



Treasury Committee

Oral evidence: [Budget 2015](#), HC 1082

Monday 23 March 2015

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Members present: Mr Andrew Tyrie (Chair); Rushanara Ali, Steve Baker, Mark Garnier, Mr Andrew Love, John Mann, Jesse Norman, Teresa Pearce, Alok Sharma

Questions 1-179

Examination of Witnesses

Witnesses: **Paul Johnson**, Director, Institute for Fiscal Studies, and **Rowena Crawford**, Senior Research Economist, Institute for Fiscal Studies, gave evidence.

Q1 Chair: We are running a bit behind schedule. I apologise for that. We had a bit of private business to attend to. I alert you to that table you produced on average UK household incomes since 2002-03. I think that it is on page 4 of your publication. Do you know the document?

Paul Johnson: Which publication?

Q2 Chair: It's in your "Living standards".

Paul Johnson: Okay. I do not have that in front of me, but I think I remember generally what it says.

Q3 Chair: Only generally? If you have a copy to hand—actually, I don't think you can hand that over. I don't think you can do that. Do you remember what it says about median earnings between 2010-11 and 2014-15?

Paul Johnson: Broadly, median earnings between those two dates have fallen. I cannot remember the numbers.

Q4 Chair: I've got it here as, over the period, 0.3%. It is a tiny fall.

Paul Johnson: Sounds plausible.

Q5 Chair: Do you know how you calculated that?

Paul Johnson: It's the fall in median earnings between—

Q6 Chair: Well, do you know how you calculated that? This has become a subject of some controversy in the press, as you have probably noticed.

Paul Johnson: There are various measures of median earnings.

Q7 Chair: I don't want to know about the various measures; I want to know about how you calculated this one.

Paul Johnson: I'd need to see that table because we have provided a range of different numbers on median earnings depending on the different—are we talking about earnings or incomes?

Q8 Chair: We are talking about average UK household incomes since 2002—

Paul Johnson: Ah, so you're talking about incomes. Sorry.

Q9 Chair: Do you know the answer to that then?

Paul Johnson: The incomes between 2010-11 and 2014-15 are based on the households below average income methodology, which is the same methodology that the DWP uses in producing its annual figures. However, because the last set of figures there are for 2012-13, we forecasted forward, using what we know about what has happened to earnings, the tax system, the benefits system and employment rates over the period between 2012-13 and 2014-15, to project median incomes over that period. That allows us to compare, with a fair degree of confidence, what we think median incomes would have been in 2014-15 with what they were in 2010-11.

Q10 Chair: Okay. Since you do not have the data after 2012, you have had to make projections for it, haven't you?

Paul Johnson: Yes.

Q11 Chair: And you've done that using the labour force survey, ONS population projections, various OBR forecasts and Bank of England forecasts, among many other sources. Is that right?

Paul Johnson: Yes. For most of the stuff in 2014-15, we have not needed to use forecasts because we know what earnings are right up to quarter three.

Q12 Chair: But they are earnings, not, as you pointed out a moment ago, household incomes.

Paul Johnson: Yes. We know earnings, but we also know what has happened to taxes, benefits, interest rates and so on.

Q13 Chair: So you are using earnings data to try to work out what the effect on households is.

Paul Johnson: Yes. We have a snapshot of what incomes were for all households in 2012-13. We know, essentially, what has happened to each of those components. We know what has happened to employment rates, earnings, interest rates, taxes, benefits and so on. So we can, with quite a lot of confidence, project forward to 2014-15 what the whole range of those incomes is likely to be.

Q14 Chair: In the whole period—that is, for 2010 to 2015, or indeed for this whole table—have you adjusted for the fact that when large numbers of people enter the labour market, such as young people, the median or the average is dragged down?

Paul Johnson: The median, in our numbers, is the median in 2014-15 compared with the median in 2010-11. That is clearly a changing population in the sense that there are—

Q15 Chair: That's the question I am asking—correct. Have you adjusted for the fact that the cohort has changed?

Paul Johnson: We haven't adjusted, because I think that is the wrong thing to do in terms of looking at the median in one period compared with the median in another. There is another question that you could ask, which is: for all those households that were there in 2010-11, what is their median in 2014-15?

Q16 Chair: Exactly. And what is the answer to that question?

Paul Johnson: That's not a question we have asked.

Q17 Chair: Why not?

Paul Johnson: I am not entirely sure that that is an interesting question, but it is certainly—

Q18 Chair: Isn't it the most interesting question?

Paul Johnson: Well, we have done that specifically looking at earnings. We have looked at the median earnings for those who are in work in both periods and have stayed in work.

Q19 Chair: And what is the answer?

Paul Johnson: The median rises significantly more if you just look at those who are in work for the whole period.

Q20 Chair: How much does it rise by?

Paul Johnson: I can't remember that number. It's in one of our publications.

Q21 Chair: Okay, but is there a significant rise for earnings?

Paul Johnson: Yes.

Q22 Chair: So you've taken earnings data in order to make adjustments since 2012—we have just been through all that—and you have interpolated it to try to achieve an estimate of what would happen to households. But you have missed out this—a huge adjustment—and you have not given us an estimate of what the household data would be for those households that had people who remained continuously in work over that period, have you?

Paul Johnson: Well, that's a different question.

Q23 Chair: It is a different question; it's the question I am putting to you that you should have answered and did not answer.

Paul Johnson: Sorry, it is a second different question to the one you originally asked. You have asked two questions. The first was: what is the overall household median for all those households that were there in 2010-11 and were still around in 2014-15? What would the difference there be? That would exclude new households that are formed as a result of either immigration or of 16-year-olds becoming 20-year-olds. It will also exclude pensioners or others who are dying at the end. So you would have a select part of the population. Your second question was about those are staying in work over that period.

Q24 Chair: I understand that. I am asking you why you have not made an estimate of household income data for those households where employment has been continuous.

Paul Johnson: For where employment has been continuous? We have done that for earnings. It would not be terribly hard to interpolate that for income as a whole, earnings being the large—

Q25 Chair: Why haven't you published it?

Paul Johnson: We haven't calculated that for income as a whole.

Q26 Chair: Why don't you publish that?

Paul Johnson: We might be able to look at that.

Q27 Chair: Okay. Perhaps you could come back in 24 hours, since you said it would not be very hard, and supply that.

Paul Johnson: I very much doubt we could do that in 24 hours, but we will see what we can do.

Q28 Chair: Why don't we make it 12 hours? You have just told us it's not very difficult. We would like the answer. It seems to me to be a crucial number. You have put out what has been interpreted as a fall in household incomes, when in fact—

Paul Johnson: Sorry, your first question was about earnings, and earnings have gone down. Incomes have not gone down; incomes have gone up, certainly up until 2014-15.

Q29 Chair: That's