HOUSE OF COMMONS

Treasury Committee

Oral evidence: Spring Statement 2025, HC 813

Tuesday 1 April 2025 (Afternoon Sitting)

Ordered by the House of Commons to be published on 1 April 2025.

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; and Yuan Yang.

Questions 103 to 184

Witnesses

I: Paul Johnson, Director, Institute for Fiscal Studies; Dr Jumana Saleheen, Chief Economist and Head of Investment Strategy Group, Europe, Vanguard Asset Management; and Ruth Curtice, Chief Executive, Resolution Foundation.

Examination of witnesses

Witnesses: Paul Johnson, Dr Jumana Saleheen and Ruth Curtice.

Q103 **Chair:** Welcome to the Treasury Select Committee on Tuesday 1 April 2025. We are looking at the spring statement, which was unveiled by the Chancellor last week on the back of the Office for Budget Responsibility's forecast. After a session this morning with the Office for Budget Responsibility, we are delighted to welcome a panel of experts on the economy: Paul Johnson, director at the Institute for Fiscal Studies; Dr Jumana Saleheen, chief economist and head of investment strategy group, Europe, at Vanguard Asset Management; and Ruth Curtice, chief executive of the Resolution Foundation.

Not to cut you out, Dr Saleheen, but we think this is Paul Johnson's last time in front of us as director of the Institute for Fiscal Studies. Paul, you are off to head up The Queen's College, Oxford. Is there anything you wanted to say about your time at the IFS?

Paul Johnson: It's been fun. *[Laughter.]* I don't know what you want me to say. It would be fair to say I seem to have covered nearly 15 years of not great economic news—a combination of the very austere days of the 2010s, the difficulties after Brexit and big increases in spending and taxes over the last five years, and we are still in really difficult economic waters. It is very different from how it would have been in the previous 20 years. I hope my successor has some better news to deal with.

Q104 **Chair:** Thank you. Also, Ruth Curtice has just been appointed Chief

Executive of the Resolution Foundation. We will not ask you for a valedictory, Ms Curtice, because I think and hope you will be here a bit longer than today's session.

Q105 **Dr Sandher:** Ms Curtice, welcome to the Committee. I want to ask about the real household disposable income forecast and about living standards. Obviously this is going to be the big priority, not just for Government. As Mr Johnson alluded to, performance has not been great over the past 14 years, or indeed since the financial crisis. Do you think there is potential to reduce costs through investment and get living standards up that way?

Ruth Curtice: As you say, it has been a really tough decade for living standards already. We saw some improvement in the OBR's forecast for RHDI at this forecast but unfortunately from very low levels, so under their numbers this still would be the third worst Parliament on record. At Resolution Foundation we also do projections of household disposable income, which is a slightly different measure. Those show some growth in incomes between 2023-24 and 2024-25, but from 2024-25 incomes fall for all parts of the distribution. That means the poorest households are projected to get £500 worse off over the course of the Parliament. I certainly hope that we can improve on those projections, but we are not starting from a good place unfortunately.

Q106 **Dr Sandher:** On your projections, it would be real income inside your model?

Ruth Curtice: Yes.

Q107 **Dr Sandher:** I am thinking specifically about measures with which to reduce price and cost. That is another way to get incomes growing as opposed to just looking at the income side, important though that is. We have been hit specifically by global gas prices, to which we are uniquely exposed. Is there an upside to your forecast if investment gets energy costs down, for example?

Ruth Curtice: Our projections are based on the OBR's forecast for inflation. If inflation were to be lower than those forecasts, that would be upside to our projections. We are about to see big rises in council tax and water bills this week, so I am sure people are hoping for better news in the future.

Q108 **Dr Sandher:** What about the ways in which that leads you to input costs? On the one side, you have lower inflation and if on the other side you had lower energy prices, for example, you would expect that to have an impact on growth in incomes. Do you see that as also being an upside potential if certain investments work out?

Ruth Curtice: Broadly, the best way to get these projections up would be to have higher growth. Clearly for the poorest households, some of the most important inputs will be the welfare system as well. Of the £500 that we project the bottom entire half of the distribution will be worse off, about £200 of that comes from the welfare changes that we saw at the spring statement.

Q109 **Dr Sandher:** You might not know the answer to this—I just want to check—but the Climate Change Committee thinks that energy bills could fall by about £200 for a typical household over this Parliament if we meet our policy aims. Do you know whether that is being incorporated in your forecasts, or do you just take that from the OBR if it is within theirs?

Ruth Curtice: We take our inflation forecast from the OBR. I do not know whether that specific effect is in the OBR forecast. Obviously, when the OBR are looking quite far out, they tend to project inflation of 2% because of the Bank of England's target, and they tend to expect price effects therefore to be offset in other ways, rather than having lower inflation.

Q110 **Dr Sandher:** That is a very good point. Finally, a very easy question: how would you raise disposable incomes by 2030?

Ruth Curtice: Thanks! It's always good to have an easy question. In the long run, we do agree with the Government that improved living standards need to come from improved growth, and we are supportive of lots of the things the Government are doing on that front. However, there are areas in which they could go further, such as on the tax system and on trade.

There are also questions about the short term; we are about to see falls in 2025-26 as well. The Government have introduced, for example, higher than inflation increases to the standard rate of universal credit, but they could have brought that in sooner and eased some of the effects this year without hitting the fiscal rules in five years' time.

Q111 **Lola McEvoy:** This is to each of you on the panel: I would just like to hear your analysis of the productivity puzzle. The OBR said this morning that the measure for productivity has been lowered because of a revision of half a million into the workforce, and we wanted to hear from each of you your analysis of why we in the UK are struggling so much with productivity. Do you want to go first, Ms Curtice?

Ruth Curtice: Yes, I am happy to. One thing that I wanted to say on the productivity statistics—we have had news about the Government reviewing the ONS today—is that we have done quite a lot of work in the Resolution Foundation on the labour force statistics, and it is worth emphasising that the labour force statistics also affect the productivity statistics.

Our best guess is that employment is and has been higher than estimated by the LFS, because there are biases in that survey, and that would mean that productivity is lower. So particularly when you stand back and look at the trend between 2019 and 2024, the ONS would see some small rise in productivity through that period—I think it is 0.4% or 0.5%—while we would see a fall instead.

Neither of those is a good answer, and there is still a productivity puzzle. I am happy to come back and talk more about that, but I think that the fact that we do not actually know whether productivity was positive or negative between 2019 and 2024 is quite a big problem in trying to diagnose what is going on.

Lola McEvoy: Indeed. Dr Saleheen?

Dr Saleheen: If we look at international comparisons of productivity, we see that productivity fell everywhere during the global financial crisis. After that and up to today, many areas have recovered their productivity. It has recovered in the US and in the euro area, although the euro area is mixed, and some economies have seen more favourable productivity while others have seen less, but in general we have seen improvement, whereas in the UK we have seen stagnation.

That is because of factors quite specific to the UK, such as Brexit—the trading relationship with Europe falling back—and that being followed by covid and then the energy crisis. Each of those times, we have not actually managed to recover back to pre-crisis levels—pre-GFC levels. We do therefore see the UK as an outlier in the international context. That is the first thing.

The second point is that, while the main reason for the productivity puzzle is obviously these economic shocks, actually, if you look closer, there is a whole array of reasons why productivity has been weaker in the UK. Public sector investment has tended to be volatile in the past. It has picked up now, but the UK has not had that consistency of 3% or 4% public sector investment that we have seen in other economies.

Those are probably some of the key factors in business investment as well, but we know that firms that export and play in the international market tend to be more productive, because they learn from their counterparts. So even if you look among firms, you see the laggards and the leaders. To answer your question, there is a host of hypotheses and all of them play a little bit of a part. There is no silver bullet.

Lola McEvoy: Mr Johnson?

Paul Johnson: I agree with all of that, both on the measurement issues and the diagnosis. I would add a couple of things to what Jumana said, though I do not disagree with anything at all. It appears there is a sort of rundown of dynamism in the British economy, with fewer firms going out of business or being created. You have this extraordinary divergence in productivity between the most and least productive, with any increase over a long period only occurring towards the top of that distribution.

There are potentially measurement issues on the other side, because part of measuring productivity and living standards is whether we are capturing prices well. When we are developing iPhones and all the associated stuff that goes free on the internet, they are not picked up well in either productivity or in living standards statistics. Those are difficult things to measure.

There is clearly a separate issue around public sector productivity, where over the last five years or so we have had an absolute collapse in the health service, justice system and elsewhere, and they play a role—not the biggest, of course—in productivity numbers.

The Government are absolutely right to identify the planning system as something that has been holding them back; in my view, they are not going far enough and could go further with reforms in that direction. However, I think there are things they have done that will make some difference over a longer period, and that probably applies to other areas in which Government interact with the private sector.

The post-Brexit collapse in the number of firms involved in trade—since the big firms have continued, but the small firms have largely stopped—will, going forward, hit the dynamism of the economy. Then there are lots of long-standing issues, particularly around our non-university further education system. I could wax lyrical about problems in the tax system if you like, but as I said in this forum after the October Budget, increasing stamp duty will probably not help, to put it mildly.

Chair: Your favourite tax! That was ironic, for anyone watching.

Paul Johnson: My favourite tax. The gross and continuing uncertainty in the tax system is something that does not help.

