



Economic Affairs Committee

Corrected oral evidence: Preparing for an ageing society

Tuesday 1 July 2025

3.10 pm

Watch the meeting

Members present: Lord Wood of Anfield (The Chair); Lord Agnew of Oulton; Lord Blackwell; Lord Davies of Brixton; Baroness Liddell of Coatdyke; Lord Liddle; Lord Londesborough; Lord Petitgas; Lord Razzall; Lord Turnbull; Lord Verjee.

Evidence Session No. 9

Heard in Public

Questions 127 - 155

Witnesses

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

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Examination of witnesses

Richard Hughes, Professor David Miles and Tom Josephs.

Q127 The Chair: Welcome to the Economic Affairs Committee's ninth evidence session of our inquiry on preparing for an ageing society. We are delighted to have, from the OBR, the chair of the Office for Budget Responsibility, Richard Hughes, and his colleagues, Professor David Miles, member of the OBR's budget responsibility committee, and Tom Josephs, also a member of the OBR budget responsibility committee. Thank you so much for your time and expertise. I should state that the session is being broadcast on Parliament Live TV and a full transcript will be taken, which we will share shortly after the meeting so that you can make any corrections.

Can I start with a general but rather dense question? It is not dense from my point of view, but dense, I hope, in terms of the comprehensiveness of your reply. We are interested in the impact of current demographic trends on various features of Britain's future economic life. I am asking you, Richard, to give us a sense of an overall summary. To give you some themes that we would love you to touch on and give us some statistics or conclusions on, we are interested particularly in the impact of demographic change on the dependency ratio over the next 30 to 40 years. We are interested in the impact on borrowing, which we know you have done work on before, and healthcare spending. We are interested in your sense of demographic impact on those key features and some other broad indicators.

Richard Hughes: Thank you for this committee's interest in issues around fiscal sustainability, which is a core part of our mandate at the OBR. It is great to be able to have a further discussion of this after the inquiries you did last year on debt sustainability. For the UK, current demographic trends are likely to place intense and growing pressure on the public finances over the next 50 years, largely through, in our projections, their effect on health, social care and welfare spending, in particular on the state pension.

To give a sense of the demographic trends that drive our 50-year projections that underpin the fiscal risks and sustainability report that we published this time last year, over the next 50 years they are based on the ONS's long-term population projections, which show the old-age dependency ratio increasing from around 31% today to 47% by the time we get to the early 2070s. You are roughly going from having three people of working age for every one person over 65 today to two people of working age for every one person over 65 in the early 2070s.

In terms of shares of the population, that means that the share of young people aged 0 to 15 falls from 20% down to 15%. The share of people of working age, so 16 to 64, falls from 61% to 58%. The share of people over 65 rises from 19% to 27%.

If you take those demographic projections and run them through current government policy settings on things such as demand for healthcare, the welfare system, the pension system and the tax system, you see over the next 50 years that they put intense and growing pressure on the public finances. Government spending rises from about 40% of GDP today to about 60% by the time we get to the 2070s. We assume that government revenue remains broadly flat over that period as a share of GDP. It actually slightly falls, because a number of taxes are falling out of the tax system, in particular fuel duty, as all those electric cars driving around on the roads do not pay fuel duty. The more petrol-driven cars disappear from our lives, you will lose about 1% of GDP in revenue from fuel duty.

You therefore get a gap between spending rising from about 40% to 60% of GDP over 50 years and revenue staying roughly flat at 40% of GDP. That opens up a big gap in terms of government borrowing. At the end of our projection, we had a small deficit of around 1% or 2% of GDP. That rises out to 20% of GDP by the time you get to the early 2070s, based on those demographic and other ageing pressures. That drives government debt into a spiral from where it is right now, at about 100% of GDP, up to over 270% of GDP by the time you get out to the 2070s. Increases in age-related spending are driving much of that increase in spending, borrowing, and debt over the period.

You asked in particular about health. About a third of that overall increase in spending is being driven by health spending. It rises from about 8% of GDP today to about 15% of GDP by the time we get out to the 2070s. Adult social care is a fairly modest share of public spending at the moment, at 1.5% of GDP. It rises to 2.4% of GDP, but that is not a big share of the overall rise. Much of the remaining rise comes from increases in spending on the state pension from around 5% of GDP to around 8% of GDP. Other pension benefits also rise slightly, which means that, when you take the state pension and other pension benefits together, that accounts for about another three percentage points overall of that increase in spending, or about 15% of the total rise in spending.

All in all, you have about 11% of the 20% increase in borrowing over the next 50 years coming from different kinds of age-related spending. The remaining 9% comes from the fact that, as debt rises, your debt interest bill rises, and you get a kind of snowball effect. The other 9% of the 20% comes from rising costs of debt interest on that rising stock of debt.

The Chair: That is a pretty stark picture. Can I ask one follow-up from this? It is a rather broad question, but, in terms of impact on fiscal sustainability in the long term, how much should we be concerned about ageing as opposed to the other huge major challenges, such as climate change, for example, or other long-term commitments? Should the large proportion of the anxiety be reserved for the effect of ageing and its various consequences?

Richard Hughes: In our fiscal risks and sustainability report, we have combined together our reports on risk and sustainability into one

assessment, because we think that those things are related. Both upward pressures and trends can push up debt, but, as we have discovered in the last decade or so, shocks can also push up debt quite a lot and create sustainability problems. We look at a wide range of risks, so not just ageing but also things such as climate change, trade wars and actual wars.

One reason to worry in particular about ageing is that, barring a big and dramatic turnaround in fertility rates, ageing is a certain and relentless process, as we all know all too well.

A second reason to worry about ageing is that actually we have a remarkable number of fiscal policy levers that can impact its fiscal consequences. Although we cannot do much about ageing if we do not get the fertility rate up, you can, through things such as auto-enrolment in pensions, affect how much people are saving. Through the indexation of the state pension you can decide how much you spend on pensions. Through the state pension age you can decide when people receive their pension. Through employment and welfare policies, you can affect the participation rate of older workers.

There is actually much more that you can do about the fiscal consequences of ageing than you might be able to do about things such as climate change and trade policy. In effect, those are shocks where the most important policy levers lie outside the UK, because the concentration of emissions of carbon in the world is dictated by US and Chinese choices about net zero and trade wars. We are more likely to experience the consequences of decisions that the US or Europe make about trade policy, rather than have a big impact on it ourselves.

Q128 Lord Blackwell: You have rightly spoken about the impact on public finances and debt borrowing. I wonder whether I could ask you to comment on a couple of other possible macroeconomic consequences. If the population of retired consumers and their spending rises faster than the rise in the productive capacity of the remaining workforce, does that not mean that there is going to be pressure on the balance of payments? That extra spending, if it cannot be satisfied by domestic production, will cause a balance of payments problem. To the extent that retired pensioners drawing down their savings, which I assume they would do, want to spend it on domestic services, does that not create a built-in inflation problem?

Professor David Miles: It is not so clear, perhaps, what the propensity to spend or consume in old age is, relative to people of working age. There may not be much difference there. It is not so much that there are more older people and therefore consumption will be higher than it would be with more younger people. Obviously, the productive potential of the economy is affected, though. That is undeniable.

Lord Blackwell: My point is simply that a smaller percentage of the population is working.

Professor David Miles: Yes, so the profile of the productive overall potential of the economy is certainly shallower when you have a larger proportion of the population that is in retirement. In the limit, if you had a country that was becoming dominated by people who are outside the workforce, the productive potential would become small. Those people would be running down their stocks of accumulated savings, perhaps. They would be financing it by importing more and more and producing less. There would be current account deficits, which would be matched by the running down of assets.

Whether it is necessarily inflationary is a bit less obvious. You could imagine in the limit that there would simply be balance of payments deficits year after year as they ran down the stock of assets, as a shrinking population is made up increasingly of people who are outside the workforce. I am not so sure about the inflationary impact.

