HOUSE OF COMMONS

Treasury Committee

Oral evidence: Spring Budget 2020, HC 214

Monday 16 March 2020

Ordered by the House of Commons to be published on 16 March 2020.

Watch the meeting

Members present: Mel Stride (Chair); Harriett Baldwin; Anthony Browne; Felicity Buchan; Ms Angela Eagle; Liz Kendall; Alison McGovern; Alison Thewliss.

Questions 1 - 36

Witnesses

I: Torsten Bell, Chief Executive, Resolution Foundation; Paul Johnson, Director, Institute for Fiscal Studies; Diane Elson, Chair, Women's Budget Group; Professor Linda Yueh, Oxford University and London Business School.

Examination of witnesses

Witnesses: Torsten Bell, Paul Johnson, Diane Elson and Professor Linda Yueh.

Q1 **Chair:** Good afternoon and welcome to our session on the spring Budget 2020 inquiry. There are three panellists facing us today, but we have a fourth, Diane Elson, joining us by audio feed. I am going to start by asking our panellists to introduce themselves briefly to the Committee. Thank you.

Diane Elson: This is Diane Elson. I am emeritus professor at the University of Essex and adviser to the UK Women's Budget Group.

Torsten Bell: I am Torsten Bell. I am the chief executive of the Resolution Foundation.

Professor Yueh: I am Linda Yueh. I am a fellow in economics at St Edmund Hall, Oxford University, adjunct professor of economics at London Business School and a visiting professor at LSE IDEAS.

Paul Johnson: I am Paul Johnson. I am the director of the Institute for Fiscal Studies.

Q2 **Chair:** Thank you very much. Welcome to our session. We will try to get through by 5.45 latest today, because there is going to be a statement on corona and we are anxious to hear it.

Can I start with corona? When the OBR set out its forecasts, it did so at a point when the coronavirus was largely contained to China. It certainly would have had no inkling at that point that it might have end up as a global pandemic, as it now is, with the implications of that. Is that forecast worth the paper it is written on?

Torsten Bell: No, but, to be fair, the OBR said so and some of the Chancellor's language reflects that. Particularly if you look at the short term, the forecast is 1.1% for this year and 1.8% for next year. That is in contrast to the OECD's slightly more recent but still out-of-date forecast of about 0.8% for both those years. Forecasts coming out today point to recessions this year for most developed countries.

If you are going to take anything away from the economic forecasts, it should be the bigger picture they paint, which is just weaker growth at the back end of the period, even without the impact of the coronavirus, based on pessimism about the productivity and capacity of the economy. In the short term, no, we should base our views about what is happening now on real-time data insofar as we can have it. You will have seen the data from the hospitality sector and bits of the retail sector over the weekend. That is the best we have. As we learned in 2008-09, it is far from perfect. We are very bad at judging what is happening in real time to the economy, but it is definitely not a question of whether the economy is growing by 1.1% or 0.8% this year. The question is probably how much we are shrinking.

Professor Yueh: I would stress that it is just very hard to know right now what the impact of the coronavirus is going to be. We have some scenarios that various think tanks and economists are working towards. I will start with the global economy and then focus on the UK.

For the global economy, there is an emerging view that we are probably heading towards, if not already in, what would be considered a recessionary time. Global growth below 2.5% is widely viewed as recessionary. This is very difficult to assess. The coronavirus is a crisis; it is both a demand and a supply shock. It affects major economies and, broadly speaking, almost every sector of the economy. This is very unusual. That suggests that we are still trying to work through what the impact might be.

Taking it to the UK, as you all know, growth has essentially been stagnant since last October. The latest figures from the ONS suggest that the economy is probably not expanding; it is stagnant. We are already at a point where a downside shock is likely to tip the economy into a contraction of GDP. That will probably show up in the second quarter. I say "probably", because it is hard to know how much of the impact we will feel this month, in March. The coronavirus really started to affect supply chains in the earlier part of this quarter. Again, it is quite uncertain. If we were to head into a recession, it would not be out of line with the expectations for other major economies. We would be in sync with what is happening globally.

Paul Johnson: I do not have a great deal to add. You ask whether it is worth the paper it is written on. It is valuable in the way that it described the situation that the coronavirus hit: weak business investment, weak productivity growth and weak expected growth over the next two or three years. When you layer this additional shock on top, we are more likely to get a deeper recession than if the economy had been whizzing ahead with high productivity growth and so on. It gives a useful backdrop to what is happening now, but, as a forecast for what is going to happen over the next couple of years, no, it is of no value at all.

Professor Yueh: The OBR said that the fiscal measures announced by the Government added about 0.5 percentage points to growth. That is a pretty sizable statement. Even though the growth forecasts were out of date because they were done by mid-February, the fact that the fiscal measures intended to combat coronavirus were incorporated gave you a sense as to how much support fiscal stimulus or fiscal spending was giving to the economy. It is sizeable, and it is worth noting.

Diane Elson: I would echo the points that the others have made and emphasise that this is happening in an economy that is already weak and, particularly, with public services that are already weak. It is going to be particularly hard to deal with this.

Q3 **Chair:** A major feature of the Budget has been a loosening of spending, not least investment expenditure and the 3% rule. Is the 3% rule about right? Why would it not be more than 3%? If we have these historically low interest rates and Governments can borrow at very low rates, why would we not go beyond 3%? Subject to the cap of not exceeding 6% of Government receipts, why would we not go beyond that?

Paul Johnson: There are a couple of points worth making. First, there is a particular set of things defined as investment and then a particular set of things defined as current spending. Where we are going at the moment is towards very significant looseness on the investment side. It will be quite difficult for the Government to find good-value things to spend on in the next two or three years up to that 3% cap on the investment side while, at least as was set out in the Budget, the amount of money available on the non-investment side is still very tight.

There is a serious question as to whether, even given what we have at the moment, you are going to get the optimal allocation of resources. If you want to invest in the future, it is not obvious that a road is better than investing in schools, education, early years or what have you. There is that issue. Again, what we are talking about here is all pre-coronavirus, in a sense.

There is a second issue about the level of deficit and debt going forward. If you were to raise spending further, even pre-coronavirus, you would have debt beginning to be on quite a swiftly increasing path. That is okay for a while; we can clearly afford that, but in normal times you do not want debt to continue rising forever. The 3% limit draws a reasonable balance between what is deliverable and what you might be concerned about in terms of fiscal sustainability in the long run.

I suppose one of the surprises was how quickly the Government wanted to get to 3%. To be honest, I assumed they might look to move there a little more slowly and get there towards the end of the Parliament rather than 2022, as they were suggesting. In the short run it looks ambitious, rather than the reverse. In the long run you might be able to do a bit more, subject to your overall fiscal situation.

Q4 **Chair:** Can I ask you, Paul, very specifically about the 3% rule? The OBR assumes that only 80% of that spending will occur. If you rely on what the Government say they are going to do, is it not the case that you would breach the 3% rule? If that is the case, it seems a rather odd way to manage these forecasts.

Paul Johnson: I am not sure whether that is what they said. As I understand it, the OBR was thinking that 20% of the increase would not occur rather than 20% of the 3%. The Government were talking about aiming for 3% rather than aiming for 3% or more, but we do not have anything like the full set of projects that they want to fund set out. Only about half of the additional spending is set out, so we remain to find out what the particular plans are.

Torsten Bell: It is worth saying that, at least in theory, the 3% is an average. In theory, there might be underspends, because, as Paul rightly points out, we have what you would call stretch targets in the early years for the capital ramp-up, which is probably driving a lot of the project selection. A lot of the capital that has already been announced is going into R&D, for which you do not need a large construction team; you just need some scientists to accept a large cheque, which they probably will, reluctantly.