Q112 **Yuan Yang:** We heard earlier from the OBR about concerns about the labour force survey. It is an issue we have raised with the ONS as a Committee. I wanted to start by asking Ruth Curtice to describe the different modelling the Resolution Foundation has done, which in your central estimate finds no net increase in activity from 2019 to 2024. Could you go more into the other differences between the estimates, and the confidence level you place on the ONS's estimates as a result?

Ruth Curtice: There were two adjustments that we tried to make regarding the ONS data. One was not to rely on the survey data, given what we have seen of survey response rates, but to use the payroll data from HMRC. The other was, when we originally did those estimates, to adjust for updated population figures more quickly than was done in the LFS. As I understand it, the second of those adjustments has now been broadly taken on, so it has become less important.

Those two adjustments suggest that employment recovered post pandemic more quickly than the ONS thought. Rather than focusing on whether the specific level is exactly right, what is important is that our estimates suggest quite a different picture: quicker recovery post-pandemic until spring 2023 and a fall in employment since then, whereas in the LFS data it looks like employment is rising. We think that is the LFS catching up with the truth, if you like; but certainly, given the variations and the issues, I think that, like other institutions, we do not have confidence in the LFS at the moment.

Q113 **Yuan Yang:** Does that mean that you think that the UK is not an outlier in terms of inactivity, and that that is a problem for the Government to address, or do you have a different opinion about that?

Ruth Curtice: When we are talking about inactivity, there can be offsetting things happening. Given what has happened to caseloads in the welfare system, we think that there has certainly been a rise in people claiming certain benefits, which we might come on to, and in the number of people inactive due to health. Our total employment suggests that, as you say, there has not been a big fall in inactivity overall. That is because we think it has been offset by other things, like female and older workers, where employment has gone the other way, but we do not disagree that there has been a rise in ill health causing inactivity.

Q114 **Yuan Yang:** Mr Johnson, whose statistics do you prefer: the Resolution Foundation's or the IFS's?

Paul Johnson: Part of the problem is the huge uncertainty about this. It is really problematic that we are working off such uncertain official data. Probably the best evidence we have at the moment comes directly from the HMRC tax data, which does show a rather different pattern—actually, a significantly different pattern—from the survey data. If you are looking at overall numbers—I think this is broadly what the Resolution Foundation numbers are based on—you are probably better off taking the administrative data, as it were, more seriously as your fundamental measure of the number of people who are actually engaged in employment, but of course, that does not tell you anything about why people are out of work or those sorts of things.

Q115 **Yuan Yang:** We will go on to the reforms later, but as a final question on the data, does anyone on the panel have any confidence in the sickness-related inactivity data? How much can we track the underlying increase or otherwise in sickness-related inactivity?

Paul Johnson: Colleagues of mine have done quite a lot of work on that. The trouble is that different surveys show really different patterns of change over time—some go up and some do not—in terms of the numbers of people who say they have a disability and who are saying they are out of work for those reasons. What we do know is that, as we will come to, the number of benefit claimants has clearly been going up and the number of people—particularly younger people—saying they have mental health problems has been going up really quite fast. That bit has been associated with a really worrying increase in the number of people under the age of 25 not in employment, education or training.

There are definitely some things you can glean from that. There is clearly a problem with reported levels of sickness for some groups, particularly for mental health issues. There is clearly an issue, particularly among younger people, with not being in the labour market. And there is very clearly an issue in terms of people claiming benefits. Putting precise numbers on all those things, other than the benefit numbers, is very hard.

Q116 **Yuan Yang:** What is your central estimate of sickness-related inactivity, given the difficulty you describe in getting precise numbers?

Paul Johnson: I do not have a number in mind, I'm afraid, but maybe Ruth does.

Ruth Curtice: Sorry, I do not have a sickness-specific number in my head, but I am happy to send you one.

Q117 **Yuan Yang:** It just seems to me that the picture of the underlying data is complex and often quite vague. Is that correct?

Paul Johnson: It is complex, but it is pretty clear that there is a problem.

Q118 **Yuan Yang:** It is clear that there is a problem, but it is unclear where the problem lies and what the actual trend is—is that the correct summary of what you are saying, Mr Johnson?

Paul Johnson: Some trends are clear. As I say, there has been an extraordinary increase in the fraction of people, particularly younger people, reporting mental illness or mental health problems, and that is very closely associated with not being in employment, education or training. I do not think there is too much doubt about that. There is some uncertainty about what is driving levels of inactivity among older people, where you have an increase in the numbers on sickness-related benefits, but much more complex information about what is actually happening to their underlying health.

Q119 **Lola McEvoy:** I wanted to come back on your international comparisons, Dr Saleheen. Obviously, we are obsessed with the data and the inaccuracy on this Committee, because so many policies are being made, but if you have some good examples of other economies that have bounced back quicker and a bit more specific detail on how they have done that, I would be grateful for your thoughts. Obviously, you talked about public sector investment at 3% or 4%. Are there any other elements that the US or the thriving economies in Europe have—

Dr Saleheen: Is the question just about the comparisons with the data, or is it more—

Lola McEvoy: With productivity specifically and the bounce back.

Dr Saleheen: With the productivity bounce back specifically, obviously it depends on the nature of the shocks. Investment is obviously the big one, and if you think about the shocks hitting Europe and the UK with the energy crisis, that has been a negative shock, whereas the US has actually benefited from that, being a net exporter of oil and gas. That is another factor that drives that difference in productivity.

But in general I also want to note that if we look at the OBR's long-run productivity estimates, we see that it has revised them up since last time, from roughly 1.67% to 1.75%. That was a surprise to markets because the trend growth rate of productivity is above the range of estimates. In chart 2.21 of the external forecasts, you see that from 2026 the OBR line is well above the range of external forecasters. It feels like, "On what basis is that?"

Reading the report, I was thinking that on the one hand the OBR has a top-down view, from the macro side. It says, "Hey, productivity growth before the global financial crisis was 2% and we think it is going to go back halfway between what we have seen recently and what saw pre-financial crisis." That is a top-down judgment—and last time it had 1.67%.

But then the OBR is adding in housing reform, which is a more micro, bottom-up approach. It feels like there is potentially a little bit of double-counting. Our forecast at Vanguard for trend growth is 1.5%, which is in line with IMF estimates and with consensus estimates of where trend growth is. Obviously, that will be a key factor driving the outlook for the public finances.

Lola McEvoy: We will have to get you back in when we get the next one, to see who is right.

Q120 **John Glen:** Could we turn to tariffs? Dr Saleheen, could you explain how Vanguard's economic models incorporate the effect of US tariffs on the economy?

Dr Saleheen: If the question is about how our models take that into account, we would look at a range of different models and estimate the impact on growth and inflation on particular economies, if the tariff rate went up. That is the normal model: we would look at tariffs and then shock those tariffs up and see how that transmits through the economy.

What you find very simply is that if you put up tariffs, that puts up the price of the goods that the UK is exporting to the US, so you would have fewer exports to the US and through the trade channel you would impact GDP. But actually what we find is that the direct effect through net trade is quite small. The bigger effect comes through the confidence and uncertainty; those are the channels that drive it. So the range that you would get from the modelling is quite uncertain, and it would be very state-dependent: what is happening in your economy at the time? Is the confidence level already low or is it high? If it is already low, then obviously given the greater uncertainty you could take a bigger knock than you would if confidence was high.

Q121 **John Glen:** The OBR's central forecast did not, I think, take account of the effect of the US tariffs. Obviously, we are trying to scrutinise it as thoughtfully as we can, but it feels like more could have been done. Given how central the US is as a trading partner to the UK, would it not have been more prudent for the OBR, at least with all the caveats you have mentioned, to have put more on the US tariffs and their possible effect in its core forecast?

Dr Saleheen: Thinking about our forecasts for 2025, we would say that obviously there is a whole range of possibilities about what tariffs would be, but we have to take a base case view on the most probable outcome on tariffs. At Vanguard, we took the view that there would be additional tariffs on China and the rest of the world. We said that there would be about a 5% rise in tariffs for the rest of the world. That was the base case view that we put into our forecasts for 2025 and beyond, but we recognise that there are risks around that, and it could potentially be more than that. You would want to have a base case view, despite the fact that there is of course a lot of uncertainty.

Q122 **John Glen:** Could the OBR have done that, had it wanted to?

Dr Saleheen: It could have done that. You would have to take a base case view and make a judgment on what you think is more likely, what the drivers are, and who would be affected. It probably does require you to look in a little more detail at what that would be, or look back to previous experiences.

Q123 **John Glen:** If the OBR were here, I imagine that it would say, "We do things based on what the considered policy of the Government is, and there was a degree of uncertainty over exactly how it was going to play out," but I guess that is always the case. At the end of the day, the effects of the tariffs as stated were going to have an impact on the economy regardless of the mitigation. Is that a reasonable assumption for us to make?

Dr Saleheen: Everybody has their forecasting practices. Some people do it when the policy is announced. Other people will say, "Actually, I want to make sure that my forecast is as correct as possible, so I am going to take a base case view," but it is a judgment—a view—and there will be a lot of uncertainty around that view.

Q124 **Chair:** You did a base case. Did you model other scenarios, because 5%, from what we are hearing, could be quite low? Different levels will obviously have hugely different impacts globally.

