of the spring statement last week, there was information that, from the outside, looked to have come from your forecast. Do you believe that was a leak of your forecast?

Richard Hughes: Again, I do not know. I am satisfied that it was not the OBR that was the source of the story.

Q4 **Chair:** Have you had any conversations with the Treasury about this matter?

Richard Hughes: I have, and I know that the Treasury has initiated its own leak inquiry, which I think is ongoing, so we will find out the conclusions of that.

Chair: Thank you for that. Certainly, it was a serious matter. I should also say, for the record, that it did also appear in the *Financial Times*. In my experience, both publications would be keen to ensure that they had a solid and independent source, which seems to suggest that it came from someone quite familiar with what was going on. But that is speculation on my part.

Q5 **Bobby Dean:** Mr Hughes, you are probably aware of some criticism of the OBR's role in our national policy debate at the moment. That is not necessarily about the work you do or your independence, but the reliance on your forecasts above all others in determining the Government's fiscal policy. I would like to hear your response to that, and whether you think we would benefit from having a plurality of forecasts in these moments when the Government are making key decisions.

Richard Hughes: The OBR's role in the Budget process has been the same for the last 15 years. Our powers were given to us by Parliament in legislation. Those powers are to produce a forecast to scrutinise the cost of

Government policies, to reflect those in our forecasts, and to assess the Government's performance against their fiscal rules. It is for Chancellors to set the rules that they set for themselves; it is for Chancellors to decide what policies they want to pursue relative to those rules, how much headroom they want to set aside against those rules, and whether they want to change those rules. Those are all decisions made by Chancellors.

One thing that has attracted more attention to our forecast in recent years has been the fact that in recent years Chancellors have left themselves very little headroom against their fiscal rules, which has meant that small changes in our forecast can make the difference between meeting or missing those fiscal rules and require Chancellors to make policy responses, as you saw in this event.

The result is that Government policy tends to be quite responsive to what are, in the grand scheme of things, very small changes in the fiscal outlook. There is £1.5 trillion-worth of Government spending and revenue out there, and the change in our forecast this time around was just £14 billion—1% of the total sum of tax and spending that the Government do in a given year. With that kind of slim margin, if you have so little set aside, it is inevitable that small forecast changes, may warrant a policy reaction.

Q6 **Bobby Dean:** We will come back to fiscal headroom later on, but you mentioned that the OBR's role has been the same over the past 10 or 15 years. Can you describe to us how your relationship with the Treasury has changed? Has it changed from Government to Government? Has it changed over time? It would be interesting to get an insight into that.

Richard Hughes: It has been fairly similar, I would say, throughout those 15 years. We have always provided baseline forecasts to the Treasury and been engaged in scrutinising its costings. One thing that has evolved in recent years, partly as a result of representations from this Committee and partly as a result of representations from the Government, has been more transparency about what is known as the indirect effects of Government policy, or the feedback effect of Government policy—not just the direct effect on the public finances, but how it might affect the macro-economy.

In recent years we have aimed—supported, I should say, by some good work by the ONS, which nowadays provides much better contemporaneous data on the drivers of potential output in the UK—to be more transparent in the way we think about so-called supply-side effects from given policies. That has changed the nature of the interaction between ourselves and the Treasury a bit, but generally speaking it has been quite similar across Chancellors and over recent years.

Q7 **Bobby Dean:** When you say you scrutinise the costings, it is unclear to me how a decision is made about when the OBR is to score a policy. I will give an example so that we can get to the point more quickly. Obviously, we did not score the planning reforms last time, but we have this time. I think the intention of the planning reforms was known previously and the

legislation has only just entered the House, so I am not quite sure what the distinction is if you compare that with the Employment Rights Bill, which is much further along its legislative journey and has not been fully scored yet. Could you explain why that is, using those two examples?

Richard Hughes: Tom is in charge of many of the costings we do on the fiscal side but, as a general principle, before we can score a policy we need to see the detail of it. We are trying to understand in concrete terms how much the policy will cost and how it might interact with the economy, and that requires the Government to specify in quite a bit of detail what the policy is.

In the case of planning reform, that had been evolving over the course of last year. There was a consultation and then the details were finalised in December, when the revised national planning policy framework came out. That gave us sufficient clarity about how the planning reforms were going to operate to score them. Importantly, it also enabled us to talk to outside stakeholders and experts, because we are not housing market experts—well, David is quite a good housing market expert, but it is important to us to be able to talk to house builders and academics who look at the housing market. There is a big advantage in having the policy clearly specified so that you can talk to them about it, rather than its being something confidential to Government. Where detail is provided to us confidentially, we try to look at it and assess it; in the case of this particular forecast, there were parts of the welfare reform package that we were able to score and other parts that were not sufficiently well specified for us to score in our forecast, in particular around employment support.

With the employment rights legislation, a lot of details are yet to be specified; I think more than 100 amendments have been presented in Parliament, which we understand the Government are in the process of going through and considering. We took the judgment at this stage that that Bill was too fluid and the details were too up in the air for us to reflect in our forecast, but we will do that when we have a clearer idea of the specific measures being taken on the Employment Rights Bill.

Q8 **Bobby Dean:** On a final point of clarification, you said that you take the view, so is it your decision when to score a policy? There is no veto power from the Government to say, "No, hold this one back—we want that to be scored next time, not this time." They do not have the power. It is up to you when you are ready to score it.

Richard Hughes: We decide when a policy is of sufficient clarity for us to score it. All the Government could do would be to keep things vague—we have sometimes observed this as a strategy in the past—to get around these things. But no, it is for us to decide when a policy gets called.

Q9 **John Glen:** Could I ask a follow-up on that specific point? Under the previous Government, childcare policy was quite significant and there was quite an intense iterative process between the Treasury and the OBR with respect to scoring it. It would be fair to say that the Treasury would, in some circumstances, be keen to push you on that. Can you describe the

nature of that conversation and whether there is room for iteration in the preparation of your forecast?

Richard Hughes: It depends on the timetable we are following. We do three pre-measures rounds to the forecast—that is, without any policy measures—and then we have two post-measures rounds. On occasion, when we have been in a hurry for one reason or another, be it energy crises, pandemics or whatever, we only manage to do one pre-measures round.

When there are two pre-measures rounds, the Treasury gets a first look at what the post-measures position looks like, including our judgments about the direct costs of a measure, and any indirect effects we think might have an impact on the macro economy. That gives them an opportunity to revisit some of those policies and change them, and sometimes they do—because they do not like the look of the fiscal bottom line or they do not like the look of the economic effects, be it on employment, investment or other areas. So they do sometimes revise the policy in the light of what they see as our judgment.

Q10 **John Glen:** The key concern is that the Government are elected to decide, and you have a lot of influence over that. There is contestability over what level of maturity policies are at. Obviously, all Governments would say, "This is going to deliver x," and you could say, "Well, no, it is going to deliver y." I think people are very interested to understand how that conversation works out. To the original question, you are the arbiter of the value of different Government policies, and that is material to the Government's standing.

Richard Hughes: We are the arbiter of how they score in our forecast and in terms of what policies might cost or yield and what effect they might have on the economy. Governments are entitled to pursue whatever policies they like; we just have to make sure that there is a central and credible estimate that we can explain to the public when it comes time to put it into our forecast.

After our forecasts are completed, we always try—sometimes alongside them in the EFO, and sometimes in supplementary releases—to be as transparent as we possibly can about how we have arrived at any judgments. We frequently publish articles, including on the childcare policy, about how we arrived at particular costings or treatments in our economic forecasts. We aim to explain our reasoning. When we get feedback from the rest of the world to say that they think we got it wrong, we listen to that and sometimes revise our judgments in future recostings of the measures or in views that we take on other measures.

John Glen: Thank you very much, Mr Hughes.

Q11 **Dr Sandher:** Professor Miles, I want to ask about crowding out. How do you calculate the level of crowding out in relation to public investment?

Professor Miles: It depends a bit on what the state of the economy is. If there is a lot of slack in the economy, unemployment is very high and

there are firms who are keen to do business but just cannot get work, the level of crowding out would be pretty small. That is not a good description of where the UK economy is right now, because measured unemployment, at least, is at a pretty low level. There is a big issue about whether measured unemployment, at about 4%, really is a good guide as to how much slack there is in the labour market. However, whichever way you look at it, the idea that there is a lot of slack in the UK economy at the moment does not quite stack up with the evidence.

In a situation like that, if there is a big increase in demand for one element of production in the UK, it probably squeezes out some activity somewhere else to a significant extent. That could be consumer spending, net exports or other elements of investment; it depends a bit on the nature of the public investment. To give you an example, we think there is going to be a substantial increase not in public spending, but in building houses, and there is a question about the supply capacity of the construction sector. We judge that there will be a little crowding out, on the back of more house building, of other types of construction activity—extensions to people’s houses, renovation of the existing stock, and so on. That is just one example of how it depends on the kind of public investment. It is not a great example because it is actually not public investment, but it is extra house building as a result of a Government policy measure. The big issue really is how much slack and spare capacity there is in the UK economy.

Q12 **Dr Sandher:** You say that things have not really changed that much since October. It seems that in your last judgment we were pretty close to capacity, but in your latest forecast they have changed. Take the example of quarter 3 in 2025. In October, you were saying that the economy would be above capacity and now you are saying that it will be below capacity: that is quite a big difference in terms of slack. Employment levels have not really changed and GDP has not changed a huge amount. How have we gone from above capacity to below capacity in the last six months?

Professor Miles: It is partly on the back of what you might call hardish data about what has happened to GDP growth, which was very weak in the second half of last year. Business and consumer sentiment took a pretty substantial hit at the back end of last year, and that carried on in the first couple of months of this year. Interest rates are a bit higher—not so much the short-term Bank of England interest rates, but longer-term interest rates have had a substantial increase in gilt yields. That has been not just in the UK, but in quite a lot of countries.

All those things make the likely level of economic activity for 2025 a good bit weaker than we thought back in October—what happened at the back end of last year and the first couple of months of this year. We think it is enough to go from output being slightly above the capacity of the UK economy to being somewhat beneath it. As you say, there has been a big turnaround. We thought that growth might turn out to be 2% in 2025; our best guess now is 1%. That is a pretty big change.

