HOUSE OF COMMONS

Treasury Committee

Oral evidence: Appointment of Professor David Miles to the OBR Budget Responsibility Committee, HC 966

Wednesday 15 December 2021

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Watch the meeting

Members present: Mel Stride (Chair); Harriett Baldwin; Gareth Davies; Kevin Hollinrake.

Questions 1 - 55

Witness

I: Professor David Miles CBE, Professor of Financial Economics, Imperial College Business School.

Written evidence from witnesses:

Appointment questionnaire

CV

Examination of witness

Witness: Professor David Miles.

Q1 **Chair:** Good afternoon and welcome to the Treasury Select Committee and our hearing regarding the appointment of Professor David Miles to the Budget Responsibility Committee of the Office for Budget Responsibility. We will be producing a report at the end of this session in private session, either recommending this appointment or otherwise.

I would like to warmly welcome you, David, to this session and thank you for appearing before us. Could you just very briefly introduce yourself to the Committee? Is there anything you would like to say?

Professor Miles: I am David Miles, professor of financial economics at Imperial College. I have been an economist for almost 35 years now, mainly working at universities, though I have also quite often worked in the public sector—I was at the Bank of England for quite a long stretch—and in the private sector, focusing on macroeconomics, financial economics, and to some extent demographics and fiscal policy issues.

Q2 **Chair:** I wanted to start with some general questions about inflation. We have obviously just had the latest figures from the ONS: 5.1% in the 12 months up to November. Did that figure surprise you? Is it higher than you were anticipating?

Professor Miles: It has been clear for a while—the Bank of England recognised it—that around the turn of the year the inflation numbers were quite likely to be close to 5%, maybe 5.5% or even 6%. It was not a huge surprise. Maybe we got there a few weeks earlier than might have been anticipated. If it was in December, that number would have come out in mid-January rather than today, but high inflation has been baked into the UK economy for a while now, partly because of energy prices.

Q3 **Chair:** The Bank of England has generally taken the position that this is going to be relatively transitory and it will pass through. There has been a lot of debate, including on this Committee, as to whether inflation within the labour market—a labour price spiral—might spark off and take it to a more worrying place. What are your views around that—temporary, transitory or permanent?

Professor Miles: "Transitory" is a slightly slippery concept. When the Bank of England started talking about the high inflation being transitory, it may have had in mind a shorter time horizon than it has come to see now. The risks are real that it turns into something that you could not describe as transitory, for precisely the reasons that you highlighted there.

The labour market—remarkably, in many ways—looks pretty tight in the UK. Thankfully, the unemployment rate did not rise very much over recent months. Vacancies are running at a very high rate. There are quite a lot of wage settlements to come in the early part of the year, and those wage settlements now will be negotiated in an environment of 5% or maybe even 6% inflation. It is perfectly possible that wage settlements will be significantly higher than we have seen in recent years, and unless that is combined with faster productivity growth than we have seen for quite a long time it is going to put a bit of pressure on costs. That may feed through to more sustained inflation. Maybe companies will just have to take the hit.

Q4 **Chair:** What is your view on the ability of companies to pass through those additional costs by way of additional prices? What is your thinking?

Professor Miles: It depends very much on the big macroeconomic picture, which is the balance between demand in the economy and the supply potential of the economy. The picture there is one where demand may be in line with and, until recently anyway, possibly even running slightly ahead of the supply capacity of the economy. We have a tight labour market, but this is very dependent on how omicron plays out.

Until recently it has looked, to me anyway, as if demand in the economy is running quite strong relative to supply capacity. That is really a recipe for inflation at least potentially lasting a bit longer than you would describe as transitory, so there are some risks there.

Q5 **Chair:** Getting back to the wages and what is going on in the labour markets, are you saying that you think there is some early evidence of this wage price spiral beginning to kick in, or do you think it is just too early to tell? What is your thinking?

Professor Miles: There is some evidence for that. It is patchy at the moment. Clearly, some sectors have paid big wage increases because of acute shortages. That is not generalised across the economy.

Q6 **Chair:** We had evidence in the session earlier this week from the manufacturing representatives and the IOD. In answer to the question, "Is it a more generalised upward pressure on wages or is it just more concentrated in particular areas where there are shortages?", their view was that it was fairly general. Do you disagree with that?

Professor Miles: That is what I have seen as well. That general pressure has come slightly ahead of the really sharp rise in inflation, so you have to add on to that what looks now like it could be 5.5% or 6% inflation early next year when there are a lot of wage settlements. It is a real possibility that we get a second round to the inflation pressures that started out being energy and global, and become a bit more domestic and less transient.