Dr Saleheen: We have done some analysis saying, "What if it went up another 5%?" Given the latest developments, our base case view is that actually it probably will go up another five percentage points to 10%. That is one view. When we do our modelling, we find slightly smaller effects than what the OBR has in its scenario on, I think, page 46 of the OBR report. It has an upside and a downside scenario, and I think in its extreme scenario, which is 20% on the rest of the world and everybody retaliates, you get an impact of almost minus 1%.

John Glen: It is on page 43.

Dr Saleheen: I think our estimates are a little bit smaller than those estimates. If we ran our numbers, they would probably be a little bit smaller than that, but I guess it depends on the assumptions.

We do not think that the whole rest of the world would retaliate. Some economies have been very clear that they will retaliate and take a stand. For other economies, it may not be in their best interests to retaliate. At the end of the day, if you put up tariffs in retaliation you will see higher inflation in your economy. It will hurt your economy, and do you want to do that?

Q125 **Chair:** Do you do comparisons with other people in your position doing these sorts of forecasts?

Dr Saleheen: Yes, we would be looking at other forecasts, what the modelling effect is, and what assumptions go into it.

Q126 **Chair:** Are yours similar to your cohort's?

Dr Saleheen: Ours are pretty similar to market estimates of the impact of tariffs, yes.

Q127 **John Glen:** Can I turn to Mr Johnson on these forecasts? The OBR's world economy forecast incorporates the data from the IMF's January forecast, which again does not take account of the recent developments in the US. One of the central problems that is emerging—I think all Governments face this—is that when there is grave uncertainty and challenges, the OBR comes into focus for being a prophet of doom and also being over-optimistic.

At the same time, shouldn't we able to reasonably have some of these global factors more credibly incorporated into the OBR's forecasting? It has massive implications consequentially in terms of tax and spending, and the fundamental choices that the Chancellor has to make. Is it not worrying that we cannot have a more sophisticated model from the OBR on what is, admittedly, a range of outcomes?

Paul Johnson: It is an incredibly tough judgment for the OBR. I think it is in a very difficult position because of the incredible sensitivity of the fiscal numbers, given the minuscule level of headroom that is left, as I am sure we will come on to. Had the headroom been bigger, it would have mattered less what the OBR said in its central forecast.

I actually have a lot of sympathy with those at the OBR. It would not have been unreasonable to have downgraded their productivity forecast, to bring its growth forecast back in line with the consensus, to have incorporated some effects of tariffs. I do not know what the number would have been, but the Chancellor would then have been looking to make up £20 billion or £30 billion in headroom, and there would have been an enormous political impact from its decisions. I am sure that, subconsciously at least, that must play on their minds. That is not their fault; that is the world we are in, with that sliver of headroom against the fiscal targets, where changes to forecasts are politically and economically so powerful.

On the decisions that those at the OBR have made, they can present other forecasts because they have given scenarios and shown what they think the impact of different levels of tariffs would have. I suppose the difficult question is: was a forecast assuming no tariffs genuinely a central forecast? It feels to me like that is the best case scenario in terms of where you might think tariffs might end up.

You might think that tariffs around the world, with everyone retaliating, is the worst case, and that there is something in between. My sense is that they have chosen something closer to a best case scenario, partly to be consistent with the IMF, and partly because this is not actual policy. While they are constrained to follow stated UK Government policy, they are clearly not constrained to follow exactly the day of where policy is in the US.

Q128 **John Glen:** This whole debate rather underscores that there is a high degree of volatility in these assessments. You have been through more fiscal events than we have over the past 15 years. The variance between consecutive fiscal events is usually quite significant, from something that is presented by successive Chancellors as an authoritative view. When you reflect on the particular element around international trade, do you think there is anything that could be done better to enhance the authority of the OBR's judgments?

It almost feels like there is a conversation with the Treasury to work out a set of balancing scenarios to make it work. When in fact, as you have just said around the potential £20 billion headroom, you could on one very reasonable scenario put that together as being necessary. That is not far from being a set of assumptions that a lot of people would have consensus on.

Paul Johnson: I cannot comment on how or whether the OBR and Treasury work together like that—they are certainly not supposed to, so I hope that is not what happens. Slightly to repeat myself, the OBR's forecast between last March and last October, pre-measures, changed remarkably little, and they have changed quite little between October and now. These are not big adjustments that it has been making.

Again, the Chancellor did not change policy because the world had changed; actually, the world in terms of OBR forecasts changed remarkably little over this period. If at some point we do end up with the OBR coming more into line with consensus and taking account of tariffs and so on, then I fear there comes a moment when the forecast gets significantly worse.

It is an incredibly tough judgment for it to make. On that judgment, it seems to me, hangs too much, because of the way the Chancellor has not so much constructed the rules, but left herself with no space to manoeuvre against them.

Q129 **John Glen:** I want to ask a final question of Dr Saleheen about tariffs. What are your reflections on recent events, what you see unfolding with tariffs and the effect on the UK economy that has not been reflected so far in the events of last week?

Dr Saleheen: There are two scenarios to think about. On the one hand, if there is just an increase in tariffs for the UK, that could have quite a small impact. The marginal impact of that on the level of GDP and inflation is quite small. We are talking about 0.1% or 0.2%. It is within the margins of statistical significance.

The situation is much more worrying if it expands into more of a trade war in which everybody is doing tit-for-tat strategies. That could escalate and lead to a downturn, a recession in major economies, or a global recession. That is more of an extreme scenario, but the base case is that it will not be there, because everyone is aware of it, and they do not really want it.

John Glen: Thank you; I think I have used up my time.

Chair: Thank you. We could talk about tariffs, but I think we will be here forever at this rate.

Q130 **Yuan Yang:** I have a question about the institutional framework that the OBR and the Treasury operate within. There have been numerous proposals in the media over the last few weeks about doing things such as changing the number of fiscal outlooks, or OBR outlooks a year, or adding other organisations that would make forecasts—for example, the Treasury would continue to make forecasts, as it used to do, and so on. Does any member of the panel have any particular views on those proposals or the institutional framework right now?

Dr Saleheen: In some ways it makes sense, but then the question is the credibility of those commitments if you cannot stick to them. You might say, "Okay, I am going to do one fiscal event," but if you then change it, that creates more uncertainty. It is much better to have, if necessary, two events or whatever it is, but just stick to that; then everybody knows to expect that, including markets.

For example, there was some uncertainty this time around about whether it would be a spring statement with news, or where there would really be nothing. Markets then were like, "Oh, is there an event? Is there not an event?" It creates some expectations in markets on what will or will not happen, and you get that uncertainty, which can be negative.

Paul Johnson: On the institutions, one of the things that has been so striking in recent years has been the divergence between OBR and Bank of England forecasts. The OBR is very good at comparing its forecasts with outcomes. It would do an enormous amount for transparency if we could have a joint report from the OBR and Bank of England on why they are so divergent in their forecasts, and in the ways they have been transparent about some of those things. I do not think it would be terribly helpful to have a Treasury forecast, because I am not sure anyone would believe it. I don't want to be too rude, but there is a reason we have the OBR doing it, not the Treasury. Sorry, Ruth.

On the frequency of events, I have always been a believer that one fiscal event a year makes more sense.

Q131 **Yuan Yang:** It is less work for your colleagues.

Paul Johnson: Not just for that reason. If you have two forecasts and one event, if you are so close to those fiscal rules that becomes very difficult.

One of the things that concerns me about where we are now—we have had the forecast, the headroom has been maintained, but, as we are discussing, there are lots of potential downsides to that—is there will be a lot of speculation about what will happen in October. We have had the forecast, and things are looking on a knife edge.

We have changed a small number of things. Things—as is already happening with tariffs and so on—could begin to look a little worse. I thought the speculation about tax rises before the last Budget was very damaging economically, as well as, arguably, politically. I fear we will get that again. I guess the longer that you leave between events when there is a lot going on, the more you risk that.

Ruth Curtice: Paul has covered lots there, to which I would add the number of forecasts a year. It is important to remember that these forecasts are there for the Chancellor to set tax and spending policy, but they are not there for only that. They are also there, for example, to inform the Debt Management Office of how many gilts to issue in the following year. They serve a number of really important purposes. That get can get lost sometimes in this debate about single fiscal events, and it is unlikely that the institutional solution is to have less information. Unfortunately, the world seems to be changing faster than once a year, and we might need to deal with that.

Chair: I think every Chancellor says they want only one, and then they end up having two—but maybe I am just a cynic.

Q132 **Bobby Dean:** We have been talking about fiscal headroom a little bit, but I want to get into it in a bit more detail. Perhaps I will start with you, Mr Johnson, because you have said some stuff about it already. I want to focus on this amazing coincidence that we have arrived back at the £9.9 billion figure.

John Glen: £9.93 billion.

Bobby Dean: Yes, exactly. We spoke to the OBR this morning, and they indicated that it could be a coincidence, but it does not seem to me like it is. It seems that this figure was being targeted. Is that your view as well? What do you think this does to the fiscal policy decision-making process?

Paul Johnson: Hats off to whoever is in charge of the spreadsheet, because to get within, I think, £2 million of £9.9 billion in a £3 trillion economy is quite something. I do not know whether that is precisely what was targeted, but my guess would be that the Treasury decided that it did not want the number to go down. That is a guess, though; I am speculating, which would not be allowed in a court. It worries me a little bit—possibly more than a little bit.