Q13 **Dr Sandher:** I want to talk about the impact that that ends up having on

the wider forecasts—the "crowding out" side of it. In October 2024, you said in your EFO: "with the economy operating close to its potential level, with an output gap of -0.2 per cent this year…the significant and sustained fiscal expansion of around 1 per cent of GDP per year crowds out some private sector economic activity."

Now you assess that there actually is spare capacity in the economy at that time; I think last time we discussed how public investment was to increase—maybe it could increase the supply side and maybe run at capacity at the time. That would suggest that the Government's increase in investment would not be subject to crowding out in the same way that you forecast in October 2024. How does the change in crowding out affect your forecast of the impact of public investment on the level of output in the next five years?

Professor Miles: It means that once we get through this year—as you rightly say, there will be a bit more spare capacity than we thought there would be back in October—you get slightly stronger growth in the back end of the forecast, in 2027-28 and into 2029, precisely because there is a bit more spare capacity in the economy by the end of this year. It shows up in our forecast as a bit of a bounce back in the growth of GDP, starting next year and rolling through to the end of the forecast, which would not have been as strong had more slack in the economy not been generated during the course of this year. That is how it shows up in the forecast.

Q14 **Dr Sandher:** Can I clarify that? You are saying that the public investment scored at the last EFO, which you guys had crowding out towards the end of the forecast period—there is now less crowding out or no crowding out?

Professor Miles: There is just more room generally for a combination of consumer spending, private sector investment and net exports because there was quite a slowdown at the back end of last year, which rolled through much of this year. You can just get stronger overall demand sustained from higher domestic production as you catch up on that level of slack.

Q15 **Dr Sandher:** Specifically on the crowding out, has the estimate of the crowding out assumption when it comes to public investment changed?

Professor Miles: The slack that we estimate exists a bit now but was not there before allows a balanced increase in all elements of demand to be met from domestic production. It is not all concentrated as if all the extra using up of spare capacity were all going to be investment. We spread it across all the components of demand: consumption, investment and net exports. But as an implication, there is a bit less crowding out because there is a bit more slack in the economy.

Q16 **Dr Sandher:** You also talk about how planning reforms specifically will increase the level of trend productivity—that is, slack or capacity in the economy later on—by 0.2%. I want to quote specifically from page 27 of the EFO, which says, "This increase is driven by the residential planning reforms"—that is, the increase in trend output—"which we expect to

increase construction sector productivity and housing services due to the higher housing stock." If I understand that correctly, you are saying that planning reforms increase the potential capacity of the economy because there is more construction. If the Government had invested in October, on your view, into social housing from the public purse, what impact would that have had on output in years 4 and 5? That is, on your forecast, would they have been crowded out?

Professor Miles: One of the reasons why we have a slow build-up in extra house building as a result of the planning measures, and why it is not faster than what we have built into the central forecast, is that there likely are some capacity constraints in the residential construction sector that hold back, to some extent, the ramp-up in house building. It gets a bit bigger beyond the end of our forecast horizon after 2029.

We would probably have had an even bigger assessed impact of the planning reforms over the next five years, were it not that there were some pretty obvious supply constraints, certainly in the short term, in the construction sector. If you had added a lot more extra house building for social housing on top of what is already in our central forecast, I think it would have had some impact, but it would still have been somewhat constrained by the supply potential in the residential construction sector.

Q17 **Dr Sandher:** That is not quite the question I am asking. You said that public investment in October would have been crowded out. You are now saying that planning reforms that lead to more construction investment will not be crowded out because of the increase in the supply capacity. My question is this: why is it that, if the public sector had invested in extra house building in October '24, you said the investment would be crowded out, but when planning reforms allow for more private sector investment, it is not crowded out because it increased the supply potential of the economy? Why does public sector investment not increase output, if private sector investment does?

Professor Miles: What the planning reforms have done is to allow house building on land that would almost certainly not have got planning permission in the past. If you take some land—let's say it is used for agricultural purposes and it is just outside the M25—and that acre of land has 20 sheep on it, it is producing output, but at quite a low level. If you then build houses on it, the value of what you construct, which is then used for many decades to come, is substantially higher. That is ultimately the source of the productivity effect. That planning reform was not in place in the past, but it is now clearer what it will do. That is what gives you the productivity.

Q18 **Dr Sandher:** I beg your pardon, but there are more than 1 million houses at the moment with planning permission but unbuilt. You are saying that the planning reforms lead to a higher potential output because they lead to more construction. If I am understanding you correctly, if I were to build those 1 million houses, that would not increase potential output, according to your view at the moment, but if I were to grant planning permission somewhere else, it would.

Professor Miles: I think the main source of the productivity boost is land that, used for residential construction, will produce housing of high value and generate rents—either actual rents, if it is rented out, or implicit rents, if it is owner-occupied. Many of those houses will be around the south-east of England, where there has clearly been a constraint on building. That gets eased, so that is the source of the productivity. If you had not eased that, I don't think you would have got the productivity improvements.

Chair: That was very clear. Thank you, Professor Miles.

Q19 **Lola McEvoy:** We all watched your webinar, and you outlined the three risks facing the country and the economy as productivity, interest rates and global trade. We will just dig a bit deeper into your productivity analysis. In chart 1.1 of the EFO we see the trend productivity level graph. I think it is accepted that productivity has flatlined since the economic crash in 2007-08.

I want to understand your analysis. In the EFO, you said, "In our central forecast, we expect that the level of trend productivity will remain permanently below our October forecast". This Committee is really concerned about the data feeding that analysis and about what is going on in the country. We really want some clarity, so can you give us a bit more detail on that, Professor Miles?

Professor Miles: One of the big things that happened between the October forecast and the more recent forecast, last week, was that there were some pretty big revisions to data. In particular, the Office for National Statistics' current estimate of the level of employment in the UK is something like half a million higher than we thought. There was a slight increase—but much smaller, proportionally—in their estimate of the level of GDP in the last couple of years. The impact of that was that the measured productivity—the output relative to how many people are working and how many hours are worked—actually fell a lot. On the latest data for the back end of last year, it was about 1.3% or 1.4% lower than had seemed to be the case back in October.

Now, there is a lot of uncertainty about that—there are issues with the labour market data at the moment—but given the increase in population and in the scale of net immigration in the last couple of years, it was not a great surprise that the ONS now think that there were more people employed in the last year or so. That has an effect on your estimate of the level of productivity into the future, assuming that you believe that those people really are here, are working and are going to stay. That has an impact on how you think GDP and productivity might roll out in the future.

To cut a long story short, we have taken most of that lower level of productivity as the starting point, but said that the growth of productivity ultimately gets back to the level of growth rates that we have seen in the past. That puts us in the OBR at the optimistic end of assessments of productivity, but it still gets you in the end to a level of productivity that is about 1% or 1.3% lower than we thought before, so there is a kind of level effect and a rate of growth effect.

You could look at that in two different ways. You could say, "The OBR have become much more pessimistic about the level of productivity," but some of the commentary in newspapers and from other economic forecasters still describe the OBR as at the very optimistic end of productivity, because they are looking at the rates of growth but starting from a lower level. What we have done on productivity is a slightly mixed picture.

Unfortunately for the accuracy of our forecast, the growth of productivity is a particularly important assumption for the level of GDP, standards of living and the fiscal position, and it is extremely difficult to work out what it might be in the future. It is hard enough to work out where we start from. The reason it is difficult to forecast is not that it is rocket science; it is just that over the medium term—over a five and 10-year horizon—what happens to productivity is very sensitive to new technological developments. You can't predict what they are, because if you could, you would already know what is coming down the road. That is one of the reasons why, in our analysis, we are very keen to stress different potential scenarios of productivity growth. That makes a really big difference to the fiscal outlook.

Q20 **Lola McEvoy:** Obviously, you said that population growth is half a million higher, and that brings down our productivity level, which is GDP divided by the workforce. What are those people doing, and why have they not been working at a level that would have brought the productivity level up? Is the half a million all immigration? What is your analysis of who they are?

Professor Miles: It is just that the ONS think there are half a million more people working than they thought before. That upgrade to their assessment of the level of employment is all about the last couple of years, and the one thing we know about the last couple of years is that there was an unusually high level of net immigration into the UK. The majority of those people coming into the country would have been working.

You can't infer directly that the extra half a million people are all recent immigrants. Anyway, there they are. There are people who appear now to have been working for some time whom the ONS didn't think were working before. They have not increased their GDP estimate for where we have been in the last couple of years, so just arithmetically you get a lower level of productivity.

Q21 **Lola McEvoy:** Are they guessing that it is the immigration figures that have changed? How secure are you in the data? If we have all this analysis of what people are doing, but on the ground in our constituencies we know that people are working really hard around the clock, I am just a bit concerned about suddenly saying that it is about a mass swathe of immigration that has come in and those people are not working at a productive level. I do not really understand how you can get to that conclusion.

Professor Miles: I suppose the ONS would not describe it as a guess, but in a sense it is something about which—

Chair: We might get on to the ONS in a minute.

Professor Miles: Well they might describe it as a guess, I suppose. It is well known that it has real trouble in assessing the state of the labour market. The labour force survey, which used to have very high rates of response, dropped off in covid and did not come back.

Chair: We have examined that, and we are continuing to watch that.

Professor Miles: So who knows? People should have much less confidence in the employment statistics than they used to. It is the ONS's best current estimate of how many people have been working in recent years. I do not think there is an implication that a lot of people are coming to the country and not doing very productive things. It has just happened that, in a period after which there has been a large increase in immigration, the ONS have found apparently half a million more people working. They are not saying that those half a million are more recent immigrants.

Q22 **Lola McEvoy:** We are saying that productivity is going to increase by the end of the forecast, but it is permanently below the October forecast. I just want to dig a bit deeper into why it will be permanently lower.

Professor Miles: It is because of the start point. If you take the ONS numbers on GDP and employment, the start level is depressed. We think that some of that may be transitory and some of it may be measurement error, and it is difficult to know how the ONS will change its view of employment in the future.