Q7 **Chair:** What is your view of the labour market today? We have had various people make the point to us that the 1970s was obviously a very different era, when we did indeed have a lot of inflation, but the labour market was structured very differently. There is less trade unionism today, less collective bargaining or sector deals and all that kind of thing. It is very different. Do you see the inflationary aspect being dampened down by the nature of the labour market today compared to how it has been in the past?

Professor Miles: Yes, it is very different. In the 1970s, there were times when one had quite a lot of slack in the economy. The economy was almost in recession and yet inflationary pressures were very strong. The horrible word "stagflation" started being using that in that era, and that may have partly been a reflection of the way wages were negotiated in an environment where trade union membership was much higher.

The labour market is different now. My guess would be that a significant increase in wages only really happens now when there is a very tight labour market and demand in the economy is running slightly ahead of supply capacity. Stagflation seems to be much less likely now than it was in the past, but that does not preclude wage pressures. They are beginning to come through.

Q8 **Chair:** I will quickly switch to omicron. There is obviously huge uncertainty about how this is going to progress. We all hope for the best. What is your view of the impact that could have on inflation? Just dipping into your experience, particularly when you were at the MPC, in interest rates and monetary policy, what could the economic effect of this be? You could argue, "Well, it is going to slow the economy down; therefore, let us not hike interest rates". At the same time you might exacerbate some of the supply side problems and therefore increase inflation, which suggests interest rates might go up. Where do you land on that and what is your view of the overall situation?

Professor Miles: Firstly it very much depends on how omicron plays out. We all hope that, although infections are rising very quickly, maybe hospitalisations will not and there will not need to be the generalised lockdown that we saw in 2020. One hopes that that will be the way things play out, in which case it may be that the impact of omicron on inflationary pressures actually turns out to be not first order and not hugely significant. If it is much more serious, you could see things playing out in different ways.

You are absolutely right. There are countervailing forces here. On the one hand, if companies find that demand for their products has fallen greatly—and that may be particularly true in some sectors rather than in others—it is hardly an environment in which they are going to be granting substantial wage increases. The probability of wage inflection picking up is probably lower if omicron really knocks the economy on the head, but as you rightly say, if it does knock the economy on the head, that is a reduction in both the supply potential of the economy and in demand.

If there are more lasting impacts on supply potential, looking slightly further ahead, it is not so obvious that it is very clearly deflationary, looking beyond the next few months, but slightly longer term. That depends on whether the supply potential hit is a persistent one and how quickly demands comes back after the worst of omicron has passed. It is not entirely clear whether this is a potentially significant deflationary force, which it might be in the very short term, but in the slightly longer term I suspect it is not deflationary. It will still, therefore, lead to some difficult decisions for the Bank of England on interest rates.

Chair: Yet more difficult decisions and a lot of uncertainty.

Q9 **Kevin Hollinrake:** It is very nice to meet you. In the OBR forecast, it basically says if inflation hits 5.4%—and you said it is going to hit 5.5% or 6%, which looks likely, based on today's news—on the basic monetary policy, base rate would go to 3.5%. How likely is that?

Professor Miles: If one had really persistent pressure that did not look like it was fading away after the early spring and was not going to be back down closer to the inflation target by this time next year, we could see really quite significant rises in interest rates. It would reflect demand pressures in the UK running a little bit ahead of the reduced supply capacity of the economy.

I do not think it is out of the question that we get significantly higher interest rates than the financial markets are expecting. The financial markets have taken the view that interest rates might get to 1% by this time next year, maybe a little bit above, but are not attaching any weight to interest rates at even 2%, let alone 2.5% or 3%.

In the bigger picture, looking back over 30 or 40 years, 3% would not be a particularly high interest rate. Although some people in the financial markets would say, "Well, that is just not going to happen", I think they have slightly misplaced confidence about that.

Q10 **Chair:** On the point that Kevin has raised and thinking about the OBR's last EFO, it makes the point: "If inflation was coming through higher wages, because of the fiscal drag effect across income tax, et cetera, for the public finances that might not be a bad situation". In its scenario, we would be £30 billion better off. Do you have any comments on that? Do you think that analysis stacks up?

Professor Miles: It does, because with wages in nominal terms moving higher, with the allowances being frozen for some years, more people obviously ratchet up into paying a higher marginal rate of income tax. In itself, that is quite helpful for bringing in revenue. That is right.

Of course, there are a whole bunch of other offsets that are not so helpful, one of which is the uplift on index-linked gilts. That has already had an impact, and if inflation stays high through most of next year that will have another ratchet up in payments there.

Q11 **Harriett Baldwin:** Professor Miles, I just wanted to probe a little bit about your range of interests. Obviously you have a lot of things that you do already, and I just wondered how you are going to find the time to do the OBR job on top of everything else. What is it that you are giving up or doing less of?