I have written about two things. One is—again, this is speculation—that it is very striking that almost all the additional defence spending is capital spending, so that it does not count against the current budget balance. The truth about the overseas aid cut is that it has gone to fund other Departments; it has not gone to fund defence in any real sense. I do not know whether it is right that a third of the defence budget is capital but more than 90% of the additional defence budget is capital. I do not know, but the question sits there as a result of that.

We had announcements of welfare cuts a week before the fiscal statement, and there were good reasons for those changes, but I worry that the Government undermine themselves a bit by then coming back for just a teeny bit more to make those numbers add up.

The last thing to say is that, if you look at the timing of the departmental spending increases that we are going to get in the spending review, the numbers add up also because you have 1% in the final year, which is actually outside the spending review. So there is this pattern of 2.5% next year, then 1.8% and then 1.11%, or whatever it is, but I will take a large bet with someone that that is not what is going to happen. This is exactly the criticism that we made of previous Governments: they make the numbers add up by having a fictitious couple of very low spending numbers at the end of the forecast period.

Q133 **Bobby Dean:** As you say, it kind of feels like achieving the number is driving the policy, rather than the other way around. If it was just scored normally, and it was, say, half a billion out from here, would that have made much difference? Dr Saleheen, how would the markets have responded if it ended up that there was £8.5 billion-worth of headroom? Is it important to the markets that they match this figure?

Dr Saleheen: That the fiscal rules that are stated and whether the fiscal rules are being met is really important for markets. They would be looking at that number—that number is one of the fiscal rules—and at whether it is being met. On it being £8.5 billion versus £9.9 billion, no, they probably would not have died in a ditch on that number, but markets focus on a few things.

Are the fiscal rules important? Yes, absolutely; the markets will focus on that. They will also look at what the gilt issuance is going to be. The gilt issuance for the next financial year was just under £300 billion, which is a lot higher than we have seen in past years, and it is going to remain at that elevated level. If that number was £305 billion or £310 billion and the headroom was down, that would have also concerned markets. They look at gilt issuance. They will also look at how much of the gilt issuance is at the short, medium and long end of the curve. That is important as well, because if it is all in the long end, you are kicking the can down the road and not dealing with it.

Even on the issuance side, we learned that that was lower than expected, coming in under 14%, instead of what markets had expected, which was around 17%. Markets are looking at a few things: trend growth rate, gilt issuance, the split of that issuance across the curve and whether the fiscal rules are being met. There are a number of dimensions.

Q134 **Bobby Dean:** So a bit of variance probably would not have been judged that poorly. Isn't the danger that because the Government have chosen to match this figure, it becomes a new anchoring figure? Rather than having the actual headroom, the new headroom that you have to meet is within £9 billion. Do you think the markets may pay more attention to that in the next fiscal event and say, "Actually, if it diverges from that now, because that is the figure that the Government are clearly aiming towards, it would be a bad thing."?

Dr Saleheen: I do not think that they will be looking at £9.9 billion as being the critical value and focusing just on that. It is the composition of things, and a broad-based assessment. I also wanted to comment that, on the one hand, if you say, "Okay, we are very focused on that number of billions," it is actually quite important that markets are satisfied that the Government are abiding by their fiscal rules.

I think that is really important because that actually drives some of the price that you pay for UK gilts at the moment, which is higher relative to German bunds by about 100 basis points, relative to pre-global financial crisis. That makes UK debt more expensive and it makes servicing that debt more expensive, so it is important to demonstrate to markets that the fiscal policies are credible, the rules are being met and things are in the guidelines.

Hopefully, if that fiscal credibility comes back, we could see some of that gilt yield elevation come down, which would be beneficial. It is quite complicated because the differential in gilt yields between the UK and Germany is going to be driven by a whole range of factors, and inflation is actually an important factor.

The stickiness of UK inflation and UK wages, which has been stickier than other economies, is also a driving force behind that 10-year gilt yield being elevated. I want to give a little perspective on what drives that, and what drives the price of that debt. It is a number of factors, including inflation and fiscal credibility, the latter of which is captured in the premia, which asks, "How much more do I want to pay to hold UK gilts?"

Q135 **Chair:** You talk about fiscal credibility. Are you saying with certainty that, if the fiscal rules were to be tipped in a slightly different way, it is about sticking to the fiscal rules, or these particular fiscal rules?

Dr Saleheen: Sticking to the announced fiscal rules is important. You asked whether that £9.9 billion is a critical number, and no it is not. However, if there was no headroom, would markets have reacted? Probably. Suppose they just said, "Well, actually we are not going to do anything," because we missed our fiscal rules, there probably would have been an edging up in the gilt yield, reflecting that we are not sticking to our rules. I am talking theoretically, but those are the channels of transmission.

Q136 **Bobby Dean:** I guess part of what I am driving at is striving towards a specific number, such as the extra £500 million that is going into the welfare reforms as a result. That could have a real-world impact on thousands of people, and it seems to me that we are chasing this number because it is written down, as opposed to making policy reforms that we think will be productive for the economy as a whole. Do you want to comment on how this fiscal headroom figure is driving policy making, as opposed to the other way around?

Ruth Curtice: Yes. Paul, my predecessor and I often say that £9.9 billion is not a very big number in this context, so £500 million must be a very small number in this context. I do not have the page number, but there is an interesting chart towards the back of the OBR document that shows not just headroom in the past but this probability of meeting the rule, which is at 54% at the moment.

I think that chart demonstrates that to change those probabilities, you also have to change your headroom by a lot. Therefore, a £500 million variance does not really affect the real-world probability that the current Budget will be met in five years' time, given the level of uncertainty in these numbers. As you say, if the Government had decided two weeks ago that, for example, a level of a health element of universal credit was the right level for the next five years, having thought about the employment effects that they wanted to induce, it is surprising that it changed two weeks later.

Q137 **John Grady:** I want to come back to the confidence in sticking to fiscal rules. Richard Hughes of the OBR made an interesting comment last week: "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." Dr Saleheen, how important is it to investors for confidence in the UK economy that the Chancellor sticks to the fiscal rules?

Dr Saleheen: I think it is really important. That is what people will be looking at. Your fiscal rules are there to be met. Especially seeing, five years out, the fiscal rule that the broader measure of public sector net financial liabilities is falling is something that markets are very focused on—are you meeting your fiscal rules? It is actually important.

As you say, windfalls are being spent and the shortfalls are being dealt with later, and that obviously gives fiscal policy quite big room to adjust and to absorb. To that extent, the fiscal rules should allow you that—you could still meet your fiscal rules with your policy, if that makes sense. Five years out, if you are looking at that falling, that should be manageable. If you are not meeting that, markets would see it and worry about it.

Q138 **John Grady:** I think you explained earlier that the outcome of that would be higher borrowing costs for the UK Government.

Dr Saleheen: Yes. If you missed your fiscal rules, it would edge up.

Q139 **John Grady:** It would also mean, would it not, potentially higher mortgage rates for constituents in my seat?

Dr Saleheen: Yes. If you are asking, "If the Government do not meet their fiscal rules, will that drive up the 10-year gilt yield?", probably. How much—will that be 0.05, 0.1 or 0.2—remains to be seen. Would the rise in the long-term interest rate affect mortgage rates and other financial conditions in the UK economy? Yes.

Q140 **John Grady:** I think it is important to put this in the real world of my constituents, Dr Saleheen: their mortgage rates would go up if the Chancellor were reckless with the public finances. Thinking about housing, we are very keen on getting more houses—I think everyone is—but the housing developers have to borrow money to build the houses, before they sell them. Presumably, their cost of debt could go up as well, because lenders reference the risk-free rate, do they not, when calculating what they are going to lend at? That is one of the things they take into account.

Dr Saleheen: It depends. On the particular question about mortgage rates, it will depend on the type of mortgage that the individual has. It does not mean that there is a market response, but suppose the gilt yield went up. It has been very volatile, as you can see from the chart in the OBR report. If you look at the evolution, it does go up and it does go down.

There has been quite a lot of volatility recently, partly UK-specific and partly global factors. Those rates do go up and down. They do not always necessarily translate into your mortgage rate straight away—mortgage rates are more slow moving—but in principle, in general, yes: if they went up and were sustained at a higher rate, so that was more permanent, then yes, it would feed through to borrowing rates.

Q141 **John Grady:** The gilt rates going up on a sustained basis would affect the cost of capital for businesses in the UK, which would affect business investment and, potentially, jobs.

Dr Saleheen: That depends. I want to be clear: the 10-year rate is quite different from the risk-free rate, the Bank of England rate and a lot of the borrowing rates that companies or households will have. It depends: a fixed-rate mortgage will fix on the long rate; and a tracker mortgage will fix more on the short rate. Really, there are some nuances in there—which interest rate is going to move and the impact that that will have on the borrowing rates—but in principle, yes, if interest rates go up, borrowing does become more expensive.

Q142 **John Grady:** That is why it is important to make sure that the public finances are run well. If Government borrowing rates and interest rates went up across the economy—in a relationship between the two—that presumably would be damaging for economic growth.

Dr Saleheen: Yes. In general, that is the transmission mechanism of higher interest rates—it becomes harder to borrow, and it becomes more expensive for consumers. If they have any form of debt, whether that is overdraft, their mortgage or any kind of borrowing—new businesses, new borrowing—in general, it will go up, yes. That will be negative for the real economy.