You have a stretch target. In theory, they can average and take some underspend later. If they do not get to 3%, they can spread it over five years, if they want. In practice, they may want to treat the 3% as an actual limit. The thing to think about is what purpose it serves. Does 3% have an economic justification? No, there is no reason why it is 3% versus 3.3% or 2.9%. What we are really saying as a country, which is an issue of reasonable cross-party consensus, is that we are aiming for a higher level. It is showing you the direction, which is, from today, up, and up quite quickly. In the medium term, there is no challenge with spending three years, or even slightly more if you want, choosing to have a country with a slightly bigger construction sector and slightly smaller other sectors. That can happen; that adjustment can take place. Can it happen really quickly? That is a challenge.

On the big picture, why does the Treasury want the 3% rule? It is not just for its fiscal impact. It is a spending-control device, to make sure that, in a world where everybody wants to see more capital spending, you have a mechanism with an envelope for your spending that is provided by the current-balance rule on the other side. It is not fiscal policy in the macro sense, but it is a reasonable thing for the Treasury to want to have. Is 3% the right number? Reasonable people can disagree. In my view, moving further ahead beyond this period, there is a good argument that we will want higher investment levels than we have had in the past. Climate change is the most obvious example where you could wish to have a significant step change, but that all depends on your view on the private/public sector split in how we manage the costs of transition.

Where does that fit into the bigger fiscal picture and everything that Paul was talking about? The big change going on is that we have moved, in quite a short space of time, slightly under two years or two years, from a world where we are targeting an absolute surplus, i.e. zero borrowing, to—this is not what the words in the Budget say—basically targeting £60 billion of borrowing a year. That is actually what is going on: we are going from zero to 60.

Two years ago we were targeting debt falling quickly. If I am honest, we should all be clear about what this forecast means. Coronavirus is a really good illustration. If your forecast regularly shows debt just flat-lining, what you are actually tolerating, as a policy, is debt rising, because crises happen, as we have just learned. We are going to be ratcheting up our debt-to-GDP ratio in those times. That is the right thing to do in that crisis; that is the right time to borrow. Luckily it is very cheap to do that, but there is a lesson here. If you target flat debt, do not say to yourself that you are actually targeting flat debt; what you are actually targeting is flat-ratchet-flat-ratchet. That is the experience of the last decade, broadly, for us, not for all countries. That is about to happen again today.

Professor Yueh: Having some type of guideline rather than a rule might be what we are really discussing. Since at least the 1990s, the UK has underinvested, as a share of GDP, both publicly and privately, relative to other G7 countries—it is actually at the bottom—so to go from around 2% of GDP investment to, say, 3% is a very big jump.

There are slightly different cuts of the OECD data, but, roughly speaking, since 1997 3.5% of GDP is the average public-investment ratio for other G7 countries, including the UK. For the UK to make up lost ground, realistically, it will probably have to lay out some pretty concrete plans by the autumn Budget to see where the investment is going to be. I would focus more on that and suggest that this 3% of GDP is a guideline. It may well be revised, depending on the scale of the projects.

On the overall picture, there is a lot of ground to make up, especially on the levelling-up agenda. There will have to be more investment, but you perhaps need something to guide the overall investment picture relative to current spending to get the overall picture of current versus capital spending.

Diane Elson: One problem is the straitjacket of the distinction between capital and current spending, which has now outlived its usefulness. I am glad the Chancellor is going to revisit the fiscal framework, because at the moment it pushes us towards an overinvestment in things and an underinvestment in people. We are allowed to borrow for hospitals but not for nurses, and we are going to see some problems of the lack of investment in people in the impact of the coronavirus crisis. We should definitely revisit the distinction we have at the moment between what counts as capital spending and what counts as current spending.

Secondly, we are going to see an increase in household indebtedness as people try to cope with the impact of the crisis. All things being equal, it is better for Government borrowing to rise, because Government can borrow for all of us at much lower rates of interest than individual households can. When we are looking at Government debt, we have to bring household debt into the picture as well.

Q5 **Harriett Baldwin:** On the economic impact of the coronavirus, both Mark Carney, the former Governor, and the Chancellor last week used the word "temporary", but I picked up from all the witnesses that there is going to be both a temporary and potentially a permanent impact. Is that correct?

Torsten Bell: The most important thing to say is that there will be a big impact. Too much of the discussion at the moment has focused on the idea that you are going see people off work for two days and they need sick pay to cover that. We need to step back and think more realistically. We will see a much broader economic effect, with large numbers of people losing their jobs, hours being cut and businesses in trouble.

The main thing to say is that, in the short term, there are reasons why elements of it are definitely temporary, but it is bigger than a lot of the conversations are suggesting. We are not talking about knocking a few more percentage points off our growth this year. On the temporary bit, the job of policy is to make sure as little as possible of the temporary effect becomes permanent. That is why what the Government did on support for businesses is welcome. The objective to stop a supply shock becoming a permanent supply shock to those businesses is really important.

Sometimes in this discussion, people say, "We should not be helping the firms; we should help the people". As I will come to, we think we should do more to help the people, but supporting firms so they do not have to increase unemployment by more than would otherwise be the case is a really important part of what is going on. Keeping people attached to their firms while they have problems with supply chains or sales is definitely worth doing.

The size of the permanent effect is hard to know. As you say, the workforce will be back at work at some point. Insofar as it is partly about individuals not being able to provide labour, the drive for the supply shock will go. But what have we learned from previous recessions? First, when we see these kinds of effects turning into broader demand shocks because our behaviour changes and we sensibly cut back over the coming years, it is going to have a lasting effect. When it comes to business investment, which has been weak in part because of expectations of future slow growth in the UK, insofar as that does not happen, that also has a permanent effect.

Professor Yueh: It is hard to know how long the crisis will last. The fiscal measures and everything we are discussing are premised on this being a temporary, shorter-term shock. How do you prevent something like this from translating into longer-term problems with the economy? There are a number of things to bear in mind.

The first is what economists talk about a lot, which is hysteresis. It is this idea that, if people lose their jobs, it becomes harder to re-join the labour force and you damage the potential growth rate of the economy. One of the priorities in this kind of crisis is to think very hard about helping workers and firms go through a temporary shock so they do not lose workers. We may come to it later, but we should think about programmes like those other Governments in Europe have done. I am thinking about Denmark, which has essentially said that, if you keep your workers, the Government will pay 75% of workers' pay, while the firm pays 25%, for a three-month period until the beginning of June. Those kinds of measures are intended to ensure that you do not, because of a temporary shock, cause people to lose their livelihoods.

For companies, the key is to make sure that viable businesses do not go under as a result of this shock. Obviously, some businesses have cash-flow problems or need liquidity help. The key to ensuring this is just temporary is to provide enough support. The German Government have announced they will provide unlimited credit up to €500 billion to help businesses that need cash during this period. Those are probably the overriding principles. Perhaps we can talk about the details later on.

Q6 **Liz Kendall:** Have the UK Government done enough on coronavirus compared to other countries?

Paul Johnson: They have not done enough yet. In a sense, the situation has developed since the policy was put in place. I would be astonished if the Chancellor did not come back with more in the coming weeks as we see the impact increase, and we will see that increasingly in the data. The set of things in the Budget all made sense, and they are broadly moving in the right direction. At the time they were drawn together, they may have looked like the right sort of scale, but it has become clear even in the last week that the scale of the impact is going to be bigger than it appeared to be previously.

No, there is not enough there, but the Chancellor said he would come back and do more if need be, and I would be astonished if he did not.

Q7 **Liz Kendall:** Just so you know, Diane, everybody is nodding here on that point. What more should the Government be doing? Should the Bank of England also be doing more? When we have seen other central banks act, it has not necessarily had the impact they might have wanted. I wonder whether I could ask everybody what more the Government should do.