What we have not done is permanently reduce the growth rate of productivity, which would have depressed the level even more going four or five years down the road. We have kept the growth rate more or less where it was. Some people will say that it is too optimistic, and that then implies that you just get a shift down in the level of productivity. It is still higher at the end than it is now by a pretty substantial margin. As I say, some people will judge that as excessive optimism by the OBR, but if you look at the level, it does not seem to me an optimistic assumption at all.

Q23 **Lola McEvoy:** Does anybody else on the panel have anything to add on that productivity point?

Richard Hughes: I want to underpin what has been said. I know this is an issue that the Committee has been focused on, and on which you have written to the national statistician, but it is about trying to get a clear read from both the labour force survey and the ONS GDP data, which has been significantly revised, including recently. We are expecting further revisions later this year. Matching up the GDP data with the labour force data and then trying to extract a clear signal about the outlook for productivity is very difficult at the moment, but it is something that we always keep

under review. We will take another look at it in the run-up to the next forecast, in the light of what the data says.

Q24 **Lola McEvoy:** Just a final question from me on that, is our current productivity measure fit for purpose? We are making a lot of national policies that are significantly impacting people's lives based on this productivity puzzle. What do you think we could do as a Committee, or as a Government, to improve how we are measuring productivity?

Richard Hughes: A better labour force survey is most important, but getting updates to output data that match the vintage of the labour force data is equally important. Having output from some periods and labour force data from others does not give you a good sense of what the trends are. Waiting for either the numerator or the denominator to be updated, when you are looking at either one or the other, is not a good place to be. Quality, timeliness and consistency of the main macroeconomic datasets are the things that are most important to us as forecasters. Ideally, what we want to do is have a snapshot of where the economy just was before we try to figure out where it is going over the next five years. Instead, at the moment, we get an incomplete picture from different points in time from what we get from the ONS at the moment.

Q25 **Chris Coghlan:** I fully understand the issues you are talking about in forecasting productivity in the long run, and it seems entirely reasonable to me, but chart 2.4 shows you are forecasting a big bounce back in 2026. I acknowledge the issues, and my understanding is that part of that is just bringing productivity back to its long term pre-2008 trend, but how credible is that? Surely there are pretty big downside risks to your forecast given that Citigroup is saying that if you are wrong by just 0.1 percentage points, that is £7 billion to £8 billion in fiscal headroom gone.

Professor Miles: You are right. If there were no recovery in the rate of growth of productivity from the recent apparently very low levels in 2023 and 2024 in particular, by the end of the forecast horizon instead of there being, on our central forecast, about £10 billion of headroom against the Government's don't-be-in-current-deficit rule, we would be £40 billion or £50 billion the other way.

Chris Coghlan: So no significant bounce back.

Professor Miles: Right. That is if the growth rate of productivity, which was dismal for the last couple of years, just does not recover from that level. So not only do you start 1 and a bit per cent down, but relative to October you then grow at a slower rate as well so you end up really substantially lower on productivity. That would mean that the current fiscal deficit would be something like £50 billion as opposed to £10 billion the right side of zero. It is absolutely enormous.

Of course, if on the other side you said, "So the measured productivity looked pretty bad in 2024 and there have been these new estimates from the ONS, but let's attach limited weight or maybe no weight to that and assume that the level of productivity by the end of 2029 is the same as we thought back in October," then instead of there being £10 billion of

headroom that goes up to £34 billion or £35 billion. There is a huge swing on where reasonable people could be at either end of that spectrum.

Q26 **Chris Coghlan:** Because if I am reading chart 2.4 correctly, I think you have about a 0.3% bounce back next year.

Professor Miles: In the growth rate.

Chris Coghlan: In total factor productivity. That seems quite brave given that productivity fell last year.

Professor Miles: Yes, indeed. "Brave" is a word that may be appropriate. It is partly that some of the very low measured productivity for the back end of last year might be a reflection, coming back to something we were talking about a little bit earlier, of an opening up of slack in the economy. Getting rid of that slack, which happens over the course of our forecast, in a sense gets you back that lack of the opening up of the slack in the past. It shows up as measured productivity but it is not like some kind of breakthrough in inventions that suddenly increases productivity; it is really using up a bit of slack in the economy.

Q27 **Chris Coghlan:** To be slightly more generous to the Government, they announced quite significant increases in both public investment and public R&D. Have you updated your fiscal multipliers and therefore your economic growth as a result of those announcements, and should you?

Professor Miles: Well, just coming back to the earlier question, the fact that we now think there is a bit of slack in the economy and we did not think that back in October means that we assume that the stance of monetary policy means that we get back to what you might call a balanced position of neither excess demand nor excess supply. That allows all elements of spending—consumer spending, investment spending, net exports—to be a bit higher than they otherwise would be. So we kind of spread out the extra output across the main components of demand. That is how the model works.

Q28 **Yuan Yang:** Professor Miles, you just said that people should have much less confidence in the employment stats than they used to, and when you last spoke to the Committee last November you mentioned that you were not very confident about the labour force survey data. By contrast, when we saw the ONS as a Committee the national statistician said to us that he was very confident about the data on inactivity. Can you square that circle for us?

Professor Miles: It has been difficult for the ONS because the survey, which it has relied on for many years, has self-evidently become less reliable because the number of people who are answering the survey has fallen very substantially. That then raises a question about whether you are getting a sort of sample selection bias—that there are certain sorts of people who just say, "Look, I can't spend 45 minutes filling in this survey." It is not just that you have fewer people; it may be that they become, in a way that is difficult to predict, a biased sample. Of course, one can never have perfect faith in any statistics—the ONS has a difficult job—but the

level of uncertainty seems to me to be pretty clearly higher than it was in the past, and certainly pre covid.

Q29 **Yuan Yang:** Does the fact that the ONS is very confident make you more confident, or are you still not very confident in its data, as you were last November?

Professor Miles: The ONS is trying to do something very difficult with a tool that is not working as well as it did in the past. It is working hard on trying to devise new types of evidence and new forms of survey. It may be that the reliability of the statistics will get back to something more usual in the longer run of history, but it is going to take a little while. It leaves one in a difficult situation right now, particularly on these judgments about how much slack there is in the economy, what the level of productivity is, and how many people are actually working.

Q30 **Yuan Yang:** How long in months or years do you think it might take before you are confident, or at least fairly confident, in that data?

Professor Miles: It is difficult for us to judge. The OBR is a user rather than a creator of the statistics, so it is really a question for the ONS.

Q31 **Yuan Yang:** My Committee colleagues are quite keen to know whether you think other countries have done a better job of recovering after the pandemic in capturing labour force data. Are there any other countries that we should be learning from in the UK?

Professor Miles: I am not an expert on quite how labour market statistics are collected in a large range of countries, but I think generally reliance on surveys is one of the main methods. It seems to be that the fall-off in the survey response rate may be unusually large in the UK.

Q32 **Yuan Yang:** Mr Hughes, do you have any other responses to those questions?

Richard Hughes: We are in regular touch with the ONS on the labour force survey and wider macro statistics. The ONS does have a plan to move to this thing called the transformed labour force survey, which moves the data collection online and which it is piloting at the moment and wants to move to in about 18 months.

Chair: We have looked into this quite a bit.

Richard Hughes: That may provide the long-term solution. In the meantime, we tend to rely on a panoply of data to try to understand what is going on in the economy. We also look to fiscal data to give us real-time reads on things like inactivity. If people are showing up on inactive benefits that gives you a sort of independent check on what the labour force statistics are telling you. Real-time information data from HMRC tells you what is happening to things like employment and salaries. We also try to take a read from fiscal data. More generally, where national statistics institutes seem to be going is to try to look at administrative data and a wider range of data sources, rather than simply relying on surveys, because response rates have been falling around the advanced world.

Chair: Our sister Committee, the Public Administration and Constitutional Affairs Committee, will be looking at this in more detail. We will be doing a bit of collaboration on that, as it is obviously a serious matter.

Q33 **Yuan Yang:** I have a specific question about one part of the inactivity data. Mr Hughes, how confident are you that there has been a rise in inactivity linked to ill health?

Richard Hughes: Looking across what the LFS tells you and what the benefits data tell you, there has certainly been a rise in people who are reporting ill health as their reason for being outside the labour market and claiming health-related benefits. Those numbers have risen very rapidly in the last few years, especially in the wake of the pandemic. We are confident that that is a trend that is showing up not just in the economic data but in the fiscal numbers.

Q34 **Yuan Yang:** But not about the underlying ill health trend itself? You mentioned there is a rise in claimants and self-reporting of it.

Richard Hughes: In our last fiscal risks report, we had a section on long-term health trends. Also, when you looked at both self-reported and clinical measures of ill health, there used to be rising healthy life expectancy over time. Then, around 2018, something happened and people started getting older but stopped getting healthier years of age, and just started getting more years of age in not great health. Something does appear to have happened to the rate of improvement in the health of the population in recent years as our population has aged. That can start to explain some of why people are turning up on health-related benefits.

The puzzle that remains is that the increase in that trend does not explain the very steep rise in claims of health-related benefits. That growth has much outpaced what you see either in self-reported ill health or in more clinical measures.

Q35 **Dame Harriett Baldwin:** I will give Mr Josephs a chance to speak, because I am very struck by the fact that you were last in front of this Committee five months ago and since then there have been some quite big changes in terms of the economic and fiscal outlook.

The headline number that got a lot of traction last week was that growth has halved, but there are also things like inflation. You were expecting inflation to be 2.6%; now you are expecting it to be 3.2%. You were expecting unemployment to be 4.1%; now you are expecting it to be 4.5%. Borrowing over the forecast period has gone up by £47.5 billion. Interest rates are higher. The debt interest bill has gone up by £30 billion. You expect there to be more children living in poverty by the end of the forecast period. Today, households are expecting a big increase in their bills, and tomorrow we are probably going to be hit by tariffs.

Given the difference between those two forecasts, what are the biggest things that you got wrong in that five-month period? Was it that business confidence and consumer confidence took a bigger hit as a result of the Budget?