Professor Miles: Well, I would hope to carry on having an affiliation with Imperial College, but at a much reduced commitment. At the moment I am a full-time professor at Imperial. I have already spoken to a few people in the department, and they would be happy for me to carry on with an affiliation, at a much reduced time commitment. That might come down from pretty much full time to a day or so a week.

With the other things that I might try to carry on outside my OBR time, there is an overlap between the role on the OBR and some of those other things. They are helpful in keeping in touch with research, but to answer your question the main thing I would carry on doing would be at Imperial College. I am envisaging that being about a day a week.

Q12 **Harriett Baldwin:** You are going to go from full time at Imperial College down to one day a week.

Professor Miles: Something like that, yes.

Q13 **Harriett Baldwin:** I understand that you are also on the commission of the Central Bank of Ireland.

Professor Miles: Yes. The commission of the Central Bank of Ireland is analogous to the Court of the Bank of England. We meet probably once every six or eight weeks, something like that. I have not been doing it for very long. I have been doing it for the past year. It averages out at about a day a month, and it is reading the papers ahead of the meeting. The meetings are about half a day.

Q14 **Harriett Baldwin:** It is not a huge time commitment. What about the issue, though, that in your OBR role you will be shown confidential Treasury announcements ahead of schedule? What are the risks of that finding its way, advertently or inadvertently, into your work with the Central Bank of Ireland?

Professor Miles: I cannot really see how that would happen. I am very aware of the sight I will have ahead of public announcements about policy decisions. As a matter of fact, there is very rarely discussion on the commission of what the UK Government might be doing on the tax side or the spending side. There is some interest in financial regulatory issues, but even then I would not offer any special inside information on those things.

Q15 **Harriett Baldwin:** You mentioned six to eight meetings a year. Are any of them likely to be in that very sensitive period of time before the Chancellor makes a budget announcement?

Professor Miles: It is conceivable, partly because it is not quite clear when the budget announcements will be. I have the dates when the commission meets. If there was any question, not so much of sensitivity but of time commitment on the OBR role, that would absolutely take priority. I realise your question is not about that; it is more about sensitivity.

Q16 **Harriett Baldwin:** Yes, just that very sensitive period when you are seeing stuff that is really quite market sensitive.

Professor Miles: If that seemed to be a problem I would absent myself from those meetings if that became an issue.

Q17 **Harriett Baldwin:** Has the OBR given you any advice on how you might want to remove any perception of there being a conflict of interest there? Is there a period where you might want to put yourself in a kind of purdah?

Professor Miles: They have not mentioned it. I have spoken to OBR officials and Treasury officials on intending to carry on with that role, if I could, and they did not raise issues.

Q18 **Harriett Baldwin:** What about the Profile Pensions role? Can you tell us a bit about that?

Professor Miles: Profile Pensions aims to provide pensions advice and management of pensions for people who have very small pension savings and who have found it really difficult to get advice. We are thinking of people who may have moved jobs a few times. They had a few months here, maybe a few years here, in a company pension scheme, a DC—a defined contribution—scheme, and a bit over there and a bit over here. When you put it all together maybe they have £30,000 to £40,000 of pension assets, which is too little for financial advisers to offer them any advice. The aim of Profile Pensions is to try to get to those people, offer advice, and then to manage the pension assets if they want to. I have had a role there as an adviser—I am not an executive there—on a couple of things, really.

First, it is to try to work out ways where you can ask relatively straightforward questions that people who do not have much knowledge of pensions or financial investments can understand that answer. It would allow Profile Pensions to work out what a good match would be between, for example, their plans about retirement or where their risk appetite might stand, and try to match them up against investments.

I have then advised a little bit on what are the best kinds of passive index tracking investments that, at low cost, can try to match up against people's desire—

Q19 **Harriett Baldwin:** How much time does this role take?

Professor Miles: This is about on par with the Central Bank of Ireland. I probably go to a meeting every eight weeks or so.

Q20 **Harriett Baldwin:** You are a board member.

Professor Miles: I am a non-executive board member.

Q21 **Harriett Baldwin:** Obviously quite a lot of the issues that the OBR has to look at on a medium-term basis are around the costs of pensions, the public purse and so on. Do you see any potential conflict there?

Professor Miles: As I say, my role has pretty much exclusively been to try to work out ways of understanding what people's pension needs might be, people who are not particularly interested in financial things, maybe not very financially sophisticated, and to then think about investment strategies—more risky, less risky—that might match up against what people seem to be saying they want to do.

It absolutely has not been, "Should we sell these assets now because this thing looks like it might happen in the next couple of weeks and try to get ahead of the market?" It is absolutely nothing to do with that at all. As I said, the investments that Profile suggests to people are completely long-term index tracking. They are not actively managed. They are not trying to gamble the markets and get ahead on a bit of news.