Torsten Bell: There are a lot of components in that question. I am with Paul, in the sense that a lot more needs to be done, not just a bit more. If we go through each in turn, on monetary policy, roughly, if we look at the response so far from the Bank of England, it is very small, under any traditional measure of monetary policy, compared to the response to the financial crisis, partly because we cannot cut rates as far. That is the main reason: we have cut by 0.5%, and we cut by 5.25% back in the financial crisis.

We have so far not reinstated a QE programme, although I am sure that is our next step. Even if we take into account an ambitious version of that, both Governors, the previous one and the one just appointed, have said they think there is roughly the equivalent of a two percentage point cut of traditional interest rates. In our judgment, that is optimistic. It is not clear that is true, but there is not much to be done.

What is true—and it has been larger this time—is the usefulness of direct support for lending. The additional schemes that have been announced are more ambitious in some ways, and there are reasons to think they might be slightly more effective. They do not require as much intermediation; they just give bank reserves to lenders; they have a wider share of banks involved; the pricing of the credit is cheaper. There is reason for thinking that is bigger, and traditional monetary policy has not gone that far as yet and does not have that far to go.

If we turn to the Government's part of that agenda, it would be fair to say the Government last week went further than many people expected, with direct payments to some small firms of £3,000, underwriting of statutory sick pay and underwriting of lending to small firms in particular. If you compare that to the German package, the main standout thing that is not in there is how to deal with big firms that get into trouble. There is more lending to big firms in the German approach. That is harder and involves larger risks. The airlines are the most urgent issue that people are going to have to decide about.

We then come to individuals. As I say, the action for firms will help individuals, because they will not lose their jobs in the same numbers. Direct support for individuals is much smaller than anything on firms. That is probably the area in most urgent need of coming back on.

We break this down into three areas. First—this is where the focus was until recently—what is the help for people who actually get sick so they can self-isolate for two weeks? Our main tool there is statutory sick pay. The Government have done useful things such as reducing the waiting period for that so you get paid it on day one. That is valuable. They are paying firms for some of that as well. What they have not done, which is a serious problem, is deal with the fact that 2 million workers who earn below £118 a week are not entitled to any statutory sick pay at all. That is surprising, because the Government have consulted on providing statutory sick pay to people below that limit. That is in urgent need of looking at. That ensures people get some money without having to go to the benefits system straightaway for those first two weeks.

What has changed since the discussions at the beginning, a fortnight back, is that we should be thinking less about the economic impact on individuals as coming from being sick for two weeks. We should be thinking much more about big income shocks from losing your job, your hours being cut and your firm going under. If you look at work by the World Bank and others on where the overall economic pain comes from during pandemics, the overwhelming majority is not from health effects directly; it is from the wider effects on the economy feeding back into people's living standards. You do not address that with traditional statutory sick pay.

That brings me to the second point, which is that you need to improve statutory sick pay. You need to broaden its net; you should probably also increase its value. The normal safety net is two weeks. It was not intended to do this, but in freezing benefits for the last four years all we have done is to reduce the replacement rates and how much support people get when they lose their jobs. That was bad policy for the individuals; it is pushing up child poverty, but now it is also bad macroeconomic policy. It means we have a weaker set of automatic stabilisers to support the economy as people come out of work now or reduce their hours, and we should be urgently looking to strengthen that safety net. That is a much more effective fiscal stimulus than most other areas, where you are not targeting individuals.

In general, you want to think about, in your fiscal response, VAT cuts and benefit payment increases as your two easiest levers to pull. In this crisis, because of its nature—your policy response should always be about the crisis you are in, not an abstract one—benefit increases is by far the easiest thing to do. It makes most sense and takes account of the fact that people do not want to go out and shop huge amounts. That should be the priority: statutory sick pay and the safety net.

Then the last thing—this can be seen in the Danish scheme, most of the other Scandinavian schemes and elements of the Irish approach, although it is different—is trying to maintain the attachment between workers and firms that are in trouble. That is the third element.

We are still working through what we think is the best way of handling it, but, in my view, we should probably use the statutory sick pay mechanism not for people who are ill but to get payments to people who will stay attached to a firm but are not working at that time. You may want some cost-sharing with the firm involved. The state is paying them—it is not means tested, not in the benefits system and at a slightly more generous rate—with a quid pro quo that those people are reemployed when the temporary phase is over, with some kind of claw-back mechanism.

That might take pressure off firms whose balance sheets are taking a big hit right now, to ease the chance of them going bust, while enabling workers to have their pay supported. It is not straightforward, but it is definitely doable. People are saying that we should be doing some of these Scandinavian schemes. We should be really realistic about what can be done in time. We are not starting from a big institutional setup with big collective bargaining at a sectoral level, where we can easily say, "You pay a bit of this; you pay that", and can tell which workers would have been laid off otherwise.

Do not think we can quickly enough put in place a whole new system, but the statutory sick pay system probably could be adjusted to provide a payments mechanism that keeps people attached.

Chair: That is understood. Thank you. It is a very interesting idea.

Q8 **Liz Kendall:** This strays into Angela's questions, so I apologise for that.

There has been a lot of comment that the G7 or the G20 have not acted together in their fiscal stimulus. Do you agree with that? What collective action should be taken to have a bigger cumulative impact? Professor Yueh, I do not know whether you wanted to answer that question.

Professor Yueh: They have not taken co-ordinated fiscal action, but this crisis is going to mean that Governments act in a way that is not co-ordinated but roughly coincidental in time. All Governments will have to step up their fiscal efforts. The push to have a G7 or G20 collective response is because whatever you support your economy with will have positive effects on other people's economies. If you support demand at home, it helps other countries when they support their demand. I imagine it is coming.

We have seen co-ordinated action with the central banks in a very extraordinary way. On a Sunday night, we saw the reopening of dollar liquidity lines between the major central banks. That accompanied the Federal Reserve's extraordinary announcement to cut interest rates to zero and restart quantitative easing to the tune of $700 billion, on top of over $1 trillion of liquidity that has been released into regional systems. That is important, because the US is the world's financial centre and this suggests that it will make sure there is enough liquidity, so cash flow does not become an issue for other countries.

To add to what Torsten said on what Governments and central banks should do, of the four measures announced by the Bank of England, probably the most important is the version of funding for lending. The problem with QE is that it is very general. You want banks that lend to businesses, and then they can tap the Bank of England for very low-cost money. It makes sure the money gets to the firms that need it.

In terms of what the Government can think about doing for businesses and workers—I know you want to move on, so I will be quick—there should be two overriding principles, as I have already mentioned. One is how you keep you viable businesses afloat. Therefore, there is a lot in the Budget for small businesses, and rightly so. They are the ones that need a great deal of help. What about big businesses? There is a stigma over asking for help; there are concerns about listed companies doing this.

All of this suggests that there should be a consistent policy to say, "When companies are affected, big or small, by coronavirus, this is the kind of process that we need to go through". It may not directly involve the Government helping; it may involve some type of easing of loans and credit that can come through the banks, which have already agreed, according to the Chancellor in the Budget, to help small businesses with credit conditions. That is something to consider.

The final thing is about people. A lot of this depends on what can work quickly in the system. On short-time work, this is the system in Germany, France and Italy. Where demand is low and people work fewer hours, the Government basically ensure you get the same amount of pay.

This is what prevented Germany from having a big rise in unemployment 10 years ago during the banking crisis. We need something that preserves, as much as possible, people whose jobs and livelihoods are threatened. There has to be something to make sure this temporary crisis does not cause them to lose their jobs. It depends entirely on what the system is.

If you have to go to universal credit because you do not qualify for SSP, or you do not qualify for ESA because you have not contributed to national insurance, universal credit needs to have a mechanism to make it quicker to claim.

Q9 **Ms Eagle:** I wanted to explore this issue about coronavirus and our flexible labour market, which has now turned out to be a pretty horrible place for those at the most flexible end, because they do not qualify for any of the support mechanisms that you would get in more generous social security systems.