Tom Josephs: I will focus on the biggest changes in the fiscal forecast, which is the part of the forecast that I lead on. Compared with October, there are two big drivers of the change in the fiscal outlook. The first is that interest rates increased quite significantly compared with October. We had around—

Q36 **Dame Harriett Baldwin:** More than the rest of the world, or in line with the rest of the world?

Tom Josephs: It is broadly the case that interest rates rose by similar amounts in most advanced economies over that period; certainly, UK and US interest rates both rose at similar rates over that period. More recently, we have seen quite a significant increase in German rates, on the back of the announcements Germany made on defence spending.

There is a broad international trend. UK rates rose a bit more than those of other countries at certain points, but that overall increase in rates of around 50 basis points compared with October on its own increased our borrowing forecast by about £10 billion over the medium term. That on its own was enough to eliminate the—

Q37 **Dame Harriett Baldwin:** Is that by year, or cumulatively?

Tom Josephs: It is £10 billion by the fifth year of the forecast. That on its own was enough to eliminate the headroom that the Chancellor had against her fiscal rule in October. That just illustrates the sensitivity now of the public finances to debt interest costs, reflecting the very high stock of debt that we have and exposure to interest rates. That was by far the biggest factor that changed the fiscal forecast.

The other important factor was that tax receipts this year have come in lower than we were expecting in October, particularly self-assessment corporation tax receipts. Because those taxes are paid with a lag, some of that actually relates to activity in the previous year, 2023-24, but we think that the weakness in corporation tax in particular compared with our expectations in October reflects the weaker economy and the squeeze on profits being greater than we expected in October. That weakness essentially means that the starting point for the receipts forecast is lower and therefore reduces tax receipts across the forecast as well.

There is a bit of an offset in the medium term, because nominal earnings have been a bit higher than we thought and therefore that increases the forecast of pay-as-you-earn receipts over the medium term.

Q38 **Dame Harriett Baldwin:** Can I ask the same question of Mr Hughes: did business and consumer confidence take a bigger hit after the October Budget than you had put into your forecasts?

Richard Hughes: It did not behave the way we expected it to in October, in that it fell over the second half of last year. Some of that was contemporaneous with us putting together the forecast but came in too late for us to recognise it. A mix of factors that contributed to it, some of which were global, including the uncertainty about what the new Trump Administration were going to do to things like tariffs. You have seen falls

in business confidence across advanced economies, not just in the UK. Over the winter there have also been rises in energy prices, and it was a colder winter in Europe, which has a big impact on inflation and inflation expectations. The pick-up in inflation has also put a dent in consumer confidence and has kept the savings rate higher than we would otherwise have expected, which affects how much consumption there is in our forecasts. The momentum that we thought was going to carry on from 2024 into 2025 stalled over the second half of last year, which was also consistent with what looked like softening of both business and consumer sentiment.

Q39 **Dame Harriett Baldwin:** We are already hearing speculation about tax increases in the next Budget. People can see through some of these bad revisions of the forecast and recognise that it is going to be hard for the Chancellor to do more on the spending side. They recognise that unless growth actually materialises there will be difficult choices when it comes to the Budget. Are you seeing business and consumer confidence still continuing to react to that threat of tax rises later in the year, or can you rule out the risk of any tax rises?

Richard Hughes: All of those are matters for the Chancellor rather than for us. We will forecast whatever the Chancellor decides to do in the autumn. It is certainly the case that when we put this forecast together it was at a point where our uncertainty about the outlook was very high—partly for domestic and partly for international reasons. Part of it comes down to just trying to interpret what the mix of output and employment data from the second half of last year and recent months tells us about the future, which was very difficult because of all the issues that we have discussed.

It is also partly because the international environment is very volatile and uncertain. There are very volatile interest rates. We will find out tomorrow what US tariff policy is and what that might imply for UK firms and our ability to trade with other countries affected by US tariffs. There is an extraordinary degree of uncertainty about both the domestic and international outlook. On top of that, as Tom pointed out, the single biggest moving part in this forecast was interest rates. Interest rates have gone up and down by 100 basis points over a six-month period. There is 100% debt to GDP ratio.

Q40 **Dame Harriett Baldwin:** We are just more exposed to interest rates than we were before, aren't we?

Richard Hughes: We are. For all three of those reasons—the domestic outlook, interest rates and trade—we emphasise the importance of looking at not just our central forecast but all the scenarios around that as an indicator of where we might end up by the autumn.

Q41 **Bobby Dean:** I am going to skip backwards slightly to the productivity conversation, because I would like clarity on public sector output. We had some interesting comments from Andrew Bailey when he was in front of the Committee last month; he talked about how productivity since 2019

can be 8% to 9% lower, and as high as 17% to 18% lower in the health sector alone. He also reflected on how difficult it is to actually measure that, and that Britain might be a bit of an outlier in the way that we measure it. Obviously, that could be hugely consequential to our overall productivity figures. Do you have any views on how reliable our public sector productivity statistics are?

Richard Hughes: We are better at measuring. We attempt to measure public sector productivity in a way that other countries do not, in the sense that they just value public sector output at cost rather than at the level of activity going on in different public services. We make an attempt to ask how many patients were seen in a given day, month or year. In that sense, we try to directly measure public productivity rather than infer it by how much it costs to produce.

One of the hypotheses that we, the Bank and others are interrogating is what explains the large, measured slowdown in productivity that we saw in the second half of last year and whether it can be explained by changes in the sectoral mix of output. If public sector productivity is lower than private sector productivity, and we have seen strong employment growth in the public sector, does that explain it? It is a hypothesis that we are all interrogating, and I do not think that anyone can draw any firm conclusions about it at the moment.

Clearly, improving productivity in the public sector would be important to improving the quality of services that people receive from the health and education sectors, and elsewhere. From the point of view of our forecasts, when we are trying to assess the tax generating capacity of the UK economy and how much people are paying in tax, what they are being paid matters more than what they are delivering in terms of services. Clearly, the quality of the services matters for other people's ability to get back into the workforce, and contribute to employment, tax receipts and those sorts of things.

Q42 **Bobby Dean:** It is good that we are trying to measure it more accurately, but it does make us different from others and adds to the question mark over whether Britain has a unique productivity problem compared with others. Is this real, or is this measurement? Do you have any sense of that?

Richard Hughes: When we looked at it, what we found over the course of the second half of last year—which, again, I think leaves us with more questions than answers—is that the slowdown in productivity was pretty broad-based across sectors, both public and private. It included some big employers like hospitality. It was not obvious that this was the slam-dunk, as it were, to explaining the productivity puzzle—"Oh, it's just the way we measure productivity in the UK, and it's just that we're better at doing it in the public sector." It does seem to be a mixture of measurement challenges, real whole-economy effects, and then possibly something around sectoral mixes. It is something that we will have a further look at between now and the autumn.

Q43 **Lola McEvoy:** Just a quick one from me. Going back to GDP and the way in which we measure productivity, household expenditure is the largest section of GDP. Is the productivity problem linked to the cost of living crisis, and the cost of living crisis scarring? We know wages are increasing but it will take a bit of time before people feel better off. Could we envisage a scenario in which household expenditure goes up, people start spending more, people are feeling better off, and we see an increase in GDP because of that, which would then support a better productivity rate?

Professor Miles: I think it comes back to the issue of slack in the economy. If right now what is holding back economic activity and GDP—to some extent, anyway—is that demand has fallen a bit short of the supply capacity of the economy, anything that boosts demand will boost GDP. There may not be a big increase in employment, but it would show up in productivity. That is one of the reasons our growth rates of productivity look a bit optimistic in the eyes of some, because maybe some people are not factoring that in. There is something of a link between demand, confidence and productivity. That stops working once you have got up to full capacity. You need other things to boost productivity then.

Q44 **John Glen:** Last week, President Trump announced tariffs on car imports. If those had been in your forecast, would all the Chancellor's headroom have been used up already?

Richard Hughes: We looked at a range of scenarios around tariffs. What the announcement on cars last week amounts to is elements of that downside risk materialising, but, as of 2023 data, we export about £60 billion-worth of goods to the US, about £6 billion of which—so 10%—is in the form of cars. That announcement did not affect the whole of our goods exports to the US. It is elements of that downside scenario that we had included in our forecast materialising, and we will see whether more of it materialises.

Chair: For anyone who might be following, chart C in your Blue Book covers this.

Richard Hughes: Yes.

Q45 **John Glen:** The key issue that is dominating the news today is what effect these tariffs will have. I appreciate this is in the context of ongoing conversations and that the Business Secretary is anxious to say that we do not want to do anything that will precipitate a worse outcome, but given that your central forecast is the one most likely to happen, why did you not explicitly include tariffs in it? You cannot be expected to include something that happens the day of or the day after, but it surely would have been reasonable to expect this to have been set out more explicitly?

Richard Hughes: There are two reasons. First, our forecast has to be based on a forecast for the global economy. We have 50-odd people at the OBR, and we cannot maintain a full global economic model the way the likes of the IMF and the OECD can. Like the Bank of England and other forecasters, we rely on the IMF's world economic outlook as the global economy forecast on which we base things like UK exports and imports.

Q46 **John Glen:** And that does not incorporate the recent changes?

Richard Hughes: The last one was from January, and it did not take US tariffs into account.

The second reason—as you saw from box 2.2, which we published in the EFO—is that we did our own scenario modelling of what the impact of US tariffs might be on the UK economy, including three different scenarios depending on the escalation of tariffs. We wanted to make sure we were transparent about what the possible effects might be. The other reason not to take account of US tariff policy is that it was changing every day, depending on what phone call the President had had and with which Head of State. In that sense, it was very hard to choose what day's US tariff policy to reflect in our forecast.

In light of that, for reasons of consistency with the IMF WEO, as well as the fact that tariff policy was changing, we thought it was best to keep US tariffs out of the central forecast, while making it very clear what the delta would be if you saw higher tariffs on other North American countries and China, 20% additional tariffs and then 20% additional tariffs with reciprocity from the rest of the world.