Q22 **Harriett Baldwin:** If any of that were to change, would it be regarded as a conflict of interest so that you would have to step down from that role?

Professor Miles: Oh, absolutely. One could imagine that it could be become a conflict of interest if they change strategy.

Q23 **Harriett Baldwin:** You are telling the Committee today you do not see it as a conflict of interest.

Professor Miles: I do not.

Q24 **Harriett Baldwin:** Can you also elaborate, because I know you have worked for the Treasury in the past? You have done pieces of work for them, have you not?

Professor Miles: Yes.

Q25 **Harriett Baldwin:** Has that been paid work?

Professor Miles: Yes, it was. Back in 2003 to 2004, I was asked to do an independent review—this was when Gordon Brown was Chancellor—of the structure of the UK mortgage market, and why we had an unusual mortgage market and very little long-term fixed rate borrowing. All the borrowing was short term. I had to take time away from Imperial to work on that. I got paid a bit for doing that. It lasted about 18 months or so.

Q26 **Harriett Baldwin:** Presumably you would not regard it as appropriate during your time at the OBR to do any further work for the Treasury.

Professor Miles: It would not be, no.

Q27 **Harriett Baldwin:** Obviously, if it were to occur, would you declare that as an interest? It would look pretty odd to the outside world.

Professor Miles: That would be difficult to do.

Q28 **Harriett Baldwin:** You can assure us that you will not do any work for the Treasury.

Professor Miles: I can, yes.

Q29 **Harriett Baldwin:** Are there any other areas of your work that you want to share with the Committee where you could conceivably be perceived as having a conflict of interest?

Professor Miles: There are a few things that I intend to give up. I suppose you could say they were potential conflicts. I have had a longstanding affiliation with the Institute for Fiscal Studies, and in the last few years I have been the chair of the board of trustees of the Institute for Fiscal Studies. I do not think it is exactly a conflict, but it does not quite feel right to be simultaneously at the OBR and to be the chair of the trustees for the Institute for Fiscal Studies. If appointed to the OBR I would step down from that.

Q30 **Harriett Baldwin:** Are there any other changes that you plan to make to your portfolio?

Professor Miles: Yes. Sometimes I get asked to do paid talks at events and I would stop doing those things.

Q31 **Harriett Baldwin:** Do you think there is enough in the system at the OBR to have given you the right kind of advice about any potential conflicts or perceived conflicts of interest, and that there is enough of a mechanism for you to declare anything and get rid of anything before you start that might seem like a conflict of interest?

Professor Miles: I think so. The timeline for all of this has been a bit truncated, because the Chancellor only made the announcement relatively recently. I was warned when I was sent the questionnaire, quite rightly, "Do not go showing your answers"—cheating in the exam, if you will—so I have not had a whole lot of contact with OBR officials over the last week or so. If you think I should be appointed, I will certainly be talking in detail to them over the next few days before taking up the appointment. If there are any issues on potential conflicts I will be guided by them.

Q32 **Harriett Baldwin:** It is not inconceivable that some of your work at Imperial could also be perceived as a conflict of interest.

Professor Miles: What I do at Imperial, like most academics, is a combination of lecturing and teaching. I tend to teach financial economics and some macroeconomics courses. I certainly would not dream of drawing on anything sensitive there in lectures. Academic research of that sort is actually helpful in what the OBR does. I cannot imagine too many conflicts coming on the academic side.

Q33 **Harriett Baldwin:** What would you do if you saw one?

Professor Miles: I would do everything I could to avoid it and step back from whatever activity as an academic looked like it was generating a conflict.

Q34 **Harriett Baldwin:** As a Committee we have to rely on your ability to do that. There is no mechanism for that being flagged to the public.

Professor Miles: Well, if there was something that seemed questionable to me I would certainly seek advice from colleagues at the OBR. Charlie Bean before me and, I am pretty sure, Steve Nickell before him did continue in their academic jobs. As I say, if there was an issue where I was a bit unclear I would certainly seek guidance.

Q35 **Kevin Hollinrake:** What is your assessment of how the OBR currently operates and what are its challenges?

Professor Miles: Its challenges are to try to understand the many different unusual forces that are at play in the UK economy right now. Some of them are short-term challenges and some of them are really long-term challenges.

In the short term, omicron is absolutely top of the list right now. Who knows quite how that is going to play out. That may have very significant impacts on the economy and on the fiscal position. The longer-term challenges are trying to understand partly the longer-term impacts of Covid and the damage it may have done to productivity, to supply capacity in the health sector, and the long-term potential damage done because of disruption to education. What are the impacts of those things over the longer term? There are the Brexit issues as well, and what effect they may have on the supply and capacity of the economy.

All those things are difficult. Part of the reason they are difficult is you cannot look back and think of events, "Well, what happened the last time we had something like Covid? What happened the last time we did something like leave the European Union?" There is nothing to look back on.