Q143 **John Grady:** If you were out with me and some voters in Mount Vernon in Glasgow East, a lovely part of the city—it is all brilliant—I suspect you would say to them that it is very important that the Chancellor sticks to her fiscal rules and runs the public finances responsibly, because if she does not, it could have real-world implications for them in terms of their own family finances.

Dr Saleheen: Yes.

Q144 **John Grady:** Coming to headroom briefly, chart 7.2 of the OBR report shows an average of headroom up to March 2022 of around £30 billion, and then it drops down from November, through Jeremy Hunt's tenure as Chancellor of the Exchequer, and then onwards, in October and March, to around the £9 billion to £10 billion mark.

Chair: I note that one Chancellor is missing from that, but they were there so briefly—

John Grady: We better not get into that—we will come back to that later.

Chair: That might be the reason for the drop

John Grady: I think we know who it is; I think he has been back in the press giving advice again, actually. Anyway, good for him. Mr Johnson, is the current headroom enough?

Paul Johnson: Enough for what? I do not think it is enough for confidence that we will not need more adjustments over the next fiscal events. The problem is, as we have been discussing, given the rules are there and the way that the markets look at them, it will be important for the Chancellor to meet them.

It is worth stepping back a moment to say why. We can see that borrowing is not free. One of the big problems facing this Government is that we are spending well over £100 billion a year on debt interest as it is, and if you take that longer term it creates more problems down the road. Even on the debt rule, if we were to look at the measure inherited from the last Government—the standard measure of debt—that is actually going up all the way through the forecast period. It is very important to be clear that this is not a tight fiscal policy; it is a fiscal policy that is just about meeting some relatively loose fiscal rules.

Coming to your question, when you leave yourself £10 billion of headroom against that, there is a very significant probability that you lose that as you move through fiscal events. That creates uncertainty as you go towards those, and forces the Government's hand to either cut spending or increase taxes, at least into the future, in terms of what is promised.

We will be in a better world if we had more like the average pre-2022 level of fiscal headroom, of something like of £30 billion. Then you have much more space for manoeuvre. It is worth saying that from this time next year, when we are only three years away from the end date of the rules, the Government have said that they are allowing themselves 0.5% of GDP wiggle room against them. That helps, particularly if you have got a couple of forecasts a year but only one significant fiscal event. That is a long way of saying, all things equal, it would be better to have more headroom, but if you create more headroom that means you are either promising higher taxes or lower spending, and neither of those are particularly desirable in their own right.

Q145 **John Grady:** My final question is for Ms Curtice. If we decided to go hell for leather and increase this headroom as quickly as possible—Geoffrey Howe-style in 1981—that implies quite significant tax rises or spending cuts. What do you think the implications of that will be for my constituents in Glasgow East?

Ruth Curtice: I am sorry to give an equivocal answer, but it would depend very much on how those changes are done. On the structural break in that chart—then I will come back to your question—what really happened between those two lines is a very significant rise in the interest rate, as Paul says, and a structurally much harder fiscal position.

Both Governments subject to that second, lower line have been grappling with the trade-offs between headroom and balancing the public finances when it has got structurally quite significantly worse off, even though the rules have changed through that period. The choice that the Chancellor faces, as you imply, is how quickly to tackle that problem. More headroom now would require her either to have set lower spending targets or to have higher taxes.

It is worth saying that in this event there were not, in the grand scheme of things, very big adjustments to public spending, so the Chancellor seems broadly to have decided, subject to some important detail that Paul is the expert on between ODA and Defence, that the numbers she set in the autumn, which were quite a big increase in public services, were the right ones. Clearly, if those had been lower, public services would presumably be less good for your constituencies than otherwise, but we have not really seen the spending review, so we do not really know what those quite significant increases in the autumn will mean.

On taxes, at the Resolution Foundation we see scope to increase taxes in a way that would not significantly harm growth, certainly in the short term. The Chancellor did have the option, for example, to extend the threshold freezes, which would cost your constituents in the last two years of the forecast, but would not have cost them in the short term and would obviously have hurt wealthier households more.

Q146 **John Glen:** Would you approach that in a gradual way, or a quicker way? What would your advice be to the Chancellor and her team?

Ruth Curtice: That is a great question. There are big advantages to tackling as much up front as you can; it reduces the uncertainty that Paul has talked about and I assume—although you are the experts—that it is politically easier to make some of those choices earlier in a Parliament. However, it does mean raising taxes in reality, in a way that impacts the economy, so obviously you do not want to go too far in those judgments. Given that the Chancellor made quite big moves in both tax and spending in the autumn, it is a difficult judgment whether she could have gone even further to shore up the fiscal position.

Q147 **Dr Sandher:** I want to ask you, Dr Saleheen, about something you said about fiscal rules and the impact on interest rates and gilts. The last Government had seven sets of fiscal rules, and presumably they changed them six times because they were going to break them six times. Am I right in thinking that you would see an increase in the interest rate and the gilts six times, given the testimony we have just had?

Dr Saleheen: That is one of the reasons we have seen a trending up of the gilt yield above the German bund, which is a measure of the risk premium. There has been quite a lot of chop and change, and that uncertainty has been factored into how fiscal risk is being priced. Chop and change is not necessarily good, and it is priced into markets. If you look at the rates now, we are trading about 200 basis points above German bunds whereas, if you look back before the global financial crisis, it was more like 100. We are seeing that chop and change that we have talked about priced in.

Dr Sandher: I suppose, on Germany, quite a tight debt brake would have led to less spending overall—but I will leave that there, Chair.

Q148 **Chris Coghlan:** Mr Johnson, I was struck by something you just said: we are obviously fiscally pretty loose, as you say, and we are running pretty hot in terms of our borrowing capabilities. Is it not slightly extraordinary that we are borrowing money and injecting it into the economy, and yet growth is going down, or is flat? That does not sound very Keynesian to me.

Paul Johnson: I am not sure that most of the policy is aimed at being particularly Keynesian—especially given that, as you say, I think the OBR now thinks the economy might be slightly beneath trend. I don't think the effort is a Keynesian one; as I think you discussed this morning, there might have been a risk, with the big increase in investment spending, of a little bit of crowding out.

To go back to the last question, the big picture of the last 25 years has been that we have moved from low borrowing, low debt by OECD standards to high borrowing, high debt, and from well below the G7 to about average for the G7. That reflects a continual period of relative fiscal looseness, which has been related to very poor economic performance.

Q149 **Bobby Dean:** I want to move on to the welfare reforms in a bit more detail. There is widespread acknowledgment that the welfare reforms could result in better outcomes. If more people who are currently out of work, or who are disabled and struggling to find work, get into work, that would be a good thing both for those people and for the economy.

But given our conversation about the drive towards the figure for fiscal headroom, it seems like these reforms may not be driven by that. We have also not yet received the findings of Sir Charlie Mayfield's report, which is meant to give us more insight into how we can do this best. Do you fear that this moment has been about balancing the books on the backs of the poorest and the disabled?

Ruth Curtice: I think the welfare changes are about balancing the books, and I think it is worth separating them into two buckets. One is the changes to PIP, which is a benefit paid to people regardless of whether they are in work—I will come back to that. The other bucket is the changes to universal credit, which seem to be based on achieving higher employment.

The reason I think it is important to separate those two is because the Government clearly had two objectives in looking at this. It wanted to save money on a bill that has been rising, and rising quite sharply, for working-age health and incapacity benefits overall. The Government also wanted to improve the incentives for employment within the system.

Those are both reasonable objectives, but some of the policies achieve one and other policies achieve the other. In particular, the changes to PIP disability benefit raise £4.5 billion of the £4.8 billion net that the Chancellor is raising through welfare changes. The decision has been to change the level of disability for which, as a country, we will compensate people's costs. It is paid regardless of whether people are in work and, because you are changing eligibility, it means that the savings come from very large cuts to a relatively small group of people.

You are raising £4.5 billion by removing PIP eligibility from 800,000 people and carer's allowance from 150,000 people. As the DWP told us when it published the impact assessment, those losing PIP eligibility will lose £4,500 a year on average. We estimate that is an 18% drop in income for those people, for people who are quite distant from the labour market, who do not currently face a disincentive to work through the benefit system.

The evidence is that, given disability benefits are paid regardless of whether someone is in work, a big change in income does, in general, affect people's propensity to work. Having a slightly higher income makes it slightly less worth your while to work, and recent studies in the US have found such effects there. On the other hand, those studies are of the general low-income population, not of people facing particular barriers to work. And there is evidence on the other side that these payments are enabling people to have a car or get taxis that enable them to work.

To us, there are effects both ways on disability benefits, and the reforms look like they are designed to save money rather than increase employment. I am happy to come on to universal credit, but I am conscious that I have already given you a very long answer.

Q150 **Bobby Dean:** That has answered my point well, because obviously the Government are saying that the driving purpose of these reforms is to get people back into work, but from what you are saying, it sounds like you do not think that a huge proportion of the people who look like they may lose out, particularly in relation to PIP payments, will be able to get into work, or will be newly incentivised to get into work. So, for you, this is much more about driving down costs than about getting people back into work.