Q47 **John Glen:** I recognise that that is a very fair depiction of the uncertainties, but none the less you are, as we discussed earlier, the arbiters of what Government policy is, which must evolve in real time. We will see some economists this afternoon who I think have incorporated tariffs into their forecasts, and private sector organisations, such as—I have been informed—Vanguard, have put them into their forecasts. Would we be wrong to conclude that we should expect to have more from the OBR on this critical element of how the economy will perform over the coming months and more forward-leaning expectations around the impact of tariffs?

Richard Hughes: You have a complete assessment, and I would really encourage you to read box 2.2, as well as our full assessment of their fiscal implications at the back of the book in terms of what they mean for the current balance and net financial liabilities. We are the first official UK Government forecaster to do this work, and we have done it with 50 people.

Q48 **John Glen:** Do you want more people?

Richard Hughes: I am very happy with the people I have.

Q49 **John Glen:** Everyone always says that, but do you need more to be at the cutting edge?

Richard Hughes: We do our very best to satisfy this Committee's rightly high expectations of us. We also compared ourselves with trade modellers around the country that have made similar official estimates, and so far we are the only official forecasters that have done it.

Q50 **John Glen:** Turning to Professor Miles, the theme we are finding is that there is a grave amount of uncertainty in world trade policy. The

countermeasures that the respective countries that are most impacted take are also difficult to compute. Is it fair to say that we should view all economists' assessments of future trade policy and economic consequences with some considerable trepidation?

Professor Miles: Frankly, one can be fairly confident that it is not good news for anybody. That is a very weak and blindingly obvious statement. But actually, even that is not quite so obvious, because supposing there is a very limited tariff war with China, Mexico and Canada—the countries for which it is pretty clear what Trump is going to do—and that is it, with the UK and most of the rest of the world staying out of it, it would not be unreasonable to think that that could be, if anything, very mildly positive for the UK. There is a bit of trade that will get diverted to the UK, and some of the exports from, for example, China that would have gone to the US will need a home in the rest of the world, so stuff will be available a bit cheaper in the UK than it would otherwise have been.

That is one, not at all central, scenario that is very mildly potentially positive for the UK, but all the other ones, which involve the UK facing tariffs, are negative, and they are negative to very different extents. If tariffs at 20% or 25% were put on the UK and maintained for five years, our assessment is that what that does is knock out all the headroom that the Government currently have. Had we made that a central forecast, and had the Government not changed policy at all, knowing that we were going to take that as our central forecast, then the headroom would have pretty much all gone. Of course, that would have been a very extreme assumption in some ways, because not only would that be as bad as people might expect in the very near term, it would have been maintained for five years, which is beyond the next presidential election in the US. I think that is at the pessimistic end of the—

John Glen: Trump could still be there, if recent reports are correct.

Professor Miles: Apparently so.

Q51 **John Glen:** Could you help the Committee and those watching to understand what assessment you make beyond the tariff policy of the Trump Administration, in terms of broader economic policy, and how that is reflected in your assessment of the impact on the UK economy? How does the UK economy respond to the other elements of Trump's trade and economic policy?

Professor Miles: It already shows up a bit in confidence surveys, particularly the ones that have come out in the last couple of months, after the new Administration in the US and it became a bit clearer to everybody that the tariff stuff looks like it is going to happen, to some extent.

Those surveys have affected our assessment of the near-term trajectory of the economy. We have talked about the downgrade to 1% growth this year, rather than 2%. That was quite heavily influenced by, particularly, the business confidence surveys that have come out in the last month or so, which have been very weak.

Beyond that, it is very hard to come up with an assessment of what the impacts of US Government policy might be, for the reasons that Richard said—it is very hard to work out what they might be. They change not just by the week, but by the day.

Q52 **John Glen:** You mentioned the business confidence surveys. My colleague Dame Harriett Baldwin mentioned them too. Given that some of them were too proximate to the autumn assessments you made, and given the experience that you have seen over the last 12 months, will you be factoring those into your assessments going towards the Budget? Will there be a greater interest in those surveys, given that they have proved to be materially consequential to the actual outcomes of this spring assessment?

Professor Miles: It is fair to say that we always look at those surveys, which tend to tell you something about where businesses are right now and what they might do in the next six to 12 months—about hiring and about investment intentions. I think we were mindful of those in the lead-up to the October Budget—they just moved a lot subsequent to that.

In a sense, you are spoilt for choice in terms of interpretation, because there are a lot of things that happened, most of them pretty negative—interest rates, energy prices, a growing realisation that the US Administration might go ahead with stuff that people had previously thought, "Well, that is just noise; they are not actually going to do that."

We pay a lot of attention to them for the near-term outlook. A lot of the surveys are really about asking companies and consumers, "How do you feel right now?" and "What are you going to do in the next six to 12 months?" rather than "Where do you think you will be three, four or five years down the road?"

Q53 **John Glen:** They are material to the growth forecast that you are predicting for the next year.

Professor Miles: Yes, for the near term—absolutely.

Chair: That is certainly going to be an interesting forecast in the autumn, depending on what exactly happens tomorrow.

Q54 **Bobby Dean:** Mr Hughes, I would like to go back to the fiscal headroom question. I think the thing that struck everybody was the restoration to precisely the same figure we had before, so it doesn't really look like an actual output of policy reforms that have been scored—it feels like that figure was targeted.

Is that the case? Did the Treasury ask the OBR for a balancing figure and then they found their way towards it?

Richard Hughes: No. You would need to ask the Treasury quite what they were trying to achieve. Our forecasting models are very transparent, and the Treasury understands how they work. The policy measures that they used in the end have quite a direct effect on the level of headroom in the final year. We aim to be transparent, predictable, boring and

understandable. We are not in the business of trying to surprise anybody, be it the Treasury, the markets or yourselves. We are very transparent about the mechanics of our forecasting—how it works and how it responds to different fiscal levers on the tax and spending side. The Treasury understands how our forecast will respond to changes in the post-measures picture, and you will have to ask it why it decided that outcome.

Q55 **Bobby Dean:** I am sure we will ask. If we are striving towards a similar figure, does that not de facto change the fiscal rules? We are not just seeking a £9 billion surplus. Do you expect to see the same thing happen in the autumn?

Richard Hughes: Again, that is a question for the Chancellor. One thing I would stress is that the number is extremely small—it is 1% of total revenue and spending, and it is for five years' time. It is akin to asking somebody who is on average earnings to forecast how much they will earn and spend in five years' time to the nearest £200. An awful lot can change in that time: your employment prospects, lifestyle choices or pressures on your household budget. Trying to predict where you will end up with that level of accuracy is very unlikely to be successful.

Q56 **Bobby Dean:** Do you think this measure within 1% of overall spending is useful for everybody to focus on? Should there be more flexibility in that? You can gain flexibility by having greater headroom, as you said earlier, and traditionally there used to be much greater headroom in these forecasts. You could also do that through a change of rules. Do you think it would take some of the heat out of the public conversation around this if there were more flexibility?

Richard Hughes: There are two things that we are at pains to try to do every time we present forecasts and wider publications. We stress the uncertainty around our forecasts and the sensitivities to key judgments, as well as scenarios around key sources of uncertainty, as we did in this forecast on productivity, interest rates and trade. We try to draw attention to the fact that we know better than anybody how uncertain the future is and how likely our forecasts are to be wide of the mark, in one direction or another, and the importance of trying to understand what might drive that and thinking about how you might respond if you end up in those different situations.

The second thing we really try to stress is that, in addition to doing medium-term forecasts, we also do longer-term fiscal projections. In many ways, they tell you some more important things about the outlook for the public finances, which face the pressures of an ageing society. Public policy and the public debates about it also need to respond to those longer-term trends, not just where the economy might be headed in a given five-year period, which can depend an awful lot on what are essentially transient factors—be it the level of interest rates, the cyclical position of the economy and what a particular US Administration are doing.

Q57 **John Grady:** Continuing the discussion on headroom, Mr Hughes, in your

presentation in March, you said, "This Spring Statement breaks a historical pattern of asymmetric policy responses to forecast changes—in which windfalls were generally spent but shortfalls were not fully made up." Against that background, do you support the Chancellor's approach of immediately confronting the reduction in headroom in this way?

Richard Hughes: We do not endorse any policy decision by the Chancellor. The point I was making is that, from the point of view of forecasting the public finances in a world where shocks are inevitable, how policy responds to those shocks matters for the accuracy of your forecasts and the likelihood of Government meeting their fiscal rules, which is ultimately the thing we have to assess.

If Governments have an asymmetric response to shocks and they spend upsides but do not adjust for downsides, you will end up in a different place from where you are forecasting. We get a lot of criticism for our forecasts turning out to be wrong, and one of the reasons why they turn out to be wrong is the asymmetric response to shocks. Governments spend windfalls but do not adjust—we do not have a good word in English for the opposite of a windfall—for downsides. For that reason, one thing that can help secure the trajectory of a given forecast and reduce the risks around a given set of fiscal rules is to ensure that the policy reaction to a deterioration in the forecast is as symmetric as the policy reaction to an improvement against it.

Q58 **John Grady:** When looking at your own finances, would you try to adopt a symmetric approach to such shocks and windfalls, if properly advised?

Richard Hughes: I am trying to think back to whether I have—probably not as much as I should, I suspect.

Q59 **John Grady:** In chart 7.2 of your report, we see that headroom averages £30 billion, but after Mr Sunak's last Budget, in March 2022, it is around £10 billion, so over the last three or four years there has been much lower headroom—it is not a new turn of events. Presumably, if we were to expand it up to £30 billion, that would involve a significant blend of tax rises and spending cuts. What would be the outcome of moving too quickly on that?

Richard Hughes: I suppose that those decisions, as well as where they set their fiscal rules, remember, are for the Chancellor of the day. Headroom is an artefact of where fiscal policy is set relative to the rules the Chancellor sets for themselves, and Chancellors can choose to have tighter or looser rules. How much headroom they leave against them once the rules have been set is a decision that they then make. To be honest, in recent years we have seen Chancellors setting increasingly loose fiscal rules, relative to the past, and setting aside relatively little fiscal headroom against relatively loose fiscal rules.