Lord Blackwell: A lot of the services that those people might require may not be importable.

Professor David Miles: Yes, that is fair enough. If spending is skewed very heavily towards non-tradeable goods, the mechanism I just described will be short-circuited to some extent. It would show up as pressure on wages of a shrinking workforce being asked to do more and more services-type work to look after the elderly. To some extent, that might be offset by, in the limit, a country deciding, "We just have to allow greater and greater amounts of immigration to provide the services that we cannot trade by buying stuff from overseas, because they are non-tradeable".

Q129 **Lord Davies of Brixton:** If you think that the two big impacts are going to be from ageing and climate change, there is a big qualitative difference between the two. You can get some sort of reasonable idea where ageing is going, but climate change is a threat of tipping points, so dealing with those things is very different.

Richard Hughes: That is right. We make a decent stab at trying to do some projections around the impact of climate change, so both the implications of trying to get to net zero as a country and the implications of a hotter climate for the UK economy and its ability to generate taxation and what pressures that might put on spending in the health service, but also from extreme weather events and those kinds of things. You have to be conscious that, in these damage functions, as the temperature rises, you see bigger and bigger negative impacts on GDP. Some of those models are fairly linear, but there are models that are much more quadratic and where, as temperatures rise, the damage rises much faster and you can face disequilibria.

As a way of trying to get a grip on things, we tend to take a centre of a range of models that have been produced by the likes of the Bank of England and others to anchor our estimates of the impact of climate change. You are right: there is always the risk that this effect gets away from you. It is not unlike, however, what can happen if your debt starts

to spiral, which can be driven by ageing. Once your debt stock starts to rise and rise and you are borrowing more and more just to roll over your debt, and especially if the interest rate starts to respond to a higher stock of debt, those non-linearities and snowball effects can also show up from letting ageing get away from you fiscally.

Q130 Lord Turnbull: You have highlighted a number of the drivers of this worsening dependency ratio and its impact on public finances. If there are more people post-retirement, they need a lot of healthcare. There is the fall-off in the activity rate of the older workers, those who are 50 to 65, which possibly is amenable to public change. The birth rate may be beneficial, actually. If the fertility rate goes down, more women are staying longer in the workforce.

The one we do not really talk about very much is how long it takes to get a young person productively into the workforce. Fifty years ago, children left school at 16. A lot of them are not even working, let alone getting to the point where they are net contributors tax-wise, until their mid-20s. Is it quantitatively significant that the working age is not just being shortened at the top end but also being shortened quite considerably at the bottom end?

Richard Hughes: Yes. One thing that lies behind all of our modelling is a handy chart that shows your fiscal contribution by age, so a citizen as viewed by the Treasury. You are expensive up until your 20s, because you are being educated, usually at public expense. You receive some welfare support. Once you get to your early 20s, you start to make a modest net fiscal contribution, because you are earning relatively less. You reach your peak fiscal attractiveness to the Treasury by the time you get to your late 40s. After that, you start to think about things like taking early retirement or winding down your hours. By the time you get to your mid to late 60s, you are no longer of interest to the Treasury and more of a pressure on the public finances. As you get further and further into older age, you become a significant net pressure on the public finances.

We assume a lifecycle of earnings over time, which does not peak until you get to your late 40s or early 50s. When you have a falling fertility rate, that means that there is a bit of a demographic window of opportunity in the near term. Debt does not really start to pick up in our projections until you get to the 2050s and 2060s. Oddly, in the near term, things seem quiet because your education costs are falling. There are fewer children to educate and claiming child benefit. As a result, your public finances look a bit cheaper.

You have seen that a bit in the outcome of the spending review, which we saw last month. The Government are managing to reduce spending on education overall, but still increasing spending per pupil, because pupil numbers are falling. The Government reap a bit of a near-term dividend from having fewer young people. The problem is that that is fewer people joining the workforce. When they do, when they start, they are at lower wages, as the baby-boom generation is entering the much more expensive bit of their lives.

Lord Turnbull: Did we not have a target for eliminating NEETs? Have NEETs started to reappear in large numbers?

Richard Hughes: Inactivity has risen across the board, but I suppose particularly worryingly among the young, because potentially that is a lost whole life of contribution to the economy, experience of working and building up skills you get in the workplace. As a fiscal sustainability problem, that is a particular worry, and more so than people taking early retirement. In the end, that would add a few fewer years of paying in tax and a few more years of perhaps drawing on public services.

Q131 **Lord Liddle:** Is it not the case that if, as a result of demographic change, education costs fall, we could actually educate more people? We could aim to have 70% or 80% of our population going to university, in the same way as happens in Korea, I think. Is that not right? Is it not the case that most economists think that education is the greatest driver of productivity? Therefore, you can offset some of the disadvantages for public finances from ageing by getting an increase in productivity of the younger workforce.

Richard Hughes: It is possible if that higher education translates into higher earnings over their lifetime, certainly, yes.

Lord Liddle: You think that there could be some offset as a result of that.

Richard Hughes: If it translates into higher wages, yes. I am not sure what the latest evidence says about the latest cohort of people going into higher education's earnings potential. Slow earnings growth has been a problem for everybody, including people who have recently joined the workforce from higher education.

Q132 **Baroness Liddell of Coatdyke:** Confession time: I am having difficulty with the robustness of the statistics. It seems that we are hiding behind other things remaining equal, that great love of economists when they come to an issue they cannot quite understand. How robust do you think these statistics are? I found it very difficult to get over my scepticism about them, particularly when you start talking about 2070 and so on. Can you reassure me somehow?

Richard Hughes: Two things we are at pains to do always when we produce our publications is talk about the limitations of statistics and explore, to the extent possible, what the realistic scenarios are around all the most important parameters that go into our projections. We can come on to it later in the session, but we look at variants around levels of migration, fertility rates, productivity of the economy and the health of the population looking 50 years out.

That is not only an exercise in humility and saying, "There are lots of ways we could get this wrong", but it also is a way of demonstrating what these projections are actually sensitive to. What are the most important parameters that can change this trajectory? Is it raising the state pension age? Is it changing the indexation of pensions? Is it bringing in more

migrants into the country? Is it educating more young people and boosting their earnings? That kind of sensitivity analysis can be quite instructive because it starts to tell you what the most important policy levers that Government might be able to utilise are to make what, at the moment, is an unsustainable position on almost any scenario that you project and almost any assumption that you could give us to plug into the model, into something that looks more sustainable once you have taken those decisions.

Professor David Miles: You make a profound point. If you had gone back 50 years and asked most people, "What do you think the fertility rate and the rate of net migration in the UK would be in 2025?", they would not have said 1.5-something, or whatever it is, and—who knows? This year it could be 400,000 or 450,000. Over the last couple of years net migration has been closer to a million. Both of those numbers would have been considered complete science fiction in 1975, and yet that is where we are. You are right. Making 50-year projections of where the demographics will be, at one level, is a bit of a mug's game.

On the other hand, I hope that the assumptions we have made in our analysis are at least clear and one can work out, "What would it be like if the fertility rate went back to 2.1, or if net migration fell to a very small number, or stayed at 500,000 or something?" The answer is that you get dramatically different answers. About 50% of the time, if our assumptions are at least central ballpark, the reality may be fiscally better. 50% of the time, things will be, in some sense fiscally, even worse than our projection.

Q133 **Lord Agnew of Oulton:** Thank you for that rather gloomy start. I am wondering whether, as part of your gloom, you have included the fact that most other developing countries will be suffering from a similar problem, and therefore their borrowing requirements are going to go up as well. How elastic is the bond market to cope with this demand? Is the only way for it to cope to put up interest rates to all sovereign borrowers?

Richard Hughes: Let me say a few things about how our demography compares with other countries. Then David may want to say a bit about implications for the bond market and things that are happening domestically in the UK, which are also relevant to pressures on demand for bonds and bond yields here.