Q36 **Kevin Hollinrake:** We kind of can now, though, because you have omicron coming through now. It has some parallels with what happened in March 2020.

Professor Miles: Sorry, you are absolutely right. In terms of the short-term impact, supposing we have to have a pretty full-on lockdown—let us hope we do not go there, but if we did—we could at least look at what happened in April or May of last year, for sure. In some ways, the more difficult questions are about long-term impacts on things like the labour supply. Some people may have decided to opt out of the labour market or retired a bit early. Will they ever come back? There are longer-term impacts on education for people who have really have a disrupted two years now. How does that feed through to longer-term wage prospects for those people? That is going to potentially last decades. The longer-term things are really difficult to work out.

In terms of how the OBR operates, I am really impressed, to be honest with you. Having spent quite a lot of time over the last few weeks reading the range of really big reports they put out with a relatively a small number of people, they are doing something very right to be able to do that. I am also struck by how thoughtful and careful a lot of the analysis seems to be. I have a hard act to follow, if I follow Charlie Bean and Steve Nickell in what they did.

Q37 **Kevin Hollinrake:** It is understandable, because we were in an unprecedented situation, but the March 2020 forecast at that point in terms of GDP impacts and the public sector net borrowing were pretty wide of the mark. What lessons can we learn from that in terms of how we do it better next time? It is perfectly understandable that we were quite wide of the mark, of course, but what lessons should we learn?

Professor Miles: In a sense it sounds a bit trite and obvious, but one thing to learn is that sudden events that can have a really enormous impact on the economy, and, given an appropriate Government response on the size of the fiscal deficit, these are not things that are in the past history of a volatile UK—"And that kind of stuff does not happen anymore". It does happen and it just did.

That then has quite powerful implications for your judgment about fiscal sustainability over the long term and, in particular, how much headroom it is advisable to have going into the future when things like this can happen. They are not potentially one in 100 year events. They may be once a decade events. We have had two now in a bit over 10 years, namely the financial crisis and Covid.

Q38 **Kevin Hollinrake:** You mentioned long-term fiscal sustainability in your application or your CV. The difference between short-term political cycles and long-term fiscal sustainability is going to be a key focus within your work at the OBR. Is that already being sufficiently addressed? I know the OBR has done some forecasts out to 2060, in terms of that kind of stuff. It shows debt to GDP at about 400% of GDP in the central forecast. How sustainable is that and what are we going to do to mitigate it?

Professor Miles: You are right. If I remember correctly, they do show that by 2069-70 on the central forecast debt to GDP is a bit over 400%. It is something like 420%. The graph of what it then looks like is exponential. It is completely unsustainable. That chart says that something has got to give.

Several things could happen that make things less severe than that. One is that—and hopefully this is how things play out—the very poor productivity growth in the UK economy for almost 20 years turns around. That can do a lot then over the next 50 years, but in the absence of that it paints a pretty tough picture. Either taxes need to go up, or some elements of spending need to rise less rapidly than is baked into that forecast.

That forecast is very sensitive to assumptions about demographics, about when people retire, about the extent to which the state pension retirement age, or the age at which you get the state pension, is indexed to life expectancy or not. There are a lot of moving parts in there. You could make adjustments at several levels and you would not get such a frightening number as 419%, but it does say, "You need to think about making adjustments somewhere, big ones, over a sustained period".

Q39 **Kevin Hollinrake:** You also talked about coaching and helping younger economists. How are you going to do that, given the time constraints? Could you offer an opinion in terms of the proportion of women studying economics? I have to declare interests here; my daughter is about to study economics at Edinburgh next year. I understand that is a much lower proportion than in STEM subjects such as maths and physics. Is there something we can do to encourage more girls in that area?

Professor Miles: I am not entirely sure of the numbers, but my impression is that the OBR has an unusually large number of women working there, many of them as economists. What the Institute for Fiscal Studies does has a lot of common interest with the OBR. Interestingly, the Institute for Fiscal Studies is 50% women among the economists. There is a very high proportion of women there.

You are right; economics has been male-dominated and a subject dominated by white men for a long time. One of the reasons for that is a dirty secret about economics in the academic world, which is that it is quite aggressive. Academic seminars in economics are gladiatorial. It is a bear pit, testosterone-fuelled battle, where people consider they have done well in the seminar if they have shouted down the speaker and shown they are much cleverer than the speaker. It really is a bad atmosphere. It is beginning to change.

Kevin Hollinrake: It sounds like Parliament.

Chair: It is not as bad as that.

Professor Miles: Yes. It is remarkable. I sometimes go to seminars at other departments at Imperial, such as the maths department or the statistics department, and they are much politer and gentler. In the academic world women have really been put off academic economics by that, and it is beginning to change.