We have a problem about not only the coverage of statutory sick pay but the generosity of it, as you have said, Torsten. We also have an issue about second-order effects beginning to happen, with the demand-side shocks now running through the labour market. For example, Virgin Atlantic says it is going to ground 85% of its aeroplanes, and it wants its employees to take eight weeks' unpaid leave. They would just not be supported at all in our current system. They would be at work, so they would not be able to claim benefits. They would be getting no pay, so they would have no support at all.

Do we not need very radical and immediate changes from the Chancellor to what would be available for people who are laid off in this circumstance, to compensate them much more effectively? I do not mean at 20%, like statutory sick pay, but something much higher, as the Irish, the Germans and the Norwegians are doing. Is that not better than seeing people literally left without any support at all, apart from their own savings?

Torsten Bell: There is a lot in there. Specifically on self-employment, the Government did the right thing last week, which is to reduce the waiting period for what is left in contributory ESA.

Q10 **Ms Eagle:** That is not much. Not many people qualify for contributory benefits.

Torsten Bell: You need to be a higher-earning self-employed person. It is slightly different to the contributory test for statutory sick pay, but it is roughly in the same magnitude. Bringing it forward a week is quite important. We are probably talking about more than doubling how much support you get if you are claiming that for the two weeks you are quarantining. That is a valuable thing to do, but that is all the self-employed have access to.

It is hard in normal times to provide statutory sick pay as it is currently envisaged, which is as an employment benefit, to the self-employed. We have been moving, over the last 40 years, away from statutory sick pay being an entitlement from the state towards it being, since 2014, a pure employment right. That is definitely true, but, as I say, the thing they did last week was basically the right thing.

The bigger picture across all these benefits—statutory sick pay and contributory ESA for the self-employed—is that we are broadly talking about replacement rates, even of a typical person entitled to them, of 30%. For a typical person entitled to statutory sick pay—leaving out all of us who are lucky enough to have much more generous occupational sick pay, usually close to 100% for quite a considerable period—we are looking at roughly 30% being the rate. That is a big cut to their living standards.

There is a case for increasing that in the short term for statutory sick pay, although we should be clear that that helps only in the two weeks you are sick. To reiterate what I said, the overarching problem we have here is that our baseline safety net has been cut back. If you look at the value of JSA or basic universal credit, it is back to the real-terms values it was in 1992. Since then, our GDP per capita is up 50%. That is the scale of how much less generous our core safety net is. That is the bigger living standards challenge, rather than sick pay itself.

Then you asked another question, about how you keep people attached to the labour market. I would advise caution. I understand why you want to replicate the more generous schemes that we see in Denmark and other places, or the hours-reduction scheme the Germans have just ramped back up again and reduced the thresholds for. We will not be able to implement that in time to have an effect here, particularly an hours-reduction scheme.

In Denmark, we are seeing 75% of workers' pay coming from the state. Unless you have significant mechanisms for making sure you are not just encouraging all firms to lay off all their staff because the state is picking up 75%, you are going to be in very serious trouble. It is really important to focus on the schemes that definitely exist. I would point you towards a broader use of statutory sick pay as a way for the state to pay workers while they are still attached to their firms. It could be at a higher rate; it does not need to be at the £95 a week rate we are looking at.

That is the kind of thing I would be looking at, because I have more confidence that it can happen before the peak in two months. If we learned anything from the financial crisis, the immediate response and the last 10 years' experience with universal credit, particularly when the state is busy dealing with the health response, the idea that it is going to successfully implement a totally new scheme is optimistic. It would be okay to be optimistic if the damage from that was not individual people not getting the help they needed. I would focus that support on the ones we know definitely need it, which is via the safety net and via statutory sick pay. Then we can make a big difference.

Q11 **Ms Eagle:** The Irish have instituted very simple payment systems that can be set up. Online, one-page applications, we are told, are going to be available by the end of today for both illness and unemployment benefits. They are set at €203 and €305 for those who find themselves unemployed or off sick. Something like that, which could be instituted very quickly and would at least support people over a short period, is surely not beyond the wit of a Government even in the midst of this crisis.

Torsten Bell: Something that allows people to get their claims in for universal credit without as large a focus on fraud prevention, checks and conditionality is definitely where we are heading. If the Government were prepared to let that happen, the system would allow it relatively swiftly. If you reduce the requirements to come in, basically, you can do that. We require universal credit claims to be done online, so we can definitely move in that direction and can reduce the information requirements to make that happen more quickly.

The challenge we have there is that, insofar as universal credit is going to be the workhorse response to the income hit from this crisis, it is going to be universal credit that people coming into the benefits system are going to be relying on. All the rest of it is going to be small-fry in comparison. That system has within it this five-week wait built in.

On the five-week wait, given where we are, the exam question is not about the optimal way you would like the five-week wait to go. It cannot go; the IT system cannot be done to remove the five-week wait in time for this crisis, so we should stop saying that we would like that to happen. Whatever we think about the medium term, the important thing is that the advances, so loans against future benefits, are immediate. The Government should then probably look at how quickly those are clawed back, and not start asking for them for at least the next six months, while we get people over the hump of it. That is what will get cash more quickly. Would it have been better if there was more flexibility in the system? Yes. Is that possible within the next month? No.

Professor Yueh: To clarify, we were asked about how we compare to what other countries are doing. That is not to suggest we should necessarily copy what is being done, but to learn what could be done. I would just stress that whatever is possible within the system that is faster should be considered. I am going to throw one more thing in that might be considered, which is fast. I am hesitating. Hong Kong sent a cheque for about $1,200 to every household during the crisis.

Ms Eagle: You are saying there was a helicopter cheque, rather than helicopter money.

Professor Yueh: Yes. As I say, we all expect that more measures will come through, but there could be something like that, depending on how the circumstances work.

Ms Eagle: It would be a more evenly distributed QE.

Torsten Bell: We have to be careful about the distribution of mechanisms like that. Money sent to people who are not in trouble is not going to be spent in the current climate. Our priority has to be getting cash to people who have problems right now. Those are going to be really severe, and they are not just going to be about sickness.

Again, as a regret about the lessons not learned from the financial crisis, the state is still not even in a position to make a payment to every household in the country. We should be, but we are not. We were not there in 2008, and we are not there today. We could credit bank accounts or send cheques to every household, so long as that is not at the expense of getting money to the people who need to spend it, where the fiscal impact would be biggest, because they actually will spend it.

Q12 **Ms Eagle:** I also wanted to talk briefly about the £500 million hardship fund the Chancellor announced. As far as I can tell, this is about perhaps alleviating council tax payment problems. Is there any view on whether that is enough or what the distribution mechanism should be? Local authorities have had nothing but a great big silence from national Government so far about how that is going to be distributed and used. Does anyone have a view?

Torsten Bell: They have said that it should be principally for council tax benefit. There is a question mark. All benefits systems have holes in them, and people are real and complex. There will be times when they need money but cannot get it quickly though an existing benefit. That is where local authorities and/or jobcentres having flexibility about pots of cash, in times like this, is very valuable. That can make a much bigger difference to real people's lives.

As you say, this pot so far is sufficient to make a difference to the levels of council tax people are being asked to pay. It is a form of the kind of tax delays you are seeing for businesses and others: time to pay. That is valuable. They will probably need to think again about the size of those flexible schemes and their sufficiency. We have handled temporary housing payments via forms like that. If you have a family in front of you in a local authority with a real problem today, you have enough flexibility to spend some money. That is a good idea. We need more cash in that system to make sure we do not have people in hard crisis. So far, it is enough to make a difference to council tax payments. It is worth looking at this again.

Q13 **Ms Eagle:** Finally, the Chancellor has basically given £5 billion to the NHS, which may well go up over time, £5 billion to help companies but only £1 billion to individuals. Does that ratio need to be changed? Has he got it right? Will more support for individuals be needed in the future?

Torsten Bell: I have answered that question.