Ruth Curtice: Absolutely. The changes to disability benefits, which make up the bulk of the saving, do not seem to be about getting people into work. I should add that the changes to universal credit do rebalance incentives in the system, in a way that I would expect to have some positive employment effect. You started your question by asking whether, overall, it will be better for people. It is important to say that, even if you make pretty optimistic assumptions about how much extra employment might be generated by these changes, it is never the expectation that everyone will work enough to make up all of the income they have lost. There is no plausible employment effect, which does not mean that, net, what is happening is that millions of people are losing quite significant sums of money.

Q151 **Bobby Dean:** I do not know whether you want to come in on that point, Mr Johnson. The OBR would not be drawn on the potential impacts on employment, because they did not have enough detail to date. Would you be able to estimate—or give a ballpark region—what kind of proportion of people returning to work we might be talking about, and the effect that might have on the overall state of the public finances?

Paul Johnson: I don't know the answer to that, but it will be tens of thousands, or possibly 100,000, but it will not be many hundreds of thousands. It would take some serious modelling to give a better answer than that. As Ruth was saying, the changes to universal credit will have some positive impacts for those who are otherwise on the health-related element. On personal independence payment, it is a policy decision driven by—let us be clear—an absolutely astonishing increase in the number of people claiming it, and a decision that that is not what the Government wants.

Q152 **Lola McEvoy:** Ms Curtice, you just said that the changes to PIP will result in an 18% drop in the income of recipients. Can you elaborate on that? PIP is not means-tested, and some people are in work, so I do not understand how you could say that a fixed amount of money would equate to 18%.

Ruth Curtice: To be really clear, what the Government have told us is that there will be an average annual loss of £4,500 for the 800,000 people who the OBR estimate will lose eligibility. What we do is assume that those losers are distributed equally across the current PIP population.

We do not have details from the Government about who will actually be affected by condition, income or age, which is unfortunate, therefore we make an assumption that they are distributed across current PIP claimants. We assess that £4,500 would represent, to those people, an 18% drop in their income. If there was also an employment effect, which we do not take account of because the OBR or the Government have not estimated one, that would reduce that 18% figure. But as I say, I am not expecting an employment effect from those changes.

Q153 **Lola McEvoy:** For your organisation, obviously there is some significant missing data from the analysis that you have made, so why make it?

Ruth Curtice: I do not think there is significant missing data. Whenever you do distributional analysis, you have to make an assumption about who is affected. That £4,500 is largely a Government number; I am just trying to help people to understand what that represents as a proportion of the income of people who are affected.

Q154 **Lola McEvoy:** Right. So when you saw the reforms that were outlined in the White Paper, the Green Paper and the spring statement, was there anything missing that you would have liked to see as an organisation—

anything that you were screaming at the telly that you wished to see to help support people back into work or to balance the books in general?

Ruth Curtice: Yes, absolutely. On the topic of welfare reform, I was really disappointed when the detail of the figures came out last week that the employment support of £1 billion that had been promised comes in 2029-30. It is only £400 million the year before, so it more than doubles in that convenient year when the Government do not have to actually allocate it. Given the problems that they are clearly seized of, I am really surprised that they have not found money this year—let alone more money in 2026 when the cuts come in—to provide for that employment support.

Q155 **Lola McEvoy:** What about changes to the broader welfare system? Rather than changes to the Government's decisions, is there anything that you would have liked to see reformed?

Ruth Curtice: To be clear, we do think there is an issue in the system around health and disability benefits. For example, the changes in universal credit have been done in a way that represents a cut, which is not the way that we would have done it, but we do think that the rebalancing between the standard rate and the health element is the right direction of travel.

I would also not in any way rule out changes to eligibility for PIP, for example, because there have been really striking trends, as Paul says. I would hope, however, that those changes would be made in a way that means it is clear who is affected and that is carefully thought through, given the significant impacts on individuals, as I say. At the same time as the Government are making these changes, they have announced that they will conduct a review of PIP to ensure that it is fit for purpose. That sounds like a good thing to do, but it sounds like a good thing to do before you make very specific changes to eligibility that will hurt families.

Q156 **Lola McEvoy:** Okay. So you agree with the changes to eligibility and you agree with the universal credit rebalancing—

Ruth Curtice: I don't think I said I agree with the changes to eligibility. I agree that it is a good idea to look at the PIP system and how it is operating. The specific changes that they have made to eligibility, as I say, will have very—

Q157 **Lola McEvoy:** Yes; we don't know yet. Okay. I think that it says in an extract from your analysis that you have previously called for the same rebalancing as the DWP did in its Green Paper. Was there anything else that you were pleased to see?

Ruth Curtice: The increase in the basic rate of universal credit, which undoes about half of the erosion in the value of that benefit that we have seen since 2010, is very welcome.

Q158 **Lola McEvoy:** Okay, thank you. Mr Johnson, this is your last appearance before the Committee, so I will give you free rein to tell us what you liked about the spring statement and the changes to welfare. What would you support?

Paul Johnson: On the changes to welfare, action was clearly needed. I mean, it is really extraordinary what has been happening to spending on the health-related elements. Like Ruth, I am rather disappointed that we did not get the review, the analysis and the evidence before the decisions.

Again, we should not be starting where we are. Frankly, over the last two years, the DWP should have spent a very large amount of money on understanding the problem. If it has done so, it is not evident in what has been published or indeed in discussions. This is part of a strange budgeting arrangement, whereby there is a sort of free-for-all on benefit spending and it is very tight on the administration spending. But in a sense, it is good to see that being somewhat gripped.

If we look at the good things over the last couple of events, it is good that the Government, unlike predecessor Chancellors faced with big fiscal problems, are protecting investment spending. It is good to see some reforms to the planning system; I think those reforms could go further. On investment spending, I think it could be more growth-focused. It was probably inevitable back in October that we would have some increases in spending generally, relative to what was planned before.

I suppose that what worries me a bit about what we have seen over the last two fiscal events is that there are a lot of good intentions for the future but less in the way of implementing them in the short run. Again, going back over old ground, that includes choosing a very inefficient tax to raise most of the money back in October, and promising fiscal prudence but borrowing an awful lot more in the short run. Again, this Government did not want to inherit what they got, and I think some of that was probably inevitable, given what was left behind.

Q159 **Lola McEvoy:** Just to bring it back to welfare, is there anything that you—either personally or as an organisation lead at the IFS—have been calling for over time that you would have liked to see being reformed in the welfare changes that we are bringing in?

Paul Johnson: There are lots of problems in the welfare system. We continue to have a housing benefit system that was made a bit better a year or two ago but that is still not related to actual housing costs, creating all sorts of problems for all sorts of individuals. A lot of the issues here are also about judgments on levels of generosity. That is where we are with the two-child limit, for example, or with the basic level of universal credit.

What the Government have done is to say, “What is the biggest problem in front of us?” That is not just from a fiscal point of view; PIP was certainly not designed in the expectation that it would be such a large-scale benefit. If by the end of the decade, one in 10 of the working-age population will be on some kind of health-related benefit, you can see why the Government want to do something about that. But I very much agree with Ruth that it would have been good to see the analysis and then the outcome.

Q160 **Lola McEvoy:** Just a final question: for clarity, what were you saying about the two-child benefit cap?

Paul Johnson: I am saying that it is a choice; I am not saying one way or the other.

Q161 **Dame Siobhain McDonagh:** Ms Curtice, I just want to understand about the PIP side of things. Obviously, the thing about PIP is that, as I say to my constituents all the time, it does not matter whether you are the poorest person in the country or the richest person in the country: it is not means-tested; it is dependent on your circumstances. I am therefore trying to understand this idea about 18% of income. I completely understand that, at the basic rate of PIP, it would be £4,500 a year, but I do not get the thing about that being 18% of income.

Ruth Curtice: We have data on current PIP recipients—

Dame Siobhain McDonagh: So you know what their overall income is?

Ruth Curtice: From survey data, yes. That is not for all PIP recipients, but it is modelled from survey data—as is the Treasury's distributional analysis, for example—so we know what their household income is. PIP is not means-tested but, in general, recipients do tend to fall into the lower half of the income distribution. That 18% is simply £4,500 of, on average, a PIP recipient's income.

Q162 **Dame Siobhain McDonagh:** Because, for an awful lot of people I know, it would not be anywhere near 18% of their income.

Ruth Curtice: Absolutely, and I am afraid that there are some other people for whom it is much more than that. I think it is a quarter of PIP recipients for whom PIP represents more than 40% of their income as a household, for example.

Chair: Thank you; that is very helpful.

Q163 **Bobby Dean:** I just thought it was important that we addressed the point about the proportion of people due to fall into poverty according to the DWP analysis, because that has been subject to much conversation in the last few days. The DWP says that 250,000 people will fall into poverty, including 50,000 children, as a result of these measures. The Government says, "No, because it does not take into account the people going into work," but we have just had a discussion about the probably quite limited numbers of people being helped into work by these packages. Could you give us an assessment on those figures? How true do you think they will turn out to be? Will we be looking at closer to 250,000, or is there another ballpark figure that you would imagine we might end up at?

Lola McEvoy: And on that, can you give us your analysis on double-counting in that initial impact assessment, on how those things will interact, and on the severity for people with lifelong conditions and how that will interact with it as well, please?

Chair: Ms Curtice, I am sorry; that is a stack of questions. Your brain must be fizzing.

Ruth Curtice: I will do my best. One important thing to say about the impact assessment is that it is a combination of all the things that are being scored in the forecast. That means two things.