The Royal Economic Society here in the UK and the American Economic Society in the US have developed guidance on what is good behaviour. It is, "Do not shout people down. Do not try to show you are the cleverest person in the room". All these things have absolutely been the norm in economics. It is beginning to change. I am hopeful that there will be many more women who decide they want to carry on doing economics and do postgraduate economics. Some will become academics and some will not.

I am glad to say that recently quite a lot of very senior positions in economics in the UK have gone to women. For example, the last two presidents of the Royal Economic Society—which is the premier economic society, certainly in the UK, possibly even in Europe—have been women. One of them was from Imperial College, Carol Propper, and one from the Institute for Fiscal Studies, Rachel Griffith. You will know Clare

Lombardelli, chief economist at the Treasury, and then there are Christine Lagarde at the European Central Bank and Janet Yellen in the US. There are now more women in senior positions in economics than when I was at university by quite a way, but it is still a male-dominated subject.

Q40 **Chair:** It is an interesting point. You are saying that, environmentally, economics has not been a healthy space for women, perhaps. What is happening at the point where women or girls are looking at the subjects they will take at A-levels, where they are presumably not factoring in any potential problems of that nature further down the line? They are just either interested in the subject or not, or encouraged to take the subject or not. What does the data show at that stage?

Professor Miles: I may be wrong—and I need to check on this—but I thought that, if you take the last 10 years, there are more girls doing economics at A-level now than there had been, but the balance between boys and girls doing A-level economics is still strongly in favour of boys. It may be a bit better than it was, but it is still many more boys than girls.

Why is that? This is just speculation, really. It may be that economics still has a bit of a reputation of being that kind of subject that is just all about money, money grabbing and commercialism. People who have a wider set of interests may prefer to do geography or psychology, which in some ways are closely related subjects, but they are not economics. They do not have a perception in some people's minds that they are all about making money and going into banking, so that may be a factor.

Coming back to the Royal Economic Society, there is a really big push, led by women, to try to make it clear to younger people that economics is not just about money, banking and going into the City. In fact, it is largely not about that. It is about social phenomena and public policy issues. A lot of the issues that the OBR is concerned with are about health, demographics, and the distribution and inequality in income and wealth. There is a push on to try to reduce this perception of economics, particularly at the point where people decide, "What am I going to do at A-level; what am I going to do at university?" to get rid of the perception that it is all about money, and money grabbing to some extent.

Q41 **Gareth Davies:** Professor Miles, thanks for being here. I wanted to ask about economic growth and the forecast for economic growth, and then touch on Government debt very briefly, mindful that you have already answered some questions on this. Why do we not start with the OBR's macroeconomic outlook and its forecast? Is there anything you disagree with in what it has published?

Professor Miles: It has moved a fair bit from what was not, at the time, an implausible forecast, back right at the beginning of the year, when there was a view that unemployment would be a lot higher and growth would be a lot weaker. Thankfully, that did not turn out to be the case.

The latest forecast, the October forecast, in many ways is a lot brighter, at least for the near term.

Looking further ahead, from my reading of the OBR work, it has a good appreciation of things that matter a lot and where there is a lot of uncertainty. That does not make it easy to make forecasts, but at least it is better than not understanding the things that you do not know enough about that are really important. On that list of such things are some of the issues to do with labour supply.

It looks like the population in the UK is rather lower than we thought a couple of years ago and the labour force is lower. That is not entirely clear at the moment, I do not think, but that has a material impact on your view of growth over the next few years. If it is true that the labour force in the UK has fallen by a material amount and it does not come back, absent faster productivity growth to offset it, growth potential in the UK is a bit lower than we thought. So the demographics are important.

Right now, there is that obvious uncertainty about how omicron plays out. That has the potential to have an enormous impact on the fiscal outlook. I hope it does not, because, if it does, it is probably going to be a bad one. I am sure the OBR right now is spending a lot of time thinking about the possibilities there. We will learn a lot in the next four weeks. There is still a lot of uncertainty about the assumptions that it has made—I am sure the OBR recognises that it is an assumption, rather than a precise forecast—about what you might call the Brexit impact.

Its assessment, if I remember correctly, is that it knocks 4% off the supply capacity of the UK. For what it is worth, my own view there is that it is unclear which side of 4% we might get to. In my more optimistic moments, I think and hope that 4% might actually turn out to be an overestimate of how much damage, if you will, has been done to the UK economy. That is partly because it depends on issues that could change a lot over the next few decades.

Q42 **Gareth Davies:** The OBR has actually said that it will be double the amount of scarring as a result of Brexit compared to the pandemic. Do you agree with that?

Professor Miles: I would hope that it was not double that.