Paul Johnson: It is hard to know whether the ratio is right. Supporting businesses in the first instance probably is where you want to be putting the money. If you can support the businesses to keep the workers on, provide them with income or stop them going bust in the long run, that is going to be more effective than letting the workers go and then supporting them. One should not think that supporting businesses is not about supporting individuals.

The £5 billion for public services was not just for the NHS, but it will be interesting, because there are challenges there. I suspect a substantial chunk of that ought to be to local authorities for the sorts of hardship and flexibility funds that Torsten was talking. Support for social care services, working alongside the NHS, will probably be needed. I suspect we will need more money for Jobcentre Plus at some point as well, if there is a significant increase in the number of people looking for work. We should not think about that public service sum of money as just for the NHS. I suspect that all these numbers are going to have to rise.

There is another issue on the public service side. Again, if you think the peak is coming in two months, you can chuck a whole bunch of money at the NHS in two months, but, if there are not the doctors, nurses, ventilators, hospital beds or what have you today, it is going to be genuinely difficult to spend that money effectively. Increasing the amount of money available may be less valuable than providing expertise or, as we have heard, getting companies to make more of the machinery that is required. We need to think about the micro-details of how to spend that money on public services.

I am guessing the Chancellor is not going to feel constrained in how much he spends on supporting public services over the next three months. He may feel very constrained in finding ways of spending that usefully and delivering what he would like to deliver.

Q14 **Felicity Buchan:** I am wrapping up on coronavirus. You have answered lots of my questions, so hopefully I can be very quick. First, how bad could this get in terms of the effect on GDP this year? I know it is a real hypothetical.

Professor Yueh: It is very, very, very hard to say. We are heading into recessionary times. It depends whether the coronavirus epi curve starts to come down. It depends on the policy responses, which we have all discussed, on the fiscal/monetary side. That could have a significant effect in terms of GDP.

There are already some indications. For instance, in the airline industry, the international body, IATA, expects this to be the first year in which global aviation will contract since the 2008 crisis. That gives a sense, perhaps, of the scale. With the central banks’ responses, that would not be too far from what they are thinking the scale of this could be, given the scale of what the Bank of England, the ECB—although they are going to do a bit more—and the Fed have done.

Torsten Bell: Numbers are a fool's game in the short term, and the exact numbers are not important. What is important is that the direction of travel is pretty clear, we know what the problems are and we are addressing them with policies that can ramp up depending on what actually happens. We should be thinking about stabilisers for firms and individuals that move with the scale of the problem.

Yes, overall, it will be bad. The numbers from Goldman Sachs today for the eurozone range from a contraction of 3.5% in Italy down to 1%. A 1% fall is the best for anyone. That is their view. I have no specific view on the UK's exact number, but this is much more serious than any of us thought it was three weeks ago.

We have learned from previous crises that the danger now is not overreaction. That is unlikely to be the danger. We have definitely learned things from living through the last crisis. The most important thing is the health response, and that is happening. As Paul says, we are going to throw the money at that and hope we can spend it well, but there are a whole host of other things in public services. We are not discussing prisons anywhere near enough. What if serious incidents start happening in our prisons? None of the money we are talking about now is for that, and they have had their budgets absolutely hammered over the last few years. Overall, I do not have a number, but let us plan for it not being good.

Q15 **Felicity Buchan:** Do you have a number, Paul?

Paul Johnson: The GDP effect is clearly going to be big. It is pretty clear that, at the moment, it is mostly coming through the demand side. It is coming through the complete lack of demand for air travel, hospitality and people not going out. For a substantial chunk of the economy, that is going to be really big. I do not know how big, but, yes, there is no reason to suspect that it will be a lot better than what happened in 2008-09.

Professor Yueh: It is too soon to say this, but, given the amount of concern we are all expressing, what is different between this time and 2008 is that 2008 was a financial crisis, so the aftermath was a deleveraging of balance sheets. That leads to a very long and slow recovery. I hesitate to say this, but, in a supply shock that leads to a demand shock crisis, normally the recovery is like what you see in other recessions. It is not L-shaped; it does tend to be V-shaped. I hesitate to say this, because there is so much we do not know about the coronavirus. We do know that this is not a balance sheet recession.

Q16 **Felicity Buchan:** We have talked about how the Budget was very focused on helping SMEs to the detriment of large companies, for example aviation and the likes of the hotel sector. What would you like to see the Chancellor do for these large market-cap companies?

Paul Johnson: I do not know. On one level, it is easier to help a small number of big companies than to help a large number of small companies. If hundreds of thousands of cafés, individually owned hotels or whatever are having really big problems, you can do the sorts of things we saw in the budget, but that is pretty scattergun. A lot of those organisations will not be helped enough by that.

Certainly, having central Government support tens of thousands of those businesses in a targeted way is next to impossible, which is one issue we have, because we do not have too much in the way of localised regional governments or local authorities with that sort of capacity. Focusing on the smaller businesses is more difficult from a practical point of view.

In terms of big business, as one of my wise colleagues said, it is really important to have something in place that is clear, consistent and does not leave big companies, as it were, embarrassed to get Government support so this is not seen, as people might say, as a return to the 1970s or anything like that. This has to be a consistent policy, whether it is loans to them, credit or direct support. We clearly have sectors that are suffering those very big demand shocks. There are sectors that will not be suffering those very big demand shocks, and it will need to be clear that one is differentiating between them.

The difficulty with delivery is that this probably needs to be money that is paid back at some point, because otherwise it is going to be pretty easy for firms to game the system, if that is what they want to do at this point, because they have vastly more knowledge than the Government do about them. That implies some sort of clear, transparent and probably loan-based system based on the data the companies can provide about how hard they are being hit. Beyond that, I cannot give a detailed description of how it should work.

Q17 **Felicity Buchan:** I am conscious of time, so I have one final question and then I will ask Diane whether she has any final thoughts on coronavirus. Specifically on business rates, there is 100% relief being given to companies with a rateable value of under £51,000. That is great in certain regions, but in London small independent retailers can have rateable values of £200,000 to £250,000 even though they are occupying a very small site. On business rates, we extended this to certain sectors like the hospitality sector but not to nurseries. Do you have any view on those two points?

Paul Johnson: Your regional point is important. There is a strong case for making it regionally varying, because, exactly as you describe, very different sized businesses are affected in different regions. To be fair, a large fraction is caught by this, because a large fraction of businesses across the country have rateable values below that, but there is differentiation across the country.

You are right; it was focused very much on the hospitality sector. There will be a series of sectors affected, not just nurseries, beyond hospitality. It might be a supply-side shock. Say you are a manufacturer and half of your staff cannot come in, because they are self-isolating or what have you. There is nothing in the Budget, as it stands, for an organisation like that.

Given the scale of this, for smaller businesses in the hospitality sector, it probably was not a bad first shot at the sorts of things you could do, but there is a whole series of other places you are probably going to have to look.

Felicity Buchan: Thank you. Diane, before we move on, do you have anything to add?

Diane Elson: The Government have missed an opportunity to design a package addressing the coronavirus crisis that goes some way towards redressing the negative gender equality impact of 10 years of austerity budgets. It was such a shame that women, particularly poor women, bore the brunt of the cuts in social security and benefits. I very much support the point that the normal safety net has become too weak and it is very important to strengthen this. Particular things can be done in the way that the payment of statutory sick pay is organised to address the gender equality issues and a range of other issues.

The other one is local government and social care. This Budget really said nothing about social care. It kicks it into touch once more. This is a problem we will address later, but I think now is definitely the time to address it. One way to have immediate impact in freeing up beds and staff time in hospitals is to invest more in the package of services that elderly people need to leave hospital and go back to live at home. I am very surprised that there was nothing of any substance about that. Maybe some of this £5 billion will go in that direction, but we do not know.

The continuing lack of investment in local government is very worrying, because local government is going to be in the front line of many of these issues.