First, it means that it includes the effect of not going ahead with the previous Government's plans to change the work capability assessment, so there is a previous cut not happening. Reflecting that is completely fair enough, and that is how it reflects in the scoring, but in terms of how it feels for people, or how the impacts will be relative to the system today, that is a different question.

Secondly, it means that the impact assessment is not reflecting much of what was in the Green Paper, which is not being scored. That includes the prospect of transitional protection, or protection for people with more severe conditions. The money for that has not been scored, and it is not in the impact assessment. It also does not include the removal of the work capability assessment entirely and using PIP as a route to universal credit, which could mean quite significant changes for people who are currently eligible only through the WCA. So there are big changes in the Green Paper that are not in the impact assessment.

In terms of the impact assessment and employment, we have not done separate poverty projections, so I cannot give you a number. Given what we have said about the employment effects likely being in the tens of thousands—Paul said 100,000 at most—it seems unlikely that that would make a material difference to these poverty numbers, which are rounded to the nearest 50,000.

Q164 **Bobby Dean:** Just reading between the lines, the Government's expectation is that the figure will be dragged down by their employment initiatives, but you are saying that there are actually risks that it could go up, because it does not take into account all the changes that have been proposed.

Ruth Curtice: Yes. I think there has to be a risk that the changes to WCA, for example, are at least as big as the employment effects. I think we do not know which direction it will go.

Bobby Dean: Thank you.

Q165 **Chair:** This morning, the OBR was also saying that, with PIP, the difference between being on PIP and not having health-related benefits under universal credit means that there is potentially quite a cliff edge there. There could be some movement towards people being put on PIP, even with the eligibility criteria tightening, on the judgment that they want to be put on PIP rather than not on PIP.

Ruth Curtice: Absolutely, and there are a lot of people who currently claim PIP who, for example, would be eligible for universal credit but do not claim it. It might be that there are quite complicated interactions and effects, yes.

Q166 **Chair:** I want to get on to the bigger interactions. We have talked about the headroom: the miraculous £9.9 billion that, as you say, it is quite clever to keep landing on—the spreadsheet gurus are doing their job. However, we all know that annually managed expenditure is the bit of the equation that is easy to squeeze in-year. That is largely the DWP budget, isn't it, Ms Curtice?

We already saw extra cuts in the spring statement and a lot of the discussion is about child poverty—again, some of that money is coming from the DWP, depending on exactly what the child poverty taskforce comes out with. Do you think that AME will be the victim of any future changes due to tariffs, or any of the other rocky things that are going on globally, such that we could see a further squeeze? Do you see any other alternative?

Ruth Curtice: Clearly, if the headroom is gone again, the Government will look at resource spending, AME and tax—all together. The autumn will feel very different because the Government will have finished their spending review, so there will be only this one year without spending totals allocated before the fiscal rules bite. The decision to not really touch spending totals at this event is interesting, because it was the last realistic chance to do that. I think it will then become a choice between tax, welfare and AME—as you say—in the autumn.

We at the Resolution Foundation are disappointed that the Government's decisions so far have a bigger impact—almost twice as much, as a proportion of income—on the poorer half of households than on the richer half. We certainly hope that tax is the area that the Chancellor would go to next, if she had to, given that that would affect the richer half of the population.

Q167 **Chair:** Mr Johnson, you have been quite trenchant in your views on tax in recent weeks—and over 15 years. Which taxes could now be pushed, if AME spending is not pushed? Where would the tax potentially come from? We are talking about small amounts from some of the taxes that are available, given that the Chancellor has ruled out rises in a number of taxes.

Paul Johnson: It is not easy. It is important to understand the baseline of where we are. We all know that taxes are now pretty much at the highest level that they have been, but they are not coming from people on average or below average earnings. In fact, the average tax rate paid by those people—certainly in direct taxes—is well below where it was 30 years ago. Higher taxes are coming from a combination of very big increases in taxes on the highest earners, very big increases in corporation tax and company taxes, and increases in other, smaller taxes, such as property taxes.

If you look internationally at the direct taxes, all the countries that have higher tax burdens than us have higher taxes on average earners. That is not a politically easy issue, because there is a lot of pressure to get tax from the rich, get it from companies, or what have you. This month is the 50th anniversary of the last time that the basic rate of income tax was raised—by Denis Healey in 1975.

Bobby Dean: A birthday only you would know.

Paul Johnson: It was raised from 33% to 35%, and back then the top rate was 98%. That lack of a rise is not true of VAT, employer or employee national insurance, or any other major tax, but I think it indicates something about the political pressure on the way the tax burden is distributed, hence the tax rise we got in the autumn.

Q168 **Chair:** So you are saying that there is nowhere easy.

Paul Johnson: If I were Chancellor and I did not have to be re-elected—which I appreciate is not a realistic situation—I would be looking at things such as the basic rate of income tax. But history suggests—

Chair: No one is going to vote for Paul Johnson to be Chancellor for the day.

Paul Johnson: Quite. It is 50 years since a Chancellor did that.

Q169 **John Glen:** Some say the Government did not go far enough on capital gains tax—it is often seen that way. The Government raised it to 24% but did not completely align it to income levels. There has been some speculation about the behavioural effect in the period leading up to that, in terms of revenues, as people are anticipating it. Do you have any observations about that option and whether you could go further to raise a bit extra and balance the books? We have discussed the likelihood of a lot of speculation over the next six months, given the tight headroom, so what do you think about that?

Paul Johnson: There are two parts to that. The speculation around this is really problematic—

Q170 **John Glen:** Should we not ask the question of the Chancellor tomorrow then?

Chair: Maybe she will be categoric.

Paul Johnson: There was lots of speculation before the last Budget, which was really damaging. One part of it was about capital gains tax, which created behaviour change, and the other was about pension taxation. We know that a large number of people cashed in their pension earlier than they otherwise would have done because they were worried that the tax system would change. As it happened, the tax system didn't change. I think the Chancellor should rule out any further change in pension taxation in this Parliament. Otherwise, we will get the same impact before the next Budget. Because I have no idea what the tax strategy is, and nor does anyone else, no one has any idea which way the Chancellor will jump the next time more money is needed.

On capital gains tax, I absolutely do not think that we should simply raise the rate, but we need a rebalancing of the base. At the very least, you need to give allowance against inflation, but I would argue that it should be allowance against inflation plus a bit. If you do that, there is scope to increase the rate to something closer to the marginal income tax rate, but if you don't change the base and just change the rate, you risk causing economic harm.

Q171 **Chair:** We probably will not tempt you into stamp duty just now.

Paul Johnson: You know what I think.

Q172 **Yuan Yang:** I want to go back to the discussion with Ms McEvoy about the problem of rising claimant counts, expenditure, and disability and incapacity benefits, and to drill a bit more into what kind of a problem that is. Mr Johnson and Ms Curtice, you said that it is a problem. From one perspective, it is a fiscal problem. On the IFS chart, looking at spending on working-age health-related benefits as a share of GDP over time, we have incapacity benefits going down from above 1% of GDP in the early 2000s and then going back up again post-pandemic to just around 1% of GDP. Disability benefits have been creeping up steadily over time, with a bit of a sharper uptick, from below 0.5% to about 1% post pandemic. That is the range, so when you say it is a problem, do you have the fiscal problem primarily in mind? If so, does it even make sense to ask what percentage of GDP we should be spending on these benefits? Or do you have a different problem in mind? Presumably, there are also problems with the fact of so many people being ill.

Paul Johnson: There are three problems. One is the sheer amount of money. If you look at the OBR forecasts for all health-related benefits by the end of the decade, you are looking at £100 billion a year. That is a very large amount of money.

The second problem is that this seems to be at least somewhat indicative of a health problem, which is clearly an issue in itself that needs to be dealt with alongside any changes to the benefit system. The third problem is the combination of incentives within the benefit system. The chart also shows that other working-age benefits have not gone up at all over this time as a fraction of national income. That is partly because there is a very big incentive to be on work-related benefits, if you can, which takes you further away from the labour market and creates incentive problems.

Ruth Curtice: Paul has covered the overall numbers, and you are right to ask the question. Just a rise in caseloads would not be an indication of a problem in a population that is ageing. It is not just ageing in the sense that there are more pensioners; the working-age population is ageing, and that will tend to mean that we have a higher rate of health-related inactivity for a given population.

When you dig into the caseloads, what we are saying is that they seem to rise by more than is explained by what you might expect from those effects. I think of the problems that Paul described. As we understand the data, there seems to be this particular uptick in young people, and that is particularly concerning given that they are the start of their working life.

Q173 **Yuan Yang:** In response to that, does it make sense to have a kind of fiscal-first solution, in which you decide what percentage of GDP should be spent on these benefits and work from there? How should the fiscal calculation feed into the broader policy calculation?

Paul Johnson: Clearly there is not a correct proportion of GDP to spend on these things. We had this remarkable change, which occurred somewhere around late 2021 and early 2022, in the numbers of people coming forward and claiming each month.

We need to understand exactly what has driven that as well as the very low numbers of people coming off the benefits, alongside the apparent uptick in mental health problems among younger people and the sheer numbers of people affected. For a lot of the people affected, this is not the life they want to be living. All that should be driving change. The cost is clearly an important ingredient, but we should not be targeting a particular number. I am sure, however, you would think that continuing to increase at this rate is not where we should be.