Q60 **John Grady:** This may be a question for Professor Miles. If we carried out significant spending cuts and tax rises to get us back to £30 billion, what would that do to growth in the short run?

Professor Miles: I think it would depend on what the plan was to get back to a much higher number. The number at the moment is a number in five years' time. A policy that gradually had some combination of lower spending and higher taxes, which mainly happened beyond, say, two years in a three, four or five-year programme, would have a lot less of a negative impact than if you said, "We're going to try to get to a current fiscal surplus by the end of this year." That would mean pretty dramatic increases in tax and cuts in spending. It is a five-year horizon at the moment—it is planned to become shorter, and it will become three years within a couple of years—and that means that you could have quite a material impact on headroom without having to slam on the brakes right now.

Q61 **John Grady:** If you slammed the brakes on, that would be damaging to growth.

Professor Miles: Slamming the brakes on is generally going to do a bit of damage in some way.

Q62 **John Grady:** The other thing that some people are saying is that the Government should just increase borrowing. Professor Miles, what would be the risks of increasing borrowing and an associated change in the Chancellor's rules?

Professor Miles: I think the risks are very difficult to judge, because you have to get in the mind of the people who might buy gilts—or, rather, people who would decide not to buy gilts if they thought that the Government were going a bit soft on the fiscal rules by borrowing a lot more. The Government are going to have to issue a lot of Government bonds, gilts, this year anyway—something like £300 billion, which is a historically extremely high number, both absolutely and relative to GDP. They probably have to issue substantial amounts of new gilts next year as well, and that is before you factor in the Bank of England running down the stock of gilts that it has bought.

One way or another, the UK Government are going to have to sell an awful lot of Government debt over the next few years. Of course, nobody who buys gilts has to buy gilts. People can decide, "I don't feel quite so confident about the UK; I will buy gilts at a price, but that price is not an interest rate of 4.5%"—it could be 5% or 5.5%. With the stock of debt as big as it is, that has a material impact on the fiscal position. I think one can see why a Government might be wary of saying, "Just borrow some more, because we've had a bit of bad news, and don't adjust on other margins."

Q63 **John Grady:** If I have this right, Government borrowing costs increasing to, for example, 5% or 5.5% would feed through to the public finances quite significantly, because we have a large amount of debt—almost 100% of GDP, so we are quite unlike Germany. Additionally, however, because of the way in which people price private sector debt and equity, it would increase the cost of debt and equity for businesses developing houses or investing in wind farms, for example, which would feed through to

consumers, and it could be very damaging for economic growth. Have I understood the broad contours of this issue correctly?

Professor Miles: Yes, I think you have. A generalised rise in the level of interest rates is not just going to affect the Government payments on the outstanding stock of debt; it is likely to have knock-on effects on the cost of mortgage borrowing for households and for companies borrowing through the banking system. The impact is not just on the Government fiscal position.

Q64 **John Grady:** If a family has just bought a house in Mount Vernon in my seat, is it in their best interests, from the point of view of their mortgage rates, that the Chancellor of the Exchequer does not radically increase borrowing?

Professor Miles: I think it is in everybody's interests if the Chancellor of the Exchequer and the Government are wary of the potential knock-on impacts on the cost of borrowing. It would depend on what your constituents' mortgage situation is—whether they have fixed the rate for a long time or not. The chances are that they probably have not fixed it for five or 10 years; it might be just a couple of years. I am not saying that this will happen, but if, two years down the road, it were the case that gilt yields and the whole level of interest rates were 50 or 100 basis points higher, it would affect the cost of their mortgage when they remortgage.

Q65 **Dr Sandher:** Mr Josephs, could you tell me how much the impact of changing interest rate forecasts in your budget affects the fiscal space the Chancellor has in year 5? Just qualitatively, not quantitatively.

Tom Josephs: As I said earlier, the increase in interest rates that we saw compared to our last forecast in October was around 50 basis points on average. That was enough to eliminate the fiscal headroom the Chancellor had in October, which was about £10 billion. Looking forward, we have some sensitivity analysis in the book, which shows that a 60 basis point increase would be enough to eliminate the headroom.

Q66 **Dr Sandher:** How does the OBR forecast interest rates?

Tom Josephs: We take market expectations.

Q67 **Dr Sandher:** There has been quite a lot of volatility in market expectations recently—I think 0.5% of the standard deviation. Do you think that change in interest rates might be noise rather than signal, in the sense that it is moving around quite a lot?

Tom Josephs: It is certainly the case that interests rates have been very volatile recently. Again, we have some analysis in the book of the kind of range we have seen since our last forecast, and what it would do to the fiscal position if interest rates were at either end of that range. It is certainly the case, as you say, that that volatility adds a significant amount of uncertainty to the forecast. We take market expectations over a 10-day window. That average of market expectations over that window aims to smooth over a bit of that volatility, but we cannot get rid of all of it.

Q68 **Dr Sandher:** By extension, the 10-day period you choose has a huge impact on spending decisions in five years' time. I know there is a huge amount of volatility, but the 10-day period you choose at this point in time is having a huge impact on spending decisions and possibly tax rises later on.

Tom Josephs: The 10-day window is what we use for the forecast, and as you say, that has a big impact on the fiscal numbers, given the sensitivity of the public finances to interest rates. We reserve the right to adjust that if, after we have taken the window, there has been a big change one way or another that we think, going to your point, is sort of signal rather than noise. That has not been the case this time; I think rates are now around just 10 basis points or so higher than the window we took.

Q69 **Dr Sandher:** You tend to use your forecast model to come out with the other outputs, but with the interest rate assumption, you take the market forecast. Why that difference?

Tom Josephs: For us, that is the best source of information on the future path of interest rates. We take a similar approach for other market determinants—for example, for energy prices, where you have a very liquid forward market, we use market expectations. It is not just an approach we use for interest rates; we use it in quite a few areas of forecast.

Dr Sandher: That is very helpful.

Q70 **Yuan Yang:** On the question of welfare reforms, I note that in the preface, you have written that "details of the policy package were sent to us very late in the process, and late notice of changes and incomplete analysis hampered our ability to reflect these measures in our forecasts." To begin with, I want to ask about the timeline itself. You set out very clearly that, on 12 March, the Treasury gave you what you thought was a final package of measures; on 18 March, you sent them a near-final fiscal forecast, and one day later, on 19 March, you received final policy decisions from the Treasury. Looking at that process overall, how normal is that timeline? Were there surprises on your side, or on the Treasury side, from each other's movements?

Tom Josephs: The basic timetable that we have set out in the foreword is the standard timetable that we use for all events. Most of it was followed in the normal way, and the process ran smoothly. The exception that we highlighted in the foreword was on some of the welfare reform policies, where we received the information on the costing of those policies later than is normal; also, in some cases, the amount of information analysis provided to us on those costings was less than we normally expect.

It might be useful to go back to the questions asked at the start about how that process works. Policy costings—the impact of policy on the fiscal numbers, what we call the direct effects—are produced and owned by the Government Departments responsible for the policy. Our role is to certify that we think the costing is reasonable and central. There is always an iterative process, where the analysts send us their estimates and,

typically, we go back and ask for more analysis and more evidence before we ask them to change the costing. Eventually, we get to a point where we agree it is reasonable and central, and we put it in our numbers. So that happened on this one, but it just all happened later.

Q71 **Yuan Yang:** When you talk to the Department responsible, does that mean a conversation between you and DWP, or is it the Treasury in this case?

Tom Josephs: On welfare, it is DWP.

Q72 **Yuan Yang:** You mentioned that some of those costings were incomplete or some of the analysis was incomplete. Could you go into a bit more detail about what was lacking? What would you have needed to make a better or fuller forecast?

Richard Hughes: We received some of these costings later than normal, so we have less evidence and analysis than normal, particularly on some of the behavioural judgments that we need to make these costings. That relates to how the people affected might respond to the changes that are made, which is quite a complicated thing to model. Say you are trying to anticipate what happens if a benefit becomes less generous. An example in this package is the Government has made the universal credit health element less generous. That has a direct impact on the cost of the welfare bill, but you might also expect people to respond to that. It becomes a less financially attractive benefit, so some proportion of people will face an increased incentive to work rather than claim that benefit, for example. That kind of analysis was not as complete as we would normally expect. We did do that assessment, but we have said that the costings are even more uncertain than normal because we did not have the usual amount of time and evidence that will allow us to do that.

Q73 **Yuan Yang:** Does that mean that we should expect an update to those forecasts in the autumn outlook?

Tom Josephs: Yes. In our next forecast we will do a fuller assessment of the costs of those policies.

It is also the case that the Green Paper on welfare reform set out a very wide range of reforms, some of which we have included in the numbers in this forecast, and some of which we have not, because the Government did not set out the final details in the Green Paper. That is normal practice—they will be doing further consultations on some of the policies, and some of the policies are just at a very early stage of development, and they will announce further details. In the autumn—or, whenever our next forecast is—we will look back at the costings we incorporated at this event, and we are also likely to have the final details on the whole wider set of policies that we will incorporate.

Q74 **Yuan Yang:** Just to summarise, you are planning to bring in the forecasts related to the employment support package, which was not scored this time, in the autumn, and also relate it to the behavioural changes and other parts of the welfare packages, which did not come in sufficient detail

this time? Is that broadly right?

Tom Josephs: There are a couple of different elements of this; there is the direct impact of these policies on the public finances, and what we call the indirect effects on the wider economy—in particular, in this case, the impact on employment and labour supply. We did not make any assessment at this event of the impact of the welfare reforms on labour supply, because we were not provided with enough evidence to enable us to do that, and we did not have time to do an assessment ourselves. We will do that in the autumn. As I said, once the wider set of policies have been finalised, that will allow us to do a full job on that.

Q75 **Yuan Yang:** Do you plan to publish any analysis of welfare-related changes before the autumn? I note that in previous summers you have published papers describing the overall trends.