Chair: I am going to move us on from the virus to more general points. You are probably all relieved.

Q18 **Anthony Browne:** These are more traditional Budget questions. I should say at the beginning that I am on the advisory council of the Institute for Fiscal Studies, as a declaration of interest. The Office for Budget Responsibility has said in its report that this is the largest sustained fiscal loosening since the pre-election Budget of March 1992 that Norman Lamont did, adding £125 billion to public sector net debt by 2024-25. We see public expenditure going up to 40.8% of GDP, which I think is the highest since the early 1980s or 1970s. This is a huge fiscal loosening. Given that we are on the brink of a sharp economic downtown and

Government borrowing is at a record low, is this not the time to do fiscal loosening, or should we be worried about it?

Paul Johnson: I do not think the fiscal loosening was put in place with the current expected downturn in mind, so there are two separate things there. Ignoring coronavirus for a minute, was this the right set of policies to put in place? The £18 billion of increased spending this year set out in the spending review in September, plus the additional investment spending over the next four years, is all entirely separate from coronavirus. As it turns out, I think this is going to be a very good moment for this having been planned, because the economy is going to need as much stimulation as it can get.

Parking that, in other times would this have been a good moment to do it? We covered this a little earlier on. Of course, there is a case for more investment spending, particularly when interest rates are so very low. The risks are associated with the speed at which that is being ramped up and the borderline between what counts as investment and what does not.

It is important to be clear that, after this year, the amount of increased spending on the current side, outside of the health service, is not very much. On our calculations, there is £2 billion or £3 billion to go round across all public services outside of health, schools, overseas aid and effects. That will keep spending on most public services 15% to 20% per person below where it was in 2010. It is a loosening but it is not in any sense something that, at the moment, looks very generous to most bits of public services.

You are right to say that this will take the state to nearly 41% of national income, which is its highest sustained level in 40 years or what have you. In a way, that is extraordinary, is it not? Having had a decade of austerity, with real cuts across many parts of public services, how can this be? Partly, it is this increase in investment spending, but substantially it is a combination of very low growth and very high increases—not in historic terms but in absolute terms—in health in particular. My guess is that 41% of the national income going in public spending is a baseline from which we will move up, not down, over time, because of the way that the economy and the demography has changed.

Professor Yueh: Before coronavirus, we were essentially in the down part, or at least the stabilising part, of a global cyclical downturn. This is actually the time to think about using fiscal policy. Every use of fiscal policy is a strategic choice. It all goes to the shape of the economy that you want, so it makes sense to have a set of spending that is geared at raising productivity and therefore standards of living. For instance, the issue, which has now of course been heightened by coronavirus, is that productivity growth is very slow, as we all know. Last year, productivity growth did not increase at all. Therefore, looking at how we raise that, the OBR's estimates of potential growth and productivity growth are worrying, with potential growth around 1.4% in the medium term and productivity growth considerably below the 2% it was pre-crisis.

In fact, some recent economic studies suggest that if the UK had followed the previous trend, before the crisis, the level of productivity, GDP per hour worked, would be 24% higher this year, as opposed to the current position. In terms of labour productivity, output per hour, which is what did not grow last year, the UK level has been lower than that of other advanced economies since the 1960s, more than 20% below that of the US, France and Germany.

How do you use fiscal policy to support that? That has to be the discussion, especially on the investment side, not just in physical capital but also in terms of workers. There is no real point in thinking only about raising output if you are not going to look at the needs of people who are going to make the fiscal investment more productive. That is why thinking about using investment in this way is appropriate, in both cyclical and structural terms. I agree with Paul on current spending. Demography and others would suggest that we have to look at the size of the state anyway.

Q19 **Alison Thewliss:** First, I wanted to ask you a bit more about the OBR forecasts. Torsten Bell, you described the OBR forecasts as incredibly grim while also being far too optimistic. Can you tell us a bit more about that?

Torsten Bell: We have covered the grim bit. What I meant there was that, if you look at them as a whole—so let us pretend coronavirus is not happening—we would still be concluding this was a really bad economic outlook, with 1.4% growth at the back end. The OBR has revised up its earnings projections for the year just gone, because earnings have come in better than expected, but it has earnings falling in every single year of its forecast period. Why? Its view on the sustainable level of productivity growth of the UK economy, as it adjusts to being outside the EU and with the effect of the financial crisis still with us, is very low. That is the long-term bit.

The optimistic bit refers to the fact that, as we said at the beginning, we are not going to get 1.1% growth this year. If we get 1.8% growth next year, we will probably also be quite happy. One way of thinking about it is to look at the growth cumulatively across the whole forecast period and take what is in those numbers. Even adjusting the early years for the most gentle impact of coronavirus imaginable, which is not going to happen, you would still have the worst cumulative forecast on record of any official forecasts. That is how bad it is.

Q20 **Alison Thewliss:** It is good to get that on the record. I have a question for Paul Johnson as well. You described the forecast as a lot more positive than the Bank's, but still very weak, and projected growth rates averaging barely over 1.5% a year for the next five years as feeble and indicative of an economy that is not in a robust position for coping with shocks like coronavirus. Can you explain particularly why you would describe the next five years as feeble?

Paul Johnson: Repeating what Torsten has said, if you compare even that five-year forecast with pretty much any five-year forecast in the past, ignoring coronavirus, it is about the worst it has ever been. Average growth rates before 2008 were 2.5%. Growth rates from 2011 through to 2016 were higher than we are looking at here. You have a combination of expected lack of productivity growth, the impacts the OBR is putting in there from trade, and not very much in the way of earnings growth. You have a set of forecasts that, in all historical context, look very poor. That is entirely ignoring coronavirus. If you are only expecting 1% this year, it does not take very much to bring that down to zero and below zero. It was an extremely straightforward point; it was not a very deep one.

Q21 **Alison Thewliss:** Professor Yueh, the Bank of England's January forecast had GDP growth at 0.75%, which is half that of the OBR. Given the context now, is either of those realistic in any way?

Professor Yueh: It depends on how long the coronavirus shock lasts. At the moment, NIESR is taking off 0.5% percentage points. That is its initial assessment. It is hard to know whether that is the right amount. It is safe to say that you will have to shave off quite a bit for any forecast that predates the coronavirus. To echo what Paul said, with the very slow growth the economy is already experiencing, that shows why there has to be a much greater focus on growth. That is what this Budget did. It reflects the general sentiment. Supporting growth through investing in the kinds of skills and sectors that are going to boost growth is much more important than the concerns we have had over the past decade.

Alison Thewliss: I have a quick question for Dr Elson as well.

Chair: Sorry, Alison, we have lost her.

Q22 **Alison Thewliss:** I was going to ask if the impact on women was picked up enough in the OBR's forecast. If not, what should we be factoring in?

Paul Johnson: I do not know. Over the last decade, if you look at earnings, women have actually done a little better than men. If you look at employment, women have done significantly better than men. I do not think there is anything in the forecast to tell us whether that is going to continue. In terms of the specific measures, as a fraction of their earnings, because women earn less, the increase in the national insurance threshold will be proportionately more valuable to more women, although there will also be more women in work below the national insurance floor. There will be proportionally bigger gainers, but there will also be more in work who are not gaining. The set of measures in the Budget, in terms of impact on individuals, was pretty modest and I do not think there is a big gender effect there.

Torsten Bell: The big gender effect is from the decision to leave in place the benefit cuts that have been rolled out since 2015. Not all but a large chunk of that is changing structurally the level of support we provide to families with children. For obvious reasons, there are more women in families with children, and that is large. We are talking about the second decile losing, I think, £2,900 as a result of those, in steady state. These are not small changes. This Budget, as Paul says, has very small effects across most distributional questions. Insofar as austerity has been ended in lots of other areas, and gone into reverse on capital spending, it definitely has not on those, and it has a very large effect.