Q43 **Gareth Davies:** I think we all hope that. Do you think it is right or wrong about that?

Professor Miles: Let me be more precise. If you pushed me for an estimate, I would be inclined to say that the Brexit effect being twice as bad as the Covid effect looks a bit high to me. That is partly a little bit of pessimism about the Covid effect perhaps. Some of the areas where there has been a clear increase in costs to UK companies doing business with the EU, recognition of standards and health, whether you can sell your products into Europe without doing lots of paperwork and whether there will be mutual recognition of standards, are not in a very good place at the moment.

One might hope that it would get better and that would reduce the 4% estimate of how costly it is, which is largely not about tariffs. It is about red tape and difficulties with moving stuff between the EU and the UK. I am hopeful that maybe things will get easier there over time, rather than stay where they are at the moment, which is a bit difficult.

Q44 **Gareth Davies:** Are there any factors that have been particularly compounded by the dual effect of Brexit and the pandemic that perhaps we did not anticipate before the pandemic, if that makes sense?

Professor Miles: Perhaps the number of people who have left the country, European workers who have decided to go back, might have been a little less if them then coming back into the UK was not problematic. They might have decided, "We can go back and we can then come back to the UK". Maybe that is a little more difficult. In terms of attempts to get workers where there are shortages right now—lorry drivers is an obvious one—to come back into the UK, it is perhaps a bit more difficult to get a significant response there than it would have been if the UK had stayed in.

Q45 **Gareth Davies:** We have had a number of hearings on growth. One thing that has come up time and time again is the supply chain shortages that we have been experiencing in the economy. It is a global phenomenon. As of today, what is your current assessment of that issue that we have been facing?

Professor Miles: Supply chains over many decades have become much more global and much more dependent for key components than in the past. We have discovered how stretched they are when there is a bit of disruption somewhere. It is very difficult to change that, because we do not have the capacity, not just within the UK but in lots of countries. There no longer is the capacity to produce somethings anywhere near as cheaply as they are available if you import them. Computer chips would be one example. There are many others.

Economies will remain more susceptible to disruption than they were in the past and it is the price you pay for specialisation. When things work well, this is great. It reduces the cost of goods and we all benefit from that. When something goes wrong, it causes real problems and there is no easy answer to that. You can say, "We should bring back lots of stuff and produce it within the UK", but it is very difficult to do it.

Q46 **Gareth Davies:** There is an underlying long-term trend to outsource production and things like that. I am asking about the current situation, as of today. We have known for months that there is an issue with supply chain shortages and that is having an impact on our—

Professor Miles: That issue may persist for quite a long time. It comes back to the question we talked about right at the beginning of inflation pressures. I am more pessimistic than those who say, "This is all transitory. These supply hold-ups and the shortages are just a couple of months and it will all be sorted out". I have a sense that it will be more protected than that and that is why I am more pessimistic on the inflation front than the Bank of England has been.

Q47 **Gareth Davies:** You have touched on this in an answer to the Chair, but how are you factoring in omicron and the potential issues in Q1 next year to that assessment on inflation that you have had?

Professor Miles: As we were talking about earlier, there are two potentially big offsetting effects. It is not clear which one is the stronger. First, if things play out badly—and we hope they do not—it is probably not an environment where wage negotiations are going to see wages rise a lot. People will be really worried about their jobs. Companies will say, "We are not in a position for a 4.5%, 5% or 6% wage increase at the moment". That, in itself, is a deflationary force.

On the other side, if the disruption to supply is very significant, even though output and production looks like it has been hit by a recessionary force, it may be that the supply potential has been reduced more than the demand for goods. That works the other way. I am sounding like an economist, saying, "On the one hand and on the other hand", but there are two really big forces that could be at play. One of them would cause lower inflation. One of them would potentially cause higher inflation. I would not bank on inflationary pressures obviously eroding and going away quickly just because we have been hit by omicron.

Q48 **Gareth Davies:** There are just two more questions from me. You have touched on productivity and we have had pretty poor productivity growth for years and years. In your vast experience, what are the levers that are most effective at improving productivity growth?

Professor Miles: One thing that has not been helpful in the UK—this has been true for a long time; it is not just about the current Government—is that we have directed a lot of spending at university education and not enough at professional qualifications and more vocational degrees. It is hard to believe that that does not have an impact on how we produce all kinds of things, how we build houses, how we produce manufactured goods.

We probably have the resources going into universities wrong, relative to more vocational courses, training courses and other bits of higher education. I say that as someone who has benefited from lots of resources going into universities. It is a factor. It is a bit difficult to quantify how much, but my gut feeling is that that is pretty important.

Q49 **Gareth Davies:** Skills are important. When you talked about labour shortages, were you talking about the short-term issue of labour shortages, or is that something that you feel is a long-term issue, partly because of the skills shortage that we have?