Demographically, the UK is in the middle of the pack. It is remarkably average when you compare it to the rest of the OECD. As I mentioned, our dependency ratio is going from the 30s to the 50s over the next 50 years. The OECD average does the same. It goes from 31% to 58% between now and the mid-2070s. Within that, there are countries, such as Japan, that are already where we are getting to in 50 years in terms of dependency ratio. It already has a 50% dependency ratio. It is headed for 75% by the time you get to the 2070s.

Most OECD countries are ageing along with us and most of them do some variant of the kinds of projections that we have. Their public finances also

look like you have a growing deficit and a growing debt issuance to try to finance that, unless you take policy action to deal with it. The risk is that you do get a lot of congestion in global bond markets. To some extent, you are starting to already see some of that coming through. You have seen countries running persistent deficits and borrowing large sums on global markets. David, you might want to say a bit more about what is going on in the UK, but also internationally.

Professor David Miles: Sorry. This is going to sound a bit more gloomy again. Some people, when they look at forecasts such as the ones we have been describing, say, "Of course, it is the same for most other rich countries. They start with a high level of debt, they are running deficits and the population is ageing". They draw comfort from the fact that the UK is in the middle of the pack to some extent. I rather take the opposite view, and I think that your question suggests that.

If lots of countries are going to be trying to sell more debt and are going to have struggles bringing deficits and the debt-to-GDP ratio down, one does not want to be in the same boat. Being in the same boat when the boat is in trouble is not a good boat to be in. You are right to raise the issue. It is concerning, particularly as the rather dire projections we have been describing are ones in which we do not factor in a significant rise in interest rates because the government stocks of debt are rising. If one did that, it would look even more gloomy and the rise in the debt-to-GDP ratio would be even steeper.

There are a couple of specific issues that will hit the UK, I think, which are very much to do with the pension market and the demise over time, or the fading away, perhaps, to close to negligible of at least private sector defined-benefit pension schemes. They hold a lot of UK government debt. They hold a very high percentage of longer-dated UK government bonds. They hold a very high percentage of index-linked government bonds. That has been very helpful over the last many decades and, arguably, has kept the cost of UK government debt lower than it otherwise might have been.

One thing that is almost inevitable is that the size of those DB pension funds, most of which are now closed to new accruals and to new members joining, are gradually going to be declining over time. One strong source of demand for UK government debt will evaporate, unfortunately. You are right to ask the question of who is going to buy all the debt.

Lord Agnew of Oulton: We are struggling at the moment, given our structural deficit, the speed at which the national debt has increased and the fact that the interest rates have all gone up. That is not just here, but we are paying twice as much as the EU countries, largely.

Professor David Miles: Yes, you are right. The Government are having to sell an awful lot of gilts every year.

Lord Agnew of Oulton: There are more short-dated.

Professor David Miles: They are switching toward more short dated bonds. That is likely to be a continuing trend, because it was the defined-benefit schemes that were the buyers of the long end of the yield curve and they are not buying much anymore.

- Q134 **Lord Petitgas:** I want to rebound, because, in a way, you are not saying you agree, but you are heading in the direction of Charles Goodhart and his book, *The Great Demographic Reversal*, where he says that it is somewhat inevitable, given the high levels of debt, low productivity, low growth and, ultimately, ageing demographics, that one of three things is going to happen: a lot of inflation, so erosion of the currency, some form of potential financial repression, or default. I am not saying for the UK, but in general. We talked about the pack. Let us talk about the pack. It is less painful.

Professor David Miles: You are right that there are significant risks. If you take our projection of the 270% debt-to-GDP ratio on unchanged policies, one way to interpret that is that you will not follow that path, because the bond markets will force you off it one way or another, some way down the road. There will be a reckoning and there may have to be a significant restructuring of the role or size of the state to reflect the demographics and diminished productive potential of economies, if productivity growth stays very low.

In a sense, it is not so much a projection of what is likely to happen. It is just telling you that that is an unsustainable path and something has to give somewhere. Defaults and inflation are very painful, as you will know better than I do. They are a nasty way of making the numbers add up. One would hope that one would find a different way around this, but that is challenging.

- Q135 **Lord Liddle:** What is the comparative US position? There is a lot of talk about the present fiscal position being unsustainable in the US. Will it end up in an unsustainable position faster than us?

Professor David Miles: Our US counterpart, the Congressional Budget Office, has equally grim-looking projections for the trajectory the US might be on under what you might call unchanged policies. Actually, policies might not be unchanged, because we may be about to see a big tax cut in the US, which would obviously send you in the wrong direction.

Richard Hughes: It has the slight advantage of being the world's reserve currency and having a very deep and liquid market for US treasuries, but its bond yields are significantly below ours, and ours have been slightly above for the past few months.

- Q136 **Lord Verjee:** Under your central demographic projection, what level of productivity growth would be needed to offset the increases in the fiscal burden attributable to an ageing population? Are there any reasons to think that the level of improvement in productivity is possible?

There is another question. What other big-thinking solutions have been thought of or put around, such as a future generations wealth fund or

something like that? Are there ideas such as that around to help combat this huge deficit that is going to come?

Richard Hughes: Our projections are based on an assumption that productivity growth returns to around 1.5% per year over the long term, which is not back to its pre-financial crisis rates, but significantly above where it is at the moment. If it were to return to its pre-financial crisis rates of growth, so something closer to 2.5%, that would keep the debt-to-GDP ratio more or less flat. It actually falls a bit over the next 50 years.

There is a crucial caveat to that, which is that Governments cannot spend any of the extra money. They have to keep tax rates and real spending where they are as a share of GDP, so you can have no income effect on demand and expenditure for public services. What you have seen in practice is that actually people's demand for public services tends to go up in line with their incomes. Also, the cost of that tends to go up in line with average earnings, which you would assume is going up in line with productivity, because you have to pay doctors and nurses a roughly competitive wage compared to the rest of the economy.

On the abstract question of, "If you had higher productivity growth and left everything else equal"—as one is always suspicious of doing—yes, if you went back to pre-financial crisis rates of growth, everything looks hunky-dory. The question you have to ask yourself is whether that would just mean that we ended up spending more on the health service, education and other things. It is the single most sensitive parameter in our forecast to bending the trajectory of the debt-to-GDP ratio over time.

To give you a sense of the sensitivity, for every 0.1% increase in productivity growth over the 50-year horizon, that reduces the level of debt in 50 years by 25% as a share of GDP. You are solving about 10% of your problem, if you think of the 270% as your problem, with just 0.1% extra growth over the next few years. Yes, better productivity growth would give you more space and choices and get you out of what is currently looking like an unsustainable trajectory, but it requires restraint on the part of policymakers to not just spend it.

Lord Verjee: Is there any evidence we can have to think that we might be increasing productivity? We could decrease productivity, and that is pretty stark as well.

Richard Hughes: Our productivity performance has not been good. One thing that we have tried to do more transparently in our forecast in recent years is to show the effects of government policy on the supply side of the UK economy, including things such as childcare and helping more young parents into the workforce where they can work, earn and pay tax, and public investment and the impact that that has on the capital stock and capital per worker, and therefore productivity. That has shown, in recent fiscal events under both Governments, that modest policy changes have modest effects.

Mostly, you have seen incremental expansions of childcare provision and incremental increases in public investment, which, over time, builds up because you bring more and more parents into the workforce. You also add to the economy-wide capital stock over time, which builds up and can help support productivity growth in future. In the end, you are adding a little bit at the margin to a 30 million labour supply, or you are adding a little bit at the margin to a stock of capital that is anywhere between 200% and 300% of GDP, so you are acting on very large stocks by changing the level of some pretty small flows.