Tom Josephs: I do not think we have any plans at the moment to do that. Some of the timing on this depends on the point at which the Government finalise some of their policy decisions on the wider package. There are some pretty big reforms in the Green Paper that we did not include in any way in this event. For example, the Government have said that they are going to completely scrap work capability assessments, which is the criterion currently used to assess whether people get the universal credit health element. We have not made any assessment of that currently, but that could have some pretty big implications. They have also said they will do a full review of the personal independence payment assessment criteria. Anything we do will essentially depend on the timing around when the Government make their final decisions on those policies.

Q76 **Yuan Yang:** In the play of events from 17 March to 19 March, was there any surprise on either side? Were you surprised by being given more measures to score? Was the Treasury surprised by what you have given it? Was there a level of miscommunication? Could you explain what was happening in those few days?

Richard Hughes: Our forecasts are always full of surprises. We were forecasting in the middle of covid, and in the middle of Russia's invasion of Ukraine. Unexpected things always come up. In this case, as Tom was saying, we agree a set of deadlines for notification of measures, so that we have time to do our scrutiny properly. In this case those deadlines were not adhered to; also, a number of measures were notified to us after the deadlines were agreed. We did our best to provide our best assessment of those policies, but for the reasons Tom outlined, some of them were incomplete, and we will have to come back to in the autumn.

Q77 **Chair:** It is interesting, because, Mr Hughes, you said earlier that the Treasury "knows how our forecasts work", and, Mr Josephs, you have leant very heavily on the word "normally" and saying things were "later than normal"—I have not added up how many times you said that. Given that the Treasury and the DWP knew the deadlines and what was normal, why was it that you got it all so late?

Richard Hughes: That is a question for the Treasury. We received it when we received it. The Treasury knows how our macro forecasts work, but in the end, the job that we do, and in particular the job that Tom does, is to make a set of specific judgments about specific policy changes, all of which end up being unique, because that is in the nature of policy reforms. We have a pretty consistent track record that people can look at of how we treat different kinds of tax and spending changes. Wherever we can, we try to be as transparent as we can about explaining how those judgments work, what models we use and what elasticities we use to estimate different behavioural responses, but in the end, there are discussions that we have with the Department and judgments that we have to reach to make sure that our judgments are central. We also try to learn from that experience, because often those judgments turn out to be wrong and we have to adjust and think, "Actually, we got it wrong last time, so we have to take a different view this time around."

Q78 **Chair:** There must be a bit of gaming in this, because everybody knows the deadlines. The planning stuff was scored this time. The welfare stuff will now likely be scored in the autumn, which may impact headroom. Do you think that any of that has happened in this case?

Richard Hughes: I do not know. We try to make sure that the risks around our forecasts are symmetric. To the extent that things go up or down, the changes that we make to our judgments are not biased in one direction or another. We are not consistently optimistic when we first look at it and then revise down, or consistently pessimistic when we first look at it and then revise up. We try to make sure that, especially when we are revising judgments around costings, the judgments go in both directions.

Q79 **John Glen:** Whether or not there is consensus on the quantum, It is quite clear, directionally, that it is going one way or the other. Nobody, even the Government themselves in their impact assessment on the Employment Rights Bill, is saying that it will be anything other than a cost of up to £5 billion. You must have a sense of the net effect of things that are held back that will be negative in future and things that have been moved forward that will be positive, as with the planning and infrastructure thing.

Richard Hughes: In some cases. In a package like this on welfare reform, there is a bunch of different reforms to benefits, reforms to support being provided and a number of different incentives going in different directions. You have to look at those things in the round. In other areas, such as trade—as David said, putting in place more restrictions on global trade around the world will not be good for global output—it is pretty reasonable to say that the direction of that will be down, with the exception of a few limiting cases.

Q80 **Bobby Dean:** To probe on this a little further, your answers around the uncertainty of the indirect effects, particularly on the labour market, are similar to an answer the Chancellor gave me last week in the response to the spring statement. My question to her and to you is: could it also go the other way? The Chancellor's pitch is that more people will end up in work, so this will end up improving the country's finances overall—by the

time we get to the autumn forecast, things should look better. But are there risks going in the other direction—impacts on public services, and so on?

Tom Josephs: Specifically on the welfare reform package, as I said, we have not made an assessment at this point of the impact on employment. It is difficult to say at the moment what the overall impact would be because there are different parts of the reforms that potentially push in different directions on employment.

There is an increase to the universal credit standard allowance, which will be received by around 7 million families. An increase in the generosity of that might reduce work incentives. It is quite a small increase, but it applies to a lot of people. Going in the other direction, is the fact that the universal credit health element has been made less generous, which potentially increases work incentives. The changes there are bigger, but they apply to a smaller population, although it is a population that is typically more distant from the labour market. The balance of those two effects is not clear cut.

There is also funding for a relatively large employment support programme. You would expect that to be positive in terms of employment, but the scale of that depends on the detail. Past experience is that it is quite difficult to get really big results from employment support programmes. As I said, there are also a lot of other elements in the Green Paper where the Government have not finalised the reforms yet, so it is very difficult at this point to gauge what the employment impacts might be. That is why, at this point, we have not done an assessment.

Q81 **Bobby Dean:** I understand that you have not yet done the full assessment; I am just trying to get a sense of the direction. You said that there is pressure in both directions, but it feels to me that it should end up being net positive for the public finances overall, but maybe not to a large extent. Or do you think there is a risk that this could end up reducing the headroom in the forecast by the time you look at this?

Tom Josephs: You say "positive for the public finances". The package has certainly generated quite a significant saving in welfare costs: the bits that we have scored already add up to a saving of around £5 billion. That is a significant saving, but the wider employment effects and the knock-on they might have for the public finances is where we are saying that the net impact is unclear.

Q82 **Bobby Dean:** Is that to do with the fact that the large bulk of the savings have been driven by changes to PIP, which is obviously not exclusively for people who are out of work—it applies to people both in and out of work? Does that add greater uncertainty about the employment benefits? I am pushing you on this because a lot of the press coverage over the last week has been betting big that these welfare reforms are going to drive lots more people into work and are going to have a substantial impact on the economy.

Tom Josephs: The changes to the personal independence payment are the element that makes the largest fiscal saving, by essentially making the criteria to become eligible for PIP more difficult in the future. Our current estimate is that, over five years, around 800,000 people who would have been eligible for PIP will no longer be eligible. We have not assessed the impact of that on employment, and it is difficult to make an assessment because, as you say, PIP is not a work-related benefit and a large proportion of people who claim PIP are quite distant from the labour market.

Q83 **Lola McEvoy:** I want to ask about the 800,000 figure. I thought your 2024 welfare trends report was a fascinating read—I read it a few times to get my head around it. It explained that the increases in the number of claimants often come from claimants transitioning from legacy benefit systems, and how the numbers seem to be higher but, when it is explained on a graph, you can see that those people were already in the system, just under a different benefit name. You gave a figure of 800,000 people who would have been eligible for PIP but are no longer eligible. Is that based on a trajectory that includes those legacy benefit increases, or is it with the legacy benefit increases taken away?

Tom Josephs: I am glad you enjoyed the welfare trends report. It was primarily focused on incapacity benefits rather than PIP, although we did also include some analysis of PIP. Over the last few years, there has been a transition from the previous system to universal credit. That is what you are referring to—the big transition from people on the old benefits to universal credit. But the report also shows that, in addition to that transition, there has been a big increase in the underlying number of people—in the caseloads.

As Richard mentioned earlier, there are a number of probable drivers of that. It seems quite likely that part of the reason is that the underlying health of the working-age population has declined. The working-age population is ageing due to demographics, but there is also evidence that, even among the younger population, issues such as mental health conditions have increased over the past few years. That is probably driving some of the caseload increase in the forecast.

We also think it is quite likely that economic factors are driving it as well. In particular, cost of living pressures since the pandemic clearly increase the financial incentive to claim these benefits, which are much more generous than the standard allowance under universal credit. The welfare trends report shows that it is also quite likely that changes in the operation and structure of the system have also contributed.

Q84 **Lola McEvoy:** I thought it was very interesting that chart 3 of the report said that 20% were new claimants, and that the biggest significant change in the increase from 2018-19 to 2023-24 was due to the lack of drop-offs. Could you elaborate a bit on that?

Tom Josephs: This is the increase in the caseload, roughly since the pandemic. As you say, the analysis shows that a small part of it is just

more people putting in claims, but the bigger part of it is that fewer people are dropping out during the assessment process, and that approval rates are higher. It is difficult to understand why those things are happening. We hope we can do some further work on that with more data from the DWP.

To go back to the point I was making earlier, it could be because people are coming with worse health conditions, which means they are less likely to drop out and the approval rates are likely to be higher, but it seems likely that that is not the only driver and that there are other factors within the operation of the system driving that trend. Financial incentives are also potentially a driver. If people have more of a financial incentive, they are potentially less likely to drop out. I am sure the assessors factor in the financial benefits when they make their decisions.

Q85 **Lola McEvoy:** I would be interested in that. When you speak to people in receipt of any of these benefits, they don't say it is an easy process. It is a very complicated, difficult and strenuous process, especially if you are disabled or unwell.

Can you clarify two things? You just made a point about the financial incentive from the assessor's point of view. In 2017, the last Government brought down a mid-range universal credit element that was for limited capacity for work, rather than for limited capacity for work and work-related activities. Because that was brought down to the same level as standard universal credit, we ended up with the higher rate seeing an increase. Can you elaborate a little about the assessor's point of view on that?

Tom Josephs: I think the point you are making is that, after that change, approvals into the higher group increased quite significantly. We do not have any clear evidence on assessor behaviour, I should say, so I cannot give you a definitive answer on that, but—

Chair: It is potentially a perverse outcome.

Q86 **Lola McEvoy:** Finally, just to be 100% clear, in your projections, where you have scored the welfare changes, on the trajectory of increased cases you have not included legacy cases going into the system—the transition from the old system to the new system.

Tom Josephs: That is in the baseline forecast.

Lola McEvoy: It is? Okay.