Professor Miles: It is. It is linked to what has been a bit of a drought in funding of more vocational training, relative to resources going into universities.

Q50 **Gareth Davies:** You have already answered questions on the debt to a certain degree. The Treasury has published very clear guidance on the sensitivity of the economy to rising rates, given the level of debt, and has given some figures around that. What is your assessment of the sensitivity to the cost of servicing debt, if interest rates go up?

Professor Miles: It is more sensitive than it has been in the past because of the Bank of England asset purchases—quantitative easing. You have £800 billion-odd of UK Government bonds sitting in the Bank of England. Effectively, it makes the cost of that debt whatever the bank rate is that the Bank of England pays on the reserves that it uses to finance the bonds that it has bought.

If the Bank of England changes interest rates right now, it has an immediate impact on the effective cost to the wider-defined public sector. It has an immediate impact on £800 billion-odd of debt. That would not have been true before QE. Some of the debt would be 20-year debt, 10-year debt, 15-year debt. You are rolling over only a fraction of that debt every year, so it takes a lot longer for a change in the general level of interest rates to affect the funding costs. The size of that effect is big, just because the size of the purchases is so big. It makes the funding cost of the UK debt much more sensitive in the short run to changes in interest rate.

Q51 **Gareth Davies:** You answered my colleague, saying that something has got to give. You have to do something about the levels of debt that we have. It is not sustainable. At what level of debt would you be really concerned?

Professor Miles: Do you mean for the debt to GDP ratio? It is a concern that we have gone from—what was it?—before the financial crisis 40% debt to GDP roughly. That went up to 80%. Now we have close to, still a bit under, 100%. We have also learned that big shocks come along that really mean you want to have a buffer in extreme situations where you can run a big fiscal deficit for maybe a year or 18 months.

Starting at 100% does not look to me like it gives you much of a buffer for the next nasty thing that could happen a few years down the road. It is hard to disagree with the Government's strategy of having the debt to GDP ratio coming down when you start from such an elevated level of debt, by the standards of recent history anyway.

Q52 **Chair:** There is a final question from me, David. You have appeared before us previously and we have discussed cost-benefit analysis of lockdowns. You have done some very interesting work on that. Do you think that the Government, the Treasury, are doing enough in that area, when it comes to social distancing and the various measures and things that they bring in? Do we have enough information to properly take these decisions in that sense?

Professor Miles: I was doing a bit of that work during the period of the first lockdown, starting to think about these things, which was March, April, May, the summer of 2020. Maybe this is unfair, but my impression was that there was not an awful lot of quantified analysis of the costs of different kinds of countermeasures to the virus, thinking about the negative health and mental health effects of restrictions, as well as jobs lost. I do not think there was an awful lot of that going on back then.

A lot more has been done since. There is a much greater awareness of the very substantial costs of a sustained period of generalised lockdown. The assessment of the costs of that now is better informed than it was back then.

Q53 **Chair:** That is information that is being provided from outside of the Government, presumably, is it? Do you feel that the Treasury is doing sufficient work in this area?

Professor Miles: Over the last year or so, I have certainly talked to some Treasury officials and been involved in a few conferences where there is a lot more discussion of the issues and quantification of the cost side of certain kinds of what you might call blanket lockdown. There is a lot more discussion on that and a lot more analysis of it. There is a lot more recognition on that in the Treasury now than, understandably, there was a year or 18 months ago.

Q54 **Chair:** There may be more, but is it doing enough?

Professor Miles: To be honest with you, it is a little hard to judge from the outside. I have certainly had conversations with Treasury officials where they have been aware of a lot of the literature of estimates for costs of different kinds of things. There is now a much better awareness of some of the longer-term costs of generalised lockdown than there was before. As I say, it is a little difficult for me, as an outsider, to judge quite where they are on all that.

Q55 **Chair:** If there is a value in the Treasury publicly coming forward with analysis in this area and it is difficult to judge from the outside, that would suggest that there is not much coming out for you to base your assessment on.

Professor Miles: I would be a bit careful on that, because I have a lot of different research interests. Having worked on the Covid thing quite a lot in 2020, I have not worked so much on it recently. It may be that there is some good analysis done by the Treasury and it is there, it is in the public domain, and I just have not spotted it. I will be a bit careful in criticising them on that.

Chair: David, thank you very much for appearing before us. That has been very interesting. We have covered a lot of economic issues around inflation, productivity, fiscal sustainability, OBR forecasts, possible impacts of omicron and so on. We have also covered your personal interests that you have. We note the assurances that you provided to Harriett Baldwin on some of those issues. Also, we covered your various time commitments, so that was very helpful. It has been very nice to spend some time with you again. We will be in touch very shortly.

Professor Miles: Thank you very much.