Paul Johnson: A lot of those benefit cuts on families with children are still to come in, because they are only affecting new claimants and new children.

Q23 **Alison McGovern:** We are running behind for time and today is quite busy, so at this point I have a very simple question for Professor Yueh about the OBR's assumptions on Brexit and trade intensity with the European Union. It did not change its assumption on trade intensity, despite the change in the Prime Minister and, shall we say, approach from the British Government. Is that reasonable?

Professor Yueh: There is a lot of uncertainty over whether the Canadian-style free trade agreement, which I think was one of the aims of the Government, is where we will end up. Michel Barnier, the European negotiator, has rejected a Canadian-style free trade agreement for the moment, given our geographical proximity to continental Europe. I think the OBR finds it difficult to model this. It has taken a range of studies on the typical free trade agreement, and its effects on productivity, in its report.

Alison McGovern: Essentially, we are in the position we have always been in with the model, where the OBR finds Government's desires difficult to model when they are not actually effective policy. I think we can leave it. We do not need to talk about Brexit and trade deals today.

Chair: That is very good of you. We are about to get Diane back in.

Q24 **Liz Kendall:** Diane rightly said that the lack of extra funding for social care on coronavirus is a huge mistake. If we do not keep elderly people out of hospital where we can, or get them back home when we can, that is a problem. I wanted to ask a question on the longer-term funding issues in social care. Paul, the IFS and Health Foundation report on what funding is required for social care. Do you think the announcement at last year's spending review of £1 billion extra on social care is enough to meet demand or improve services? What do you think the long-term consequences of failing to reform social care will be on the economy, in light of our ageing population?

Paul Johnson: The answer is that £1 billion will not be enough. There are a series of questions wrapped up in that. There is a decision about the right level of social care spending, but we are clearly well below where we were in 2010. We have many fewer older people with needs who are accessing any social care. We know that the amount councils are paying social care providers is well below what private payers are paying social care providers, so there is some cross-subsidy going on there. We know the increase in national living wage is going to impact on social care providers. By the way, that increase in national living wage might not come at a great moment for a lot of small businesses that are struggling for other reasons, but that is a separate issue.

We know the demands for social care spending are rising. It is worth remembering that is not just about the ageing population. The bit of social care spending that has not fallen at all is for the population below pension age, where the increasing demand cannot be managed at all. All the management has happened in the older population, where some of the demands are less severe. You have as much spending as you ever had for those below pension age and significantly less for older people.

Obviously the long-run costs are going to rise as demographics change. One of the things holding that back is that, because more men in particular are surviving into older age, there are more couples in older age and one is providing care for the other. There is a small positive impact of demographic change there.

That is all ignoring two other things. One is the distribution across local authorities. We know some local authorities have had to make bigger cuts than others and some will be seeing a differential demand in growth from others. As we have moved to a system where there is less equalisation across local authorities and, in particular, more focus on them retaining business rates and so on, we are likely to see more divergence in funding, in a world where there are supposed to be national standards. That is an extremely difficult thing to manage.

That is all ignoring the structure of social care funding. You have this structure that provides no support if you have relatively limited income or assets, and a risk for a minority that they lose all the assets they have built up over a lifetime, including their house. If you want to deal with all that together, you are talking many, many billions of pounds a year even over the short run, let alone over the long run. This is a really substantial issue. Broadly speaking, I think the extra money provided will be enough to just about keep it staggering along as it is, not to return to where we were, allow improvements or reform the funding system.

Q25 **Liz Kendall:** My second question is coming back to Paul. In your comments post the Budget, you said that the key question now for all the capital investment is what it is spent on and where. I am sure you have your three minutes in the lift with the Chancellor. What would you say are the most important things for Government to be focusing on? There has been an awful lot on transport and potholes, but is that the key to improving productivity and boosting regional growth?

Paul Johnson: Transport clearly is important. If you are looking at the economic impact, having a lot of relatively small road schemes probably makes sense from that point of view. Housing is an important issue that we have not heard very much about, in terms of capital spending and supporting housing. That is actually more in the high-productivity areas at the moment. There is a green element to this and I think we will hear much more about how the Government are thinking about that in the autumn, when their net zero review completes. There will need to be reasonably significant public spending there, alongside tax, consumer spending and so on.

In terms of regional distribution, it is really important that we do not end up seeing investment in a silo, where the answer to lower productivity in the north-east is building more road and rail in the north-east. It is part of an answer, but only a relatively small part, alongside social investment, educational investment, industrial strategy and all those sorts of things. The fact that 24% of the workforce in the north-east and 47% in London are graduates is not going to be changed by building more roads and rail in the north-east. That is a whole series of things that you need to move to change. It is really hard and I do not know the answer, but it is far more than doing things on the investment side.

Alison McGovern: The other questions I was going to ask on net zero and levelling up have just helpfully been answered, so well done to you.

Q26 **Ms Eagle:** Very briefly, there was no pre-distribution and very little distribution at all in this budget, specifically with issues on poor households and child poverty. Clearly, this is something the Chancellor does not feel is important, but what could we be doing if we wanted to alleviate rising levels of child poverty and how much would that cost?

Torsten Bell: As Anthony Browne said earlier, we have an increase in the size of the state going on under a Conservative Chancellor who previously said I think that the state in normal times should never be above 37% of GDP, which is obviously not the world we live in. We have Christian democracy going on, without the two important components. One is tax rises to pay for the spending rise at some point. We have the Christian democrat element, which is a larger state but without paying too much attention to distribution. That is not a large part of either the coronavirus response or the broader increase in spending, beyond the regional difference, which is the distribution element that exists.

Within that, there is the rollout of, depending on how you measure it, £12 billion to £14 billion worth of cuts from 2015. There is a decent chunk coming. I cannot remember the exact number off the top of my head; it is in our reports, but it is 25% or something left to be rolled out over this period. Those measures mean that we have seen poorer families' income fall in both the last two years. We will get the best version of that data on 24 or 26 March, so in a few weeks, from the DWP. The actual income falls at the bottom are being driven by the benefit cuts, so by the redistribution side of things, not by the pre-distribution side.

On that side of things, at a minimum, if you do not want child poverty to rise, on the projections that organisations like mine and Paul's do, you probably need somewhere in the region of £6 billion, at least, depending on how well you target the money at poorer families. The two-child limit is the single largest child poverty increasing measure for obvious reasons. In large families you get a lot of children being brought in at once. The benefit freeze has also cumulatively done a lot of work to that. If you want to make bigger differences to families with disabled children, you are swiftly heading towards £10 billion worth of spending, reversing basically all the cuts that happened.

On the pre-distribution side, what Paul said is quite important. The budget confirmed the ramping up of the national living wage over the next few years to the abolition of low pay by 2024. These are big rises, building on big rises over the last few years. They have just got a lot more complicated. One of the dangers of complacency post the financial crisis is that those in the Treasury at that point, or around it, expected to see unemployment rise a lot and it did not. One of the reasons it did not, which was underappreciated at the time, is that inflation spiked exactly around the crisis, with big falls in real pay happening almost overnight. Firms did not need to adjust to a longer-term level of real pay via unemployment, as they have in previous recessions. They just got it by everyone's wages being hit.

One reason why what is about to happen in the next few months could be more difficult than we expect is that we currently have a lower rate of inflation, both here and globally. Britain has not so far been differentially affected enough that we are seeing any other sterling falls leading to inflation spike effects going on. We should not be complacent that unemployment is a very real risk. Although we are big supporters of the national living wage, we should be actively monitoring that, because it is a serious concern.

Abstracting from coronavirus for a second, it is delivering big changes in the pay distribution. We are seeing the biggest falls, or the first falls for 40 years, taking place in low pay over the last few years. That is a big change to the distribution, particularly to the hourly pay distribution. On the redistribution side I am afraid, no, we are going in the wrong direction.