Ruth Curtice: I broadly agree with that. I do not think there is a right answer to the percentage of GDP. We should expect different bits of the benefits system to take the strain at different times. The welfare bill as a whole was, in the autumn, constant as a share of GDP, and now falls slightly. What really matters, as Paul said, is what the changes in spending are telling you about what is underlying in the system.

Q174 **Chris Coghlan:** Dr Saleheen, does investment in defence have a more significant positive impact on output and growth than other sectors? Of course, I am thinking about the Chancellor's focus on using defence spending to boost economic growth and upgrade the long-term GDP forecast in the spring statement.

Dr Saleheen: On defence spending, I find it interesting that everybody wants to do this. We have seen Germany spending more on defence. They want to become the leader on military expense. At the moment, most of that comes from the US. We see quite a lot of leakage, if you like. Even if you spend more on defence, in the UK or in Europe, where does that money actually end up? It ends up with the US, so it is not driving growth in the UK.

The increase in defence spending is good news for the security of Europe, but what does that translate into in terms of the impact on GDP and long-term GDP? There is a quite a lot of uncertainty on those fiscal multipliers. I found it particularly interesting, from some of the work that has been cited, that when they are talking about defence spending, it is really R&D. At the end of the day, it is all about TFP. It is all about that elusive productivity growth. It is true that if you spend money on defence and orient it towards R&D and innovation, it will lead to higher growth rates, but the devil is in the detail. Some of those numbers for the fiscal multipliers—1.5 to 2—seem quite big relative to other numbers we have seen stated. I would say they are at the top end of the spectrum, relative to the literature.

Q175 **Chris Coghlan:** Do you think that the spending on defence is sufficient to turn the UK into a "defence industrial superpower", as the Chancellor would like?

Dr Saleheen: I cannot answer that question. It is really hard to answer that. If defence spending is to go up from 2.3% to 2.5%, and then up to 3%, it is good news you are spending more, but only if it is directed in the right way. I would note that some of that is unfunded right now. How are we going to go up from 2.5% to 3%? Where does that come from, and how will it either complement or substitute any growth effects?

In general, it will be a challenge. It is good news that we try, and I think it is part of the initiative of trying to boost long-term growth. Capital spending and public investment going up is really good news. We should keep trying to do that because it is ultimately what will make the fiscal math much more in our favour. We have already talked about the fact that interest rates are higher—there are a lot of pressures. Growth is the only way out, so we should definitely try to do that. Whether we can become a superpower remains to be seen.

Q176 **Chris Coghlan:** Mr Johnson, how will the poorest economies be impacted by the cuts in aid, especially alongside what the US and other countries are doing?

Paul Johnson: I am afraid that I am no expert on that, so I cannot give you anything other than a layman's view, which is that the effect of the cut in UK aid for the countries affected will be significant, and the US aid cut much more so. My sense is that other countries may follow suit. This may well change very significantly the flows of income to poorer countries and poorer people.

I was in the Treasury in the early 2000s when the Gleneagles agreement that we would get to 0.7% of national income was reached. The apparent consensus on that has melted away remarkably quickly without anything being put in its place about how we should think about our role in that world of international co-ordination and the role of aid. Beyond that, I really cannot say. If you put all the aid givers together, that makes a significant difference to flows. That risks making quite a painful transition in the short run. I think the jury remains out on the long-run impact that change will have.

Q177 **Rachel Blake:** Dr Saleheen, I want to ask about some of the policy reforms, specifically on house building, and their impact on growth. The OBR assessed the impact of the house building policy changes on growth by looking at the overall grey belt land—land capacity—and at the supply of labour in the construction sector. It did not think that the Government would meet their target of 1.5 million homes. My interpretation of what it stated earlier today is that the rate-limiting factor is the construction sector. What is your assessment of the construction sector's ability to step up to meet the Government's house building targets?

Dr Saleheen: I have seen quite a lot of scepticism about whether the Government will be able to meet the target in full, because of skill shortages, as you said—have we got enough people in the construction sector? We know that a lot of people are going to retire. Have we got expertise? Where does it come from? Would that be crowding out some other private sector investment? There is some scepticism on whether the numbers will be reached.

On the estimate of how much it will impact growth rates, when we have looked at some of those numbers, we get a slightly lower number. The OBR's estimate on the level of growth is 0.2%. Our numbers are closer to 0.1%. We are a bit more cautious on whether the impact will be as big as we think and, given the skills shortages, whether we will be able to meet the targets.

Q178 **Rachel Blake:** Which elements reduce the estimate from the OBR's 0.2% to your 0.1%?

Dr Saleheen: Some of it will be the skill factor—have we got that? There is also the pace at which it is going to rise. Have we seen that pace of rise? We have not seen it. It is just being more realistic, given historical evidence on what we have seen. These models use historical data to project forward. That is really the source of it.

Q179 **Rachel Blake:** On what are you basing your assessment of deliverability on the timing?

Dr Saleheen: We are basing it on what history would project forward. We are not saying that we think this is feasible or not feasible from the point of view of talking to construction. It is more that it is a gradual line. We put it in a more formulaic way to see what type of effects we would get in the long run rather than looking at actual figures.

Q180 **Rachel Blake:** Thank you. That moves us neatly on to Ms Curtice. Just based on the new targets, your estimate was 0.06%. If the Government tilt towards travel-to-work areas, your estimate goes up to 0.13%. If they tilt towards cities, it goes up to 0.14%. Can you identify that drop-off from the OBR's forecast? Due to the timing of the report, you might not have been able to consider the national planning policy framework.

Ruth Curtice: We are talking about long-run effects, but you are right to say that our estimates are somewhat more optimistic than the OBR's in terms of the benefit you might get from the planning changes. There is a separate judgment that the OBR then has to make about how much of that effect is additional to its forecast. That is not something that we consider. As we were talking about earlier, it already has a macro view on productivity baked in, so it is almost having to judge how much of this reform is additional to that, whereas our report is about the total effect.

Q181 **Rachel Blake:** On the distributional analysis, there are many families who are not in the right type of accommodation for their own income. That includes people who are paying private rent at a level that is disproportionate to their income and who really need to be in affordable housing. Have you been able to do any distributional analysis of the impact of house building?

Ruth Curtice: That is not something we have done. That is a really interesting suggestion that we will have a think about. It was also welcome to have in the spring statement—or announced a few days before—some additional funding for affordable homes. How many of these 1.5 million homes in the end are affordable homes that will be really important to the distributional effect.

Q182 **Rachel Blake:** Dr Saleheen, have you been able to do some thinking about distributional effects?

Dr Saleheen: We have not. We do not do distributional effects, but I think in general I would say that this is a growth-enhancing policy. It is good news because the mechanisms allow people to be closer to the work areas, so it is good news for raising productivity and GDP. Overall, I would say it is really good news. It maybe does not matter whether we can actually meet exactly those targets or not; the policy is in the right direction.

Q183 **Rachel Blake:** Mr Johnson, would you like to make any remarks on the positive or negative impacts of house building on growth?

Paul Johnson: I agree with the Government's view that this is a very important contribution to growth and a really important problem that we have faced. I actually think they have not gone anywhere near far enough, quite honestly.

Instead of building on the so-called grey belt within the green belt, which might just have to be an old quarry somewhere completely useless, they should be looking at building around commuter stations that have quick links in and probably moving to a zoning system rather than leaving still quite a lot up to local plans, large numbers of which do not exist. I think there is further they could go, but credit to them for doing what they have.

It is really important that the homes are built in the right places, where there is big demand: Oxford, Cambridge, around London, Bristol—those sorts of places. You can see it in the house prices, which are just way out of kilter. They need to be really focused on those kinds of things.

It is worth saying that, in terms of the targets, the OBR numbers are a bit further off than they look, because the OBR is talking about 1.3 million across the UK. The target is 1.5 million in England, so I think there has been a little elision, shall we say, in some announcements, but the general direction is definitely the right one.

Q184 **Chair:** I thank our witnesses very much indeed. We have had an interesting session and learned that, compared with other similar economies, the UK's productivity has not recovered since the pandemic. The UK is an outlier. The OBR's forecast could have been much worse, incorporating market consensus on growth, the impact of tariffs and not increasing productivity growth assumptions.

Every forecast is slightly different, but there are upsides and downsides depending on where you are sitting on this. While the fiscal rules are important, they are not the only metric for markets—there is also the number of gilts the Government need to sell—and the path for economic growth is also important. We talk to a lot of public sector people, so it was quite interesting to hear your take on that, Dr Saleheen.

We heard from Ruth Curtice that the welfare reforms look like ways to save money; not so much to get people back into work. Your highlighting of the fact that the £1 billion for getting people back into work falls into the last year of the forecast, which may well be after the general election, is quite a salutary thing. We have the Chancellor in front of us tomorrow, so your comments and thoughts have been helpful as we prepare to ask her all the important questions about the spring statement.

I thank Paul Johnson for his last appearance in front of this Committee—well, maybe we will have you back.

Paul Johnson: You are welcome to ask me again.

Chair: Well, it will be his last as director of the Institute for Fiscal Studies, because he certainly will not be doing that any longer. I thank Dr Jumana Saleheen and Ruth Curtice very much indeed for their time. The transcript will be available on the website uncorrected in the next couple of days.