Q87 **Yuan Yang:** I want to continue with one of the themes that Ms McEvoy brought up. In the 2024 welfare report, and elsewhere in the OBR publications, you refer to the "financial incentive" to applying. There is a lot of stigma in the media right now about fraud—incorrect claimants gaming the system, as it were—and the term can be interpreted in a variety of ways. Could you explain how you see financial incentives encouraging people to apply or stay in the system, rather than drop out, in relation to the broader issue of fraudulent claims?

Tom Josephs: In the assessments we have made of the welfare reform packages, when we have looked at responses, we are not really looking at whether people are going to make fraudulent claims. What we are looking at is purely how people respond to the different financial incentives in the system and the various changes that have been made to the gateway assessments for the benefits. There is a much more generous award for people who have health and disability conditions than for those who do not, and the Government's stated aim as part of their reforms was to start to narrow that gap.

The area where this was the biggest consideration in the assessments that we made of this event was the impact of the changes to the personal independence payment gateway criteria. Essentially, the Government tightened the criteria to make it more difficult for people to become eligible for the benefit. We applied the new criteria to the past results of the assessments that have been made, as DWP has a record of all the past scoring that people have made against the criteria. That led to an assessment that around 1.5 million people would no longer be eligible for the personal independence payment. But we then assumed that, in the future, people will respond to the new criteria, given the financial incentives, and that people will be able to bring forward new evidence and demonstrate that they are able to meet the new criteria, which they might not have done in the past.

Q88 **Yuan Yang:** So people will put more work into getting the right doctor's assessments and so on. There is no claim from the OBR that that evidence is mistaken and that people will be driven to—

Tom Josephs: As I say, this is not about fraud. It is about people's incentive to provide evidence, the assessments that they make of themselves and their conditions against the criteria, the sort of advice they might receive and, again, how assessors might respond. A judgment needs to be made on the criteria, and it is not a clearcut division; it leaves room for a lot of judgment. As I say, we think that will lead people to—

Q89 **Yuan Yang:** There is also the implication in a lot of media discourse that the increase in PIP caseloads is not matched by an underlying increase in disability and that, therefore, there is some gaming. Do you see that in the data that you have looked at?

Tom Josephs: Richard spoke on this earlier. There is evidence that there has been a deterioration in some areas of working-age population health, particularly starting around 2018 and then after the pandemic. There is evidence of an increase in mental health conditions, particularly among younger parts of the working-age population. But it also seems to be the case that that is not the only driver of the caseload increases we have seen since the pandemic. As I said earlier, it looks like economic factors may also have been driving that, and potentially issues around the operation of the system.

Q90 **Rachel Blake:** I want to come on to one of the other policy measures, which is around house building. Last time we were here, you said that you

did not have enough detail to do the scoring, and now we are seeing a material, additional and durable impact on transactions and potential output. Professor Miles, could you talk us through some of the methodology that got you to the point where this could be scored?

Professor Miles: We looked at a range of evidence, and we spoke directly to house builders about how they saw it and what they were going to do. Among the larger house builders—not all of them, but the ones we spoke to—there was a pretty positive response as to what they will do, certainly in the longer term. They were keen to point out that there will be time lags between the new rules and when they actually start building more houses, which seems very plausible. That was perhaps our single biggest source of information.

Q91 **Rachel Blake:** May I pause you there? What happened between their saying, "Yes, we quite like this," and your putting some numbers to it?

Professor Miles: We got some detailed information about where grey-belt land—land that was previously green belt, which you could not hope to develop—might be and what incentives there might be, both numerically and money-wise, if land that you previously could not build on now became available. Those incentives looked pretty strong, depending on where you were in the country. They were stronger in the south-east than they were a long way from the south-east.

We had a long, hard look at capacity constraints in the residential construction sector, which, in the short term, seemed very material. They add up to a time lag. Essentially our central forecast was that you got very little boost to house building this year, and not a whole lot next year. It really was backloaded to years 3, 4 and 5 of our forecast horizon.

It seemed pretty clear, whichever way you looked at it. If, as a likely side effect of the new planning rules, there was land, particularly in the south-east, that you had not had a hope of building on before, now there was a realistic prospect of doing it. Given the difference in the value of land—let us say it is agricultural land—relative to developing it as housing, in principle there is now a very big incentive. We have probably all heard house builders saying for several years that they are held back by one aspect of the planning system or another. The quantification of how big and how quickly it comes through is something about which it is difficult to be very precise. Our numbers are that by the end of the forecast horizon, which is five years down the road, on our central estimate some 70,000 more houses will be built than otherwise would have been built.

Q92 **Rachel Blake:** Do you anticipate scoring the Planning and Infrastructure Bill?

Professor Miles: It depends on what detail we get on it. The residential stuff was much more developed, and it was very clear what some of the rules were. We are not in the same place on the infrastructure stuff. When we get more detail, we will certainly look into that.

Q93 **Rachel Blake:** So it is feasible that development corporations might be

scored. In terms of decision making, they could move development forward.

Professor Miles: Yes. We are open-minded, once we get more detail on the thing to look at it and see what size of effect it might get.

Q94 **Rachel Blake:** And there is a particular element to the overall market. In London, £4 million a day is spent on temporary accommodation, which is private rented accommodation that local authorities lease. Is it possible for you to forecast and model the impact of a reduction in terms of positive growth, or is that—

Professor Miles: A reduction in which element?

Rachel Blake: In temporary accommodation costs.

Professor Miles: Do you mean as a side effect of the planning reforms?

Rachel Blake: Yes.

Professor Miles: Yes, in the sense that we have an estimate of how much lower house prices, and therefore rents, are likely to be as a result of building the houses. Although it is quite a big impact on the number of new houses built, the impact on things like rents and house prices depends on how much you move the stock of housing. Because the flow of new house building is small relative to the stock, even though you have a material impact on house building, there is not an enormous impact on the stock, even three, four or five years down the road. The knock-on impact on house prices and rents is therefore pretty small. It builds up over time. It will be bigger in 10 years than in five years, and bigger in five years than in two years.

Q95 **Rachel Blake:** Would it be fair to say that the impact on rents is the closest that you would get to it, and that the cost to local authorities hasn't, at the moment, played into your modelling?

Professor Miles: It is too limited an impact to have a material effect on the forecast horizon, on that element of it.

Q96 **Chair:** You need to have a very clear figure of social housing, presumably, to be part of that. Is that correct?

Professor Miles: I think you would need a very clear idea of that.

Q97 **Chair:** And geographically?

Professor Miles: Definitely geographically, yes. We have skewed our estimates on where the house building comes, and on the size of the effect on the economy. We have not assumed that there is going to be more house building, evenly spread across the country. There are stronger incentives in areas where house prices are higher, such as in the south-east.

Q98 **Rachel Blake:** I would like to understand in detail where we lost those 200,000 houses from the Government's target. You have forecast 1.3 million.

Professor Miles: To a significant extent, it is about time lags. We don't think there is likely to be any impact on the scale of house building, certainly not this year and possibly not even for most of next year. Therefore, you don't approach 300,000 houses built in the UK until year 5. You are short of that all along the way. That is the major reason why you don't get to the Government's target, and why you get closer to it by year 5. We think those effects are likely to be persistent, unless there are further changes to the planning system, and they will last beyond year 5. We have come up with some estimates of where you get to beyond year 5.

Q99 **Rachel Blake:** Are you able to determine whether it is more in terms of land supply or the capacity in the sector, or is it an aggregate of those two factors? Obviously, you can move capacity in the construction sector more easily than changing land supply.

Professor Miles: It is the effect of both things combined. If you have more land but there isn't capacity to build houses, that is what holds you back. If you have the capacity to build houses but you don't have the land with the permission, that is going to hold you back. In the very short term, the time lags are about both getting the permission and building up capacity in the industry.

Once you look beyond a few years, even though at the moment there may be shortages of people with the relevant skills in the construction sector, you then start trying to address questions about apprenticeships and training people. If house builders believe that these are the new rules of the game, they are more likely to expect stronger demand in the future, and more willing to take on apprenticeships and to train more people. They might not have done that if there hadn't been the planning reforms.

Q100 **Chair:** Mr Hughes, I want to go back to the information released about your forecast. The final submission was sent out to about 102 officials, mostly in the Treasury. Ministers, six special advisers, the head of the special advisers' office, who may be a civil servant—some spads are civil servants, technically, but I think they are a slightly different category—and some press officers were included in that list. Prior to the leak, or the release of the information, on 11 February, you had four meetings that included special advisers. Was it the same special adviser at every meeting, or was it a different mix of those six people?

Richard Hughes: I am trying to think back. We had two meetings that included special advisers alongside officials, and then two meetings that were with special advisers and Ministers. My recollection is that it was always the same special adviser.

Q101 **Chair:** It was one special adviser?

Richard Hughes: I believe so, yes.

Q102 **Chair:** Are you able to tell us the name of that special adviser?

Richard Hughes: You could ask the Chancellor, who was in the meetings.

Chair: For the record, an email was sent out on 7 February that didn't

have any special advisers copied in. We have had 15 years of the OBR, and there has never been a leak of information. You are very clear that it is not from your team.

Richard Hughes: I am very confident of it.

Chair: We have obviously been asking the Treasury about it, as well. It is helpful for that to be clarified. While we have been sitting here, the UK Statistics Authority and the Cabinet Office have announced a review, led by the UK Statistics Authority's Sir Robert Devereux, so it is an issue that we are pursuing with our sister Committee.

This has been a really useful session, so thank you for your time. In summary, we have learned that various Chancellors' decisions to leave themselves very little headroom mean that much greater attention is paid to small changes in your forecast. As we have heard from the Bank of England, the uncertainty about the ONS data is affecting your forecast, so I think the review is welcome to us all. We have also heard that a 50 basis point increase in interest rates was sufficient to use up the Chancellor's headroom, so we are working with quite small margins.

Before this session, it was an area of interest to us that the Treasury missed the pre-agreed deadlines for submitting policy changes, which prevented you from including the changes in your forecasts. Thank you for your answer about that. We heard from Mr Josephs that even when that is clearer, there are challenges in determining the impact because of the complexities of interactions with the welfare changes. That is something to watch in future.

I thank you for your time. The transcript of the session will be available on the website, uncorrected, in the next couple of days.