Q27 **Ms Eagle:** Paul, the IFS has said that only 8% of the gains from the national insurance cuts go to the poorest fifth of working households and only 22% of minimum wage workers live in the poorest fifth of households. Do you think that national insurance cuts are the way forward to target poverty, or do we simply have to support the benefits system more?

Paul Johnson: Raising the national insurance threshold is probably about as good as you can do through the tax system, in terms of supporting low earners, but it is nothing like as well targeted as things you can do through the benefits system. Increasing generosity of elements of universal credit would be vastly better focused, but you have the offsetting potential. If you bring more people into universal credit, you have potential negative effects on labour supply and you increase spending rather than reduce taxes. If your focus is reducing poverty and targeting those on the lowest incomes, working through the benefits system is more effective by a country mile than working through any aspect of the tax system.

Ms Eagle: Diane, do you have anything to add?

Diane Elson: Yes, I agree with that. There is also a gender equality issue here. Working through the benefits system is much better for gender equality than raising tax thresholds. Over half of adults gain from the national insurance contribution threshold rise, but the majority, 58%, are men, and 56% of women gain nothing at all from this measure. It is comparable to raising the income tax threshold. It has similar effects, so it does not really help in improving gender equality.

Q28 **Ms Eagle:** Can I raise one more issue on that? Universal credit has largely shifted payments from the purse to the wallet. The benefit system, unless it is child benefit payments, does not really help there either, does it?

Diane Elson: It depends on what part of the country you are in. In England we still, I think, insist on all the payments going to one bank account. I think in Scotland the payment can be divided, so there is a possibility of dividing those payments without completely changing the system, although there are many things wrong with the system that should be changed. The two-child cap on child benefit could be ended immediately and I do not see why it has not been.

Chair: We have 10 minutes remaining. Does any Member have a question for anybody?

Q29 **Harriett Baldwin:** Shall we ask about entrepreneurs' relief? I think you had not been in favour of the current structure for entrepreneurs' relief at the IFS. Does the panel welcome where things came out in terms of entrepreneurs' relief? It is one for Diane to welcome, I hope, on a gender balance basis. Are there any comments from the panel on entrepreneurs' relief?

Paul Johnson: It is clearly a move in the right direction. It was fairly remarkable that you could effectively earn—because that is really what it was—that amount of income and pay 10% tax on it at the end. As the numbers show, something like 5,000 people get an average of £350,000 worth of tax relief each under the system.

Q30 **Harriett Baldwin:** Do we know the gender breakdown?

Paul Johnson: I do not know, but I guess it is largely male.

Diane Elson: The Government have said it is largely white male, but they have not given detailed figures for it. These pensions and tax allowances all tend to be biased towards high-income men. They are the ones who gain most from it and other people do not. This is money we are losing that could be spent where it is really vital, like in social care.

Q31 **Harriett Baldwin:** You welcome the changes on entrepreneurs' relief.

Diane Elson: I welcome the changes, but I am sorry it was not abolished.

Q32 **Harriett Baldwin:** Does anyone else want to argue for it being abolished further?

Paul Johnson: What might it be for? It might be for increasing entrepreneurship, given the name of the relief, encouraging people to build new businesses and so on. There is absolutely no evidence that this plays any role whatsoever in that context. It is essentially a way of working as a self-employed person or what have you, keeping the money within the company and taking it free of tax, or with significantly reduced tax, at the end. If you want to promote certain kinds of entrepreneurship, you need a much better-targeted policy up front, rather than one that, in the end, rewards those who have been very lucky or productive, or what have you, far more than those doing the same thing as an employee or in any other form. It is one of the many ways in which we differentiate how we tax income according to the legal form in which it is earned, creating obvious opportunities for using it as a tax avoidance mechanism.

Q33 **Harriett Baldwin:** There were reforms to pensions tax to prevent consultants in the NHS being disincentivised from working. Torsten, I know you wanted to see wider reforms in pension tax and felt this was a missed opportunity. Do any of the panel want to say anything about other reforms they would have liked to see on pension taxation?

Torsten Bell: The bigger picture, going back to one of your earlier questions, is more about the big macro decision being made here. It is that interest rates are going to stay low. Good times might be here. We can afford to spend a lot more, borrow for it and not have to use the opportunity that you normally have. We saw big tax rises in this budget, which are pretty similar to most post-election budgets. The reason why they are not normal is that they are tiny compared to the increase in the spending. The opportunity to engage in wider structural tax reform has been ducked. Reviews have been promised on some things, business rates and VED, but on the big stuff around inheritance tax, pensions, property taxation, the Chancellor has, for understandable political reasons, but problematic in terms of the quality of the UK's tax system, decided to step back from announcing reviews.

Q34 **Harriett Baldwin:** What reform would you want to see?

Torsten Bell: How long do you have?

Harriett Baldwin: How long do we have?

Chair: We have seven minutes.

Torsten Bell: We can get through a long list. Our council tax system is a joke. Our inheritance tax system is encouraging Mr Dyson to buy loads of farmland, not because he is a farmer but because he can pay no inheritance tax on it. Our taxation of capital gains still allows someone to take £1 million on only 10% tax. That makes no sense whatsoever and does not go to lots of entrepreneurs. It goes to entrepreneurs only if they happen to have succeeded. They are not the ones who are a disincentive to becoming an entrepreneur in the first place.

On pensions taxes, the fact that we allow a lump sum to be tax relieved makes little sense, is very expensive and is incredibly top heavy in its spend. We have not sorted out our relationship between when we do and do not pay national insurance around our pension system. Those are the things that definitely need looking at. The good news is that they could raise significant money. One thing that will come out of this crisis over the next two years is that, if in the long term we want to spend the kind of money we have set out in this budget and go further, and we will need to go further in the 2020s, we will end up coming back to some of those tax rises.

Diane Elson: I strongly support that. With the majority that the Government have, now is the time for them to introduce those kinds of reforms.

Q35 **Anthony Browne:** I want to ask a follow-up to my fiscal question, which I did not get a chance to because we moved on. We have increased borrowing a lot. How worried should we be about it? The Government point out that interest debt payments are now down to 3% of their revenue, which I think is the lowest since the Second World War. Public sector net debt is falling as a percentage of GDP towards the end of Parliament. Should we be worried about it?

Professor Yueh: The debt interest rule means there is a way of monitoring whether debt interest payments exceed 6% of GDP. That change, as opposed to targeting a debt level, gives more flexibility for capital investment. One of the challenges with capital investment is that we are doing this at a time when interest rates are very low.

Q36 **Anthony Browne:** They may go up again.

Professor Yueh: Yes, exactly. Debt interest payments were over 6% of GDP decades ago. Having that rule would allow some degree of monitoring. I would stress that the 21st century global economy is really very different. We have a serious productivity challenge. We must invest in skills, connectivity and digital infrastructure, and take a hard look at the ways in which the net zero target can be met while allowing us to move into the green area, which could generate future returns, economically and for our wellbeing. All these things suggest we have to look anew at what level of spending the Government should be targeting generally.

In other words, if you know that tax revenues are always a certain percentage of GDP, is that going to change with the new system? Could we, for instance, have a carbon tax, which a lot of economists are pushing for? Could we think about having a carbon tax but it being revenue neutral; in other words raise a tax on carbon but cut taxes in other areas to reshape the way the state looks? Could we think about ways of generating future investment? I do not expect we will get all these things by the autumn, because these are very big questions. To think about debt sustainability, we look a lot at the cost of debt but it is just as important to look at the potential growth rate. So long as the potential growth rate can be increased, so long as your G is higher than your R, you have a much better ability to manage debt and investment. It is the only way we are going to deal with the challenge we have today.

Chair: Thank you to all our witnesses, including you, Diane, for being with us today. You have given us a great deal of insight into a lot of issues around the Budget. That concludes this particular session that the Committee has had on the Budget. Thank you very much.