Q137 Lord Londesborough: Can I follow up on the OBR's productivity forecast? As you point out, it is, I think you said, the single most important projection and highly sensitive. It strikes me as perhaps, if I am going to be a little bit controversial, wishful thinking that productivity will go up to 1.2% or 1.5%, I think, by the mid-2030s.

Richard Hughes: In the very long term, yes.

Lord Londesborough: If look at the history since 2008, we have had the digital revolution, which has had enormous impact on our lives, communications, payments, and everything else, and yet over those 16 years I think the average rate of productivity has fallen. It is below 0.4%. Given what has been a very grudging productivity improvement over quite a long period of time, what is it that the OBR thinks are the factors? I assume that AI is one of the factors. It is very difficult to predict. It is going to have to be a material gear change in the economy to get to 1.5% productivity. Many of us cannot remember the last time it was at that level. We are talking about 20 years ago in a very different climate and a very different global economy.

Professor David Miles: You are absolutely right on the numbers. It has been barely 0.5% since the global financial crisis, and that is 17 years ago now. If you looked at the 50 years before that, productivity growth was more like 2.5%. Our 1.5% number is, arithmetically, about halfway between the dismal 15 or 16 years since the financial crisis and the 50-odd years before that, when we got used to thinking, "The UK economy, people's real wages and everything goes up by 2.5% in real terms every year".

Why do we think that 1.5% might have been a reasonable central estimate? It is partly because there are three big things—some people would say four—that have come along in the last relatively short period of 15-odd years. There is the financial crisis itself. There is Covid. Some people would add Brexit. That is more controversial, I think. Nobody would disagree with Covid and the financial crisis as big hits to GDP in the UK, which took quite a long time to recover from, and not yet fully perhaps. Then there is the big increase in energy prices after the Russian invasion of Ukraine.

The view we have taken is not a very sophisticated piece of analysis that we are trying to pretend to the world is clever. If you ask the question, "Where do we think the UK productivity growth will be over the next five

to 10 years?", you answer, "It will be as bad as the last 15". Implicitly, you are assuming there, if that is the view one takes, that three or four very large negative shocks, by historical standards, is now what you should get used to over relatively short periods, so the next 10 or 15 years will be as bad as the last 10 or 15.

An alternative view is that we have had an unusually bad series of very bad shocks, and therefore to look at productivity over that period and say, "That is the new norm for the UK" might be somewhat pessimistic. But we are not going to go back to the 2.5% productivity, which, as Richard said, might be good enough if you could preserve that for the next 50 years, to sort out your fiscal problems. We are absolutely not assuming that. We are assuming you get back halfway. That is, nonetheless, more optimistic than most commentators on the UK, and we get accused of being ludicrously optimistic. Given what we have been saying for the last 45 minutes, it is a bit bizarre to say that the OBR is ludicrously optimistic.

Q138 Lord Petitgas: You are more optimistic than the Bank of England, as we know, because we had the Governor last week and asked this question. I had a different question. On productivity, you connected the decline to shocks. If productivity is relating to innovation and trying to do more with less, I am not sure that shocks are really the driver. It may be other drivers, such as the level of taxation, the level of deregulation, et cetera, that have risen dramatically. Who knows? I just wanted to make this observation.

Professor David Miles: I agree with you that there are other things that do not look like they are going to change very much, which may be behind poor productivity. I should not say, "It is all about these terrible shocks and they are behind us". That is much too optimistic. That takes you down to the ridiculously optimistic, "We will just get back to where we were before the shocks". That is 2.5%.

You are right on taxation. You can push taxes up to a certain extent, but, the further you go, you are going to run into more disincentives for people to invest, join the labour force and all that kind of stuff. We have gone a long way down the higher-tax road in the UK.

I would not want to suggest, "We have just been unlucky for a while. All the bad luck is behind us. It is going to be okay again". I do not want to suggest either that, at the OBR, we are close-minded on this and are going to stick with this assumption, come hell or high water, that productivity over the next 50 years will be halfway between the dismal last 15 and the much better 50 years before.

We are doing quite a lot of analysis on the scope of some things to be better than that. AI is one very controversial issue. A lot of economists think that AI is just a lot of noise and will not do anything to productivity; but others are much more optimistic. We are doing some work on that. Also, we are doing some work looking at historical periods where you have had a load of bad shocks and what happened after those. Was there

much evidence that you get a quick recovery after it? I should say that we are open minded on all this.

Q139 Baroness Liddell of Coatdyke: Putting my scepticism to one side, could you elaborate on the growing gap between life and healthy life plans, how you come to those conclusions and how you factor it into the fiscal projections? I found the graphs 1.16 and 1.19 on the fiscal risks and sustainability very good. Unfortunately, the version I have at the moment does not have the colours on it, which actually makes it very difficult. I wondered how you came to those conclusions.

Tom Josephs: Maybe if I give an overview in a bit more detail on how our health projections are constructed, that will allow me to address that point. As Richard said in his introduction, health spending is the biggest driver of the increase in public spending in these long-term projections that we produce, almost doubling over the projection period as a share of GDP. That is based on an estimate assumption that real annual growth in health spending rises by around just over 3% a year. We produce that estimate looking bottom up at the different drivers of health spending, although actually the number that that produces of just over 3% is very similar to what we have seen in the UK over the last 50 or 60 years, where it has averaged about 3% real a year.

Within that 3%, demography and the impact of changes in life expectancy is a substantial driver. It is not actually the biggest driver. I could come on to talk about some of the other drivers later. It accounts for about 0.6% growth per year within that 3%. That is, in essence, the effect of people living longer, older people obviously being more expensive in terms of their healthcare costs.

We also assume that, as people live longer, around half of that extra time in old age is spent in good health and half is spent in bad health. There are two theories around that issue of morbidity. There is a view that, as life expectancy increases, most of the additional life expectancy will actually be spent in ill health. That would obviously lead to much more pressure on health costs over time. The other theory is that advances in medicine will mean that most of that additional time in later life is spent in good health. Our assumption is broadly in the middle of those two viewpoints.

If you look at what has happened over the last couple of decades in the UK, life expectancy, which was increasing pretty rapidly over the last 100 years or so, is still increasing, but the rate of increase has slowed down quite substantially. Healthy life expectancy seems to have, in the latest data—I think the last 10 years or so—flattened out. In fact, post Covid there are some suggestions that it may even have dipped a bit. That is why we have gone for this assumption, which is halfway between the two possibilities.

Baroness Liddell of Coatdyke: How can you factor in the possibility of something such as Covid happening, or, say, a cure for cancer or something that alters life expectancy? Can you, or is it too difficult to do?

Tom Josephs: No. In our projections, we use the ONS population projections of life expectancy. We do not try to model any specific medical advances in terms of what might be driving those. We look at scenarios to illustrate the uncertainty, going back to the point you were making earlier. In the projections, we have scenarios where we assume higher or lower life expectancy. That makes a pretty substantial difference to the cost of healthcare over the longer term. Those scenarios encompass that possibility of medical advances or further shocks to health, such as Covid.

Q140 **Lord Blackwell:** I know that you said that you did not build up 3% from factors, but you could look into it. You could say, "If the spending at a certain age stayed the same, there is a demographic impact of more older people". There is also an increase in spending at any given age because of advances in medicine. There is also the population getting less healthy. It seems that more people at a younger age are off on sick. Can you give us some idea of how those three compare?

Tom Josephs: To go into more detail of how that increase in spending breaks down, as I said, 0.6% out of the 3% average annual growth is from demography. That is, as you say, because of increases in life expectancy and people at older ages having higher health costs.

The other big driver is an income effect, which is that, as countries get richer, all the evidence shows that people demand more healthcare. We take estimates of that that have been done by the OECD and others, which suggest that that drives around 1.5% of that growth, so almost half of that. In a sense, if that was all you had, you would not have the kind of pressure that our projections show, because you would, essentially, be having spending rising broadly in line with nominal GDP, rather than increasing as a share of GDP. It is the other factors on top of the income effect that drives the increase in spending as a share of GDP.

The other big one is relative productivity in the health sector. This is an issue in other sectors, not just in the health sector, that are very labour-intensive, where you tend to see lower productivity increases compared to the economy-wide average. Because the health sector still has to pay wages that are driven by whole-economy productivity, that means that costs in the health sector rise more quickly than in the wider economy. We use various estimates of that that have been produced from various studies in the UK and globally. That accounts for around 0.7% of the 3% growth, so, again, a pretty substantial part.

We also have a smaller effect from, going to your question, the fact that there is evidence that, across the whole of people's lives, they are requiring more healthcare. There are more chronic conditions that people are suffering from across their lifetime and that are increasing the average costs of healthcare to them. That also drives a small part of the increase.

Lord Blackwell: Are you able to point to any particular health conditions that are particular drivers of this? One of them I am thinking of is the

growth in mental health.

Tom Josephs: We do not attribute that number specifically to a particular condition or set of conditions, but we talk about some of the possible drivers for that. As you say, mental health is one of those. A condition such as obesity is another, where the prevalence in the UK seems to have been rising over the last decade or so.

Lord Blackwell: If Governments over the next 50 years decided that 3% growth per annum was unaffordable, what are the mechanisms they would have to scale that down?

Tom Josephs: We look at two scenarios in particular that are relevant. One is on productivity in the health sector specifically. Richard talked about whole-economy productivity earlier. We look at a scenario where we assume that health sector productivity keeps up with whole-economy productivity over the long-run projection. That makes a very big difference and really suppresses the rise in costs.

The evidence in the UK, if you go back to, I think, since the ONS started producing its latest series on this, is that productivity in the sector has been roughly half of the whole economy. There have been periods, most notably in the 2010s, when health sector productivity was more in line with that of the whole economy. That would make a big difference.

The other scenario we look at is one that goes to your point on wider health conditions. We look at a scenario where we assume that the health of the population is better than in our central scenario through a number of routes. We assume improved life expectancy and reduced morbidity, so reduced time in ill health in later life. We also assume better health during working age. That again makes a big fiscal difference, most notably because you have three channels through which that affects the fiscal numbers. You get the benefits of lower health spending, but you also get the benefits of higher tax revenues, because more people are working and they are more productive, and lower welfare costs through lower incapacity benefits in particular.

Q141 **Lord Razzall:** Following up on that, can we have a bit of an outline of the impact of future changes in the demographic profile of the population as against different workforce participation rates? Which do you think would have the greater impact: improvements in health or increases in workforce participation?

Tom Josephs: In the scenario that I just described, where we look at improved health during working life, and therefore greater participation in the workforce and, as I say, lower cost of health spending, it is the case that the biggest impact in terms of benefits to public finances of the upside scenario—we do an upside and a downside scenario—is more from the impact on working-age participation and then higher tax revenues and lower welfare.

Lord Razzall: Yes, because that is easier to achieve than a change in the demographic profile. It is too late for fertility.

Q142 Lord Turnbull: You have just been talking about the way improved health can lead to higher participation rates, but a lot of people actually have the reverse of that. Health, and particularly mental health, is declining and that is leading a lot of people to drop out. The policy response to that would be not to fiddle around with the value of benefits, but to invest in money, which engages with people, keeps them encouraged and keeps them motivated.

There is also another theory. At the younger end, my impression is that, for many younger people reporting ill health, they are trying to get into the labour force. Their qualifications are not as good or as marketable as they thought they were. Getting a lasting job is a struggle and what they get is despondency. That despondency leads to depression. In other words, it is their experience in the workforce that is actually causing their health to decline, rather than the opposite narrative, which seems to be the dominant one.

Tom Josepfs: In the medium-term analysis that we do and the medium-term forecasts, it is certainly the case that rising inactivity has been a big driver of increases in welfare spending over the past few years, especially since the pandemic. We have done some research, which we have previously talked to this committee about, around what the potential drivers of that are. Is that due to deterioration of the underlying health of the population, including mental health? Is it due to economic factors, i.e. the shock to the labour market from Covid or the cost of living crisis increasing the financial incentives to claim incapacity benefits? Is it due to changes in the benefits system? The evidence shows that probably all of those factors are contributing to different degrees in different time periods over the recent past.

On mental health in particular, it is clear that there has been a big increase in people with mental health conditions and, in particular, young people, claiming incapacity benefits. The specific reasons as to why that is happening are very difficult to discern. It is an important area where more research needs to be done, given the pressures that you have outlined.

Lord Turnbull: That is a theory that treats ill health as the exogenous factor that results in inactivity, as opposed to my theory, which is that the ill health, particularly of the young, is an endogenous factor. The poor quality of opportunities in the labour force is a serious depressant on the mental health of younger people.

Tom Josepfs: It is very difficult to discern which of those two drivers is the most important one in the kind of data that we look at. I agree that it is definitely an important area for research in terms of thinking about what the right policy response is, but it is not something we have particularly looked at.

Professor David Miles: Whatever the mixes of those two factors, in some sense, the policy implication is the same. That is to devote resources to try to help people who have mental health problems and are

outside the labour force, which may be a self-reinforcing place to be in. It is hard to believe that being outside the labour force and completely dependent on benefits is good for your mental health. Whatever the explanation for how you got there is, trying to help people get back into the labour force seems unambiguously a good thing and worth putting resources into.

Lord Turnbull: Have the Government, or past Governments, not done exactly the opposite? Looking at this rising cost, they have been trying to reduce the cost of administering the system and cutting back the advisory, mentoring, face-to-face element of it, which, in the short term, is more expensive. In the longer term, it actually makes things worse.

Professor David Miles: I have great sympathy for that view.

Q143 **Lord Petitgas:** In terms of projections, you have productivity projections. Right now, if you look at these, the percentage of the population that is not active I think is 22%, plus the unemployed; let us call that 3%. That is 25% of the population that could be active and is not active right now. When you look at your projections, is that one variable you play with? Do you say, "We think that before GFC it was 15% and therefore it is going to be back to 18%"? This must be an important variable, or do you not compute it as a variable?

Professor David Miles: It is important. We do not have great expertise in predicting mental health trends—how many people are outside the labour force and not going to find it easy to get back in. That depends, to some extent, on what government policy is to help people back into the labour force with a combination of carrot and stick. We wait to see new developments in policy and will evaluate them when they come along. It certainly makes a substantial fiscal difference for the obvious reasons that you get a double benefit when somebody moves into the labour force.

Lord Petitgas: You assume 25% going forward for the next 10 years.

Richard Hughes: We have a cohort model. Depending on your age, you have different propensities to be in the labour force. It assumes some recovery in participation, given the dip that has happened after Covid. There appears to be some recovery in participation rates coming through.

It reaches a peak around the 2040s, just before you have the weight of the population being of older age and many fewer younger people. In terms of total participation in employment, the total population employment peaks in around the 2040s, but the rate is coming down over time because the weight of your population is more likely to be in older cohorts than in younger ones. You have a declining participation rate over time, just by dint of having an older population, rather than a population that is overwhelmingly of working age.

Lord Petitgas: That number is going up.

Q144 **Lord Davies of Brixton:** There is obviously a very complex relationship

between the health of the population, the expenditure on health and the impact on productivity. Could you elaborate on where you think your central projections for healthcare spending are and how that relates to the general health of the workforce?

Tom Josephs: As Richard said, the projections that we produce are based on an assumption on whole-economy productivity. We also model within that some of the participation effects. As I was mentioning earlier, in terms of the direct impact that that has on the cost of healthcare, an important channel is the one I was describing, where we assume, based on what has happened in the past, that productivity in the health sector itself will be lower than whole-economy productivity. That makes a very important contribution to the rise in healthcare costs as a share of the economy, because it means that costs in the health sector are rising more quickly than output in the health sector.

If you could change that and get productivity in the health sector up to match whole-economy productivity, that makes a big difference in terms of the cost pressures that we are describing in this report. The scenario where productivity rises in line with whole-economy productivity is one where health spending still rises, but there is a much less steep rise than in the central projection.

Lord Davies of Brixton: Is there an extent to which increasing productivity in healthcare in itself increases demand for healthcare?

Tom Josephs: That is a good question. I was describing the fact that we break down the increases in overall health spending into these different drivers: income effect, productivity, demographics. In practice, it is very difficult to really know the importance of those different drivers.

Lord Davies of Brixton: On its own, for example, Ozempic is touted as a miracle drug that is going to cure all sorts of things. If you are going to start giving it to everyone in the population, it is going to be incredibly expensive.

Tom Josephs: The research that we base these projections on looks at the impact of technological change within the health sector and whether that leads to higher or lower costs. The evidence tends to suggest that it actually leads to higher costs over time because you have more new, complex medical procedures that are introduced. As you say, that increases the demand for those procedures. That has driven up costs, rather than reducing costs. The analysis on that is quite uncertain, but we have a small effect in our numbers. A small part of that 3% is due to that finding that technology change tends to drive up health costs.

Lord Davies of Brixton: One explanation for that is that technological change is driven by for-profit organisations that are looking at these expensive drugs and expensive procedures. Is that something you factor in, or is it just reflected in what you just said?

Tom Josephs: We do not specifically look at that. It is certainly the case that the UK is operating in a global market for healthcare. You have

expensive new treatments developed anywhere around the world, in the US for example, and clearly that leads to pressure and demand for those same procedures and technologies, to be available in the UK.

That is why I was saying that looking at the different drivers of healthcare costs over time is not straightforward. What we have described as the income effect in our modelling could capture a lot of the effects that you are talking about there. As people get wealthier, they tend to demand more healthcare and more complex and expensive procedures.

Lord Davies of Brixton: In this country, that is public expenditure. There is one particular issue that you tackled, I think it was last year, but I have read different views on it. This is the idea about what the impact of dealing with waiting lists is on the labour market. You came out quite strongly as thinking that the impact would be pretty minimal, but other people have argued a different line. You are sticking to those arguments. You do not really need to repeat them, because we have had them, but you are still on that line.

Professor David Miles: Yes, we are. It is a bit more gloomy than we thought going into the subject, but maybe the reasons are not so mysterious. It is partly that a lot of people are on waiting lists for something that will make them feel considerably better, but it is not transformational and they can suddenly go back to work. Quite a lot of people are relatively elderly. That is not everybody, of course, on the waiting list. Even if they get more or less full recovery, only some smallish proportion of them might go back into the labour force.

I think that the IFS published something relatively recently, if I am right, looking at how waiting lists affected the overall level of payments of benefits and welfare, which would have included disability benefits and other forms of benefits for not being in work. It found that there was very little link, purely statistically. As waiting lists went up or down, they did not seem to have an awful lot of effect. I do not think that we have seen much to change our view, which is a little pessimistic that you could solve a labour market problem by just getting the waiting list down significantly.

Q145 **Lord Liddle:** Pension age is one thing that Governments can do something about, in theory, anyway. In terms of putting up pension ages, how realistic of a policy is that? How far could you push it? What would its consequences be?

Professor David Miles: It works, or at least it has worked to date, in the sense that there seems to be quite a lot of bunching at the point at which people leave the labour force, and effectively not return to it, around the state pension age. Maybe that is not terribly surprising. It suggests that, if you move it up, to a limited extent anyway, you may find that there is a cohort of people who stay in the labour force longer. That might be quite a long-lasting effect.

Of course, if you try to play the game over and over again in a relatively short period of time, it is very likely you run into diminishing returns quite quickly. This is not going to happen, but if, over the next 10 years, you were to see an increase from today's level to 67, 68, 69 and 70 in a relatively short period of time, that bunching effect would diminish very quickly. It is more likely to be helpful staggered over long periods when there has been some increase in life expectancy before you get to the next point at which you raise the age at which people get the state pension .

For what it is worth, in our projections we factor in something that I think is going to happen. If I am right, between 2026 and 2028, the state pension age will go up to 67. Beyond that, we then factor in another one between 2037 and 2039, when we go to 68, and then, much more speculatively, not until something like 2071-72 to 2073-74, when we go up to 69. The reason that we staggered those a lot is that it takes quite a long time for life expectancy to rise enough for it to seem warranted to go up another year. The evidence to date has been that it probably does have quite a significant effect on labour participation at the ages right up to the higher state pension age.

Lord Liddle: Do you think that, in future, it would help the acceptability of increasing the pension age if, in fact, there was more of a relationship with when you started work? I think that it has been debated in France, has it not? Manual workers who start work at 15 or 16 get their pension earlier because they worked longer.

Professor David Miles: On fairness grounds there is something to be said for that. It may also be that people who join the labour force at very young ages, on average, have lower life expectancy. To the extent that that is true, you get a double hit. You have to wait longer in the labour force before you get a state pension, and then you do not get it for as many years after you start receiving it.

Q146 **Lord Razzall:** Do you think that there is a difference between men and women in this?

Professor David Miles: Do you mean in their response to a higher state pension age?

Lord Razzall: Yes.

Professor David Miles: That is a good question.

Richard Hughes: We have not seen much of one. The equalisation of the state pension age led to more women staying in the workforce for longer. Their response has, in the end, been pretty similar in terms of the impact on their participation rates.

Lord Liddle: You think that, if we kept increasing the pension age, there would be gains in reduced spending costs?

Professor David Miles: Yes, I think so. That is probably right if you space out the distance between every time you increase it by another year to reflect what we hope will be an increase in healthy life expectancy.

Lord Petitgas: On exactly what you just said now, I was wondering whether, with these statistics, you are flattering the curve a little bit. You said that, as life expectancy grows, we will move the pension age further out, but you said also that healthy life expectancy has actually been plateauing or declining. I do not believe entirely the fact that you will be able to push it out if healthy life expectancy stays flat in practice, or, if you do, in effect it is financial repression.

Professor David Miles: If there really is not any increase in life expectancy, or healthy life expectancy, and yet every 10 years you add another year, you are not going to do anything to labour participation.

Lord Petitgas: It helps the model.

Professor David Miles: It helps the fiscal position in the sense that you simply pay one year less. You do not get the added fiscal benefit and get a lot of people then working more, because they cannot, because there has not been an increase in healthy life expectancy. That is right.

Q147 **Lord Davies of Brixton:** I might have got this wrong, but I am a bit puzzled by your practice on how you allow for increasing retirement age. I thought that your practice was that you take the law as it is. The obvious example there is fuel duty, where there is an inflator, and you always shove it in and then the Chancellor comes along and does not. There is a law on increasing retirement ages, and it does not increase in the 30s. It increases in the 40s, but your figures assume that it is going to increase in the 30s. Why do you do that when it is not part of the legislation? The legislation is clear that it is going to increase in the 40s.

Richard Hughes: We followed what I think is basically the Pensions Commission's recommendations on what happens to the pension age.

Lord Davies of Brixton: It is in the law. It is not a forecast of what is going to happen. Pension age increases to 67 over the next two years and in 20 years' time it increases to 68. You are introducing an assumption about when it is going to increase early. Why do you do that?

Tom Josephs: In our medium-term projections, as you say, we are required by our legislation to use government assumptions. In the long term, it is obviously a bit more difficult to do that because there is not government policy set for lots of issues in the long term, so there is a bit more flex there for us to make what we would see as reasonable assumptions.

On that one in particular, my understanding is that the pensions review, that took place, I think, in 2017, made the recommendation that would imply an increase in the late 2030s. The Government basically said that they agreed with that recommendation. That is why we use that as the

basis for our assumption, even though they have not yet changed the legislation.

Lord Davies of Brixton: They did not change the law, so it is a bit of a puzzle.

Richard Hughes: We have to interpret government policy, which is not always what is in legislation but what government have said they are going to do with legislation in the future.

Lord Davies of Brixton: Why do you not do that on fuel duty?

Richard Hughes: We do. Thanks to feedback from your sister committee in the Commons, we now produce two different forecasts for fuel duty, one on the basis on which it is frozen and another on which the basis is what the Chancellor claims is going to happen.

Q148 **Lord Liddle:** A lot of our witnesses have suggested that the most helpful public policy thing that could be done about an ageing society is increasing labour force participation in the 50-to-65 age band. Have you looked at that and thought about what its impact and feasibility would be?

Richard Hughes: In the scenarios that we have looked at that Tom was mentioning, around healthy life expectancy, one thing that drives a better fiscal outcome on the healthier scenario is basically people staying healthier later in life, such that they stay in the workforce. That can make a reasonable difference to where the trajectory for our fiscal projections ends up. In the end, it is, again, about 25% of GDP once you add up the extra tax you get from people staying in the workforce for longer, their earnings potential, what you save on welfare and what you save in terms of health spending. Part of that is a participation effect, from which you get some tax revenue benefit, and they are less likely to be on an inactive benefit later in life, and then part of it is also what you save in other ways.

Tom Josephs: To put some numbers on that, it is the same scenario as I was describing earlier, where we assume better health in working life. In that scenario—it is based on certain assumptions—we have around a million more people participating in the labour market in the long run. That leads to a pretty substantial reduction in government debt compared to our central projection of about 45% of GDP. That is pretty substantial. There are not many changes within the projections that would have that sort of impact. As I said before, that comes from the fact that that has a triple benefit to the public finances from more tax revenues from people working, less welfare costs and lower health spending.

Lord Liddle: The data suggests that that should be a priority.

Richard Hughes: Apart from productivity, it is one thing that has delivered one of the biggest long-term fiscal benefits in the projections that we have done, for the reason that you get a triple payoff from that.

Lord Petitgas: It is not just the ageing society. It is the famous 25% of the population not working. Of that, how many are 55 to 65? How does it all work? I agree. If you think about 25% of the population and 25% of GDP, it is not an unreasonable idea.

Q149 **Lord Londesborough:** Can we lift the lid—that sounds a bit dramatic—or shine the spotlight on two of your core projections, the first being net immigration and the second being fertility rates? Of course, there is a relationship between the two. If we start off with net immigration, I think that the OBR, reliant on ONS population figures, has radically revised your population estimates out to 82 million in 2074 on the basis of a central forecast of net immigration of 350,000 per annum. I think that that is right.

We are at 68 million, I think, now. Without immigration, the population would be falling, so you are projecting a 16 million increase entirely through immigration. It is a critical assumption. Can you tell us a bit more, not just about the total number or the average per annum, but about the assumptions in terms of the profile of the net immigrants in terms of their age, skills or length of stay in the UK? That is going to have pretty major impacts, particularly in terms of fiscal.

Professor David Miles: Yes, it is, very much so. Not surprisingly, the purely fiscal impact of immigration being substantially higher for a long period of time than historically it has been depends very much on what kind of people arrive in the UK, in terms of what their average earnings are, what their participation rate is and how long they stay in the UK. Those are three big factors.

It is no surprise that, if people arrive in the UK and, for a given group of immigrants to the UK, a high percentage work, and they earn either at or above the average salary of people already in the UK, particularly if they stay for 10, 15 or 20 years but then leave before they get to retirement age and get the state pension, that is the most favourable set of assumptions you could make. In a purely fiscal sense, that would be great. That would dramatically have an impact on the fiscal position. On the flip side of that, if the participation rate of the group of people that arrive is no higher than the UK domestic population, or even lower than it, and they only earn significantly less than average earnings, and those people go through what you might call the fiscally favourable parts of their lives, so arrive in their mid or late 20s, work for 30 years, but then stay and receive the state pension, that is at the other end of the spectrum.

We show some simulations just focusing on the average earnings story. There is a chart—I forget which one it is—in last September's fiscal risk report that shows that, on average, for those immigrants to the UK who work earn 30% higher than the average earnings in the UK, by the end of a 50-year horizon that has reduced the stock of debt, relative to an assumption that people who come to the UK and then work only earn the average in the UK. That is worth almost 40% reduction in the amount of debt relative to GDP.

On the other hand, if the people who arrive, other things equal, have the same participation rate as the UK population but earn only 50% as much, that would send the debt-to-GDP ratio higher by something like 80%, so very unhelpful in a purely fiscal sense. It matters. In a way, it is obvious. It matters hugely, from a fiscal point of view, what kind of people are coming into the country.

Lord Londesborough: In the near term, while we are talking about 350,000 being the average run rate, we have seen net migration of around 800,000 in the last two years. You are projecting that coming down to 250,000 in 2027, which is only two years away. Is that a forecast that is going to hold, or is it likely to have to be revised, given particularly—I will come on to this—our plummeting fertility rates, which show no sign of turning around?

Professor David Miles: You are right that we use ONS projections, which, if I am right, are now slightly above the 315,000 number that we used, as you correctly said, back in September. That number will be a little bit higher. I think that it is 340,000 now. It has come down a lot from the extraordinarily high numbers of the last few years. It looks, perhaps not surprisingly, as though the changes to the visa regime and the fact that it is much more difficult for people to bring dependants in now than was the case in recent years is having an impact. We expect that that will last. Implicitly, we are assuming that that will last by using those 300,000 or 340,000 numbers projected further ahead.

As we said earlier, predicting over many decades is, in some sense, an impossible task. Who knows what future Governments will do on the levels of net immigration, to the extent that they can control them anyway? We do not have our own clever models about how the politics will play out and what the plausible number is 30 or 40 years from now. We take those ONS numbers and say, "Supposing this happened for evermore..."

Lord Londesborough: Turning to fertility rates, your FRS report back in 2018 was assuming a birth rate of 1.84. You have radically reduced that to 1.59 in last year's report. It is, in fact, now 1.44. Organisations such as the *Lancet* are projecting that it is going to fall to 1.30. This is not a UK issue; it is very much a G7 or G20 developed world issue.

Your projection of 1.59 strikes me as optimistic, if you think it is a good thing. There is a general consensus now that we need to try to get our birth rate up, although I do not think that there is a single country in the world that has demonstrated policy that has actually delivered any sort of turnaround. I know that countries such as Italy, Korea and Japan are ahead of us on that. It strikes me as an optimistic forecast of the fertility rate from the OBR's point of view. Ultimately, is this going to bleed into the need for higher immigration?

Professor David Miles: It may well be so that the 1.59 number is something that we have to revisit and move down. As you say, among rich countries, the UK fertility rate is actually above the average. If you

thought that we were going to converge on the rich country average, we would be going down further.

Whether the right response to that is to have, let us say, higher immigration than the ONS projection, so the 340,000 number, as it now is, as far ahead as you look is a bit less obvious. That is partly because it depends on what kind of people arrive. Also, for a whole bunch of reasons, there are problems with the idea that we need an ever-growing population in the UK to offset the demographics—which in an arithmetic sense it does. If you have a rapid growth in the population, it is helpful in the demographic structure sense, but you create a whole load of other issues about the creaking infrastructure, whether that can keep up with an ever-rising population, the difficulty in building yet more houses, and public sector infrastructure coming under yet greater strain if the population just rises and rises. If you have targets on pollution, emissions and net zero, that pretty unambiguously gets more difficult if the population is rising 500,000 a year every year.

Q150 Lord Petitgas: Let us finish with the fiscal framework. There are some who will say that maybe it should be thought about more strategically. Otherwise, it leads to all sorts of very short-term fine-tuning and, in a way, often very short-term decision-making. As we think about the ageing society, which obviously is very long term, do you think that it is “fit for purpose”? Are there things that you would like in the fiscal framework as we make our recommendations or review it to see changed or incorporated?

Richard Hughes: We have to be a bit careful because we are not allowed to give policy advice to Governments, but we comment on the features and risks associated with different kinds of fiscal frameworks. One thing that has been very notable about the kinds of fiscal rules that recent Chancellors have had has been that, in effect, they attempt to stabilise debt after a shock. Nearly all the fiscal rules we have had have been about getting debt to fall in five years’ time. Sometimes that horizon has been rolling forward, as is the case with the current fiscal framework.

Those rules have said is that, coming out of a shock, stop your debt from rising and get it to fall ever so slightly in the fifth year of the forecast. Because those rules have been changed several times and the deadline has been pushed out, in effect you see a ratcheting up of the level of debt over time. In this country, really since 2010, we have not experienced a sustained period where we are actually reducing our debt and rebuilding some fiscal space, either to prepare ourselves for the next shock or just to get ahead of some of these demographic pressures, which we know are going to put upward pressure on spending and potentially also downward pressure on receipts if the workforce shrinks.

The fiscal frameworks we have had for a while now do not really deliver that kind of rebuilding of fiscal space in the wake of shocks. They give Governments relatively long time periods in which to just stabilise the debt-to-GDP ratio. What we have experienced over the recent past is that

that is too late. The next shock hits you and the next thing you know your debt is even higher. That was less of a worry when interest rates were low and you could borrow very cheaply. Now, with interest rates at 4.5% at the 10-year mark, having extra debt starts eating up your fiscal space that you have to deal with these other pressures we have talked about.

- Q151 **Lord Blackwell:** We have been dissecting all the various components that lead you to this scenario of government spending rising in 50 years' time to 60% of GDP and the implications of that for borrowing. You have said that, at that level, it would be unsustainable. Do you regard this report and the projections in it, given all the uncertainties, as interesting academic background for the Government, or do you see it, and should we see it, as a clarion call for urgent action?

Richard Hughes: It is certainly the latter. I will tell you a story, which is that, 25 years ago, when I started work in the Treasury, we used to do this kind of projection when debt was at 30% of GDP. The number used to get up to 100% and everybody would say exactly what we have said at this committee, which is, "That will never happen. Somebody will do something before debt gets to 100% of GDP. The Government would never let that happen. The electorate would never let that happen". We are there. We were projecting that to happen in 50 years' time and we are already there in 25 years' time.

To some extent, this is a clarion call to worry about these kinds of issues over the medium term, but many of these things will happen faster than you think. They are already happening quite quickly in a number of countries. This is just the baseline projection of the things that are reasonably certain are going to happen. On top of that, you have all the shocks that have hit us and will almost certainly hit us in future, which add to that pressure.

The Chair: I am afraid that you have opened the door to Lord Turnbull. He probably was running the Treasury when you started.

Richard Hughes: He was indeed.

The Chair: He is now going to pounce in.

- Q152 **Lord Turnbull:** In the period where debt rose very sharply, the pain of that did not immediately appear, because there were then about 10 years where debt doubled, but debt interest as a share of GDP stayed exactly the same. It was still 2% of GDP. The alarm signal that you would normally get from a rise in debt did not happen. It came about 10 years later, i.e. about now. That is why I think that a sharp rise in debt is unlikely to have the same delayed effect of the interest cost.

Richard Hughes: As maturity shrinks, you get more of that feedback. That is one reason why some people say, "Just rely on market discipline to discipline Governments. Do not worry about forecasts, projections and everything else". The problem is that, by the time you are feeling the market discipline, it is too late. You already have the debt stock and the

cost of it has risen. There are big benefits in looking forward and trying to prevent that

- Q153 **Lord Blackwell:** I know that you could not say it, but I think that a number of us are worried that the scale of this challenge is not properly reflected in the public debate or political debate. If we were to make the point that this was something that needed much more urgent attention, I do not think that you would be disagreeing with that.

Richard Hughes: No. We have the second-highest deficit in Europe at the moment and it has been stuck at 5% of GDP for four years now. We need to have the fiscal debate in the country that is in that position.

- Q154 **The Chair:** I know that you are not allowed to offer policy advice either to a parliamentary committee or to the Government. Purely measured in terms of the quantum of impact that you could make on the fiscal consequences of ageing over the medium term or long term, what policy lever would one choose to pull in order to have the biggest effect in mitigating the kinds of consequences that we have been talking about today? Which policy space would we be looking at? I know that it is an unfair question, but I am asking it.

Richard Hughes: I will also give my colleagues a chance to get into trouble. In terms of the thing that you want to have an effect on, we cannot advise on policy, but one thing that our numbers have illustrated is that, if you can make a meaningful long-term difference to the rate of productivity growth, that makes life hugely easier for you. We have tried, in the course of putting our forecast together, to show what the dynamics look like. Some policies that Governments have introduced, we think, will make a meaningful and measurable difference to the rate of productivity of the sort that can help alleviate some of those pressures.

Lord Razzall: Would you not also suggest improvements to health?

Tom Josephs: On the health side specifically, the thing that we have looked at in our projections that makes the biggest difference is productivity of the health sector itself. If you can get that rising broadly in line with the whole economy, or even higher, that helps deal with a lot of these pressures. If you can find a way—it is very difficult, obviously—to improve people's health over their lifetime, with more preventative approaches, for example, that can also make a big difference, but that is not easy to deliver.

On the pension side, as David said, the two big pressures are demographics and the triple lock, which, when you project it over the long term, is a significant upward pressure on the cost of the state pension. We are doing more analysis on that in the next of these reports, which is coming out just next week. There will be a lot more numbers for you to digest in that one on pensions.

The Chair: Good. We will look forward to that.

Lord Davies of Brixton: Could I register a particular interest in that? I

am away, but after the recess I would really value the opportunity to have a more detailed technical discussion about whatever figure you come up with. I suspect that I will disagree with it, but I want to understand it.

Professor David Miles: Two of my three things are very difficult to achieve but could be very effective. The third one might be a bit easier, although I am not even sure about that. Productivity: who does not like higher productivity? It is win, win, win, but, then again, governments have been saying that they are going to raise productivity for all of my life.

Participation rate in the labour force is the same story in a way. It has always been helpful to have people who are out of the labour force, and particularly if they are not in training and are relatively young, get back into the labour force. That would be very helpful fiscally, but, more importantly, because of the welfare of the people.

The third thing that would be very helpful would be, if I may say, a greater degree of realism among the electorate about what the state can do. One thing perhaps that has lagged behind the facts over the last 15 years, is the realisation that the level of GDP in the UK is somewhere between 25% and 30% lower than most people thought it would be before the financial crisis. That reflects 15 years of terrible productivity growth. Despite that, people's expectations about what the state can do and its ability to help buffer them against the effect of negative shocks has, if anything, gone up, while the ability of the state to actually do it has clearly gone down. Greater realism would be very helpful.

Q155 **Lord Turnbull:** One thing I thought you might mention is the graph that shows that at age 50 roughly 70% of people are working and then it falls away. By the time you get to 70, it is probably around about 20%. Tilting that thing back upwards again seems to me feasible and quite beneficial. It may mean that people have to change jobs. They may not be able to just stay working longer in the same job, so they may need help to change jobs. There is an untapped pool of activity there, it seems to me, that we could work on.

Professor David Miles: I agree. That is one that is not just the least painful, but actually everybody could be better off as a result of that, including the people who do not drop out of the labour force and work a bit longer, or many of them, anyway.

The Chair: With that, particularly as we are all in the sweltering heat here, thank you so much, Richard, David and Tom. Thank you so much for your collective wisdom from the OBR. I guess that one man's realism is another man's gloominess, but you brought us a lot of good data and candour in your view of the future of the public finances and the way that ageing is going to affect them. Thank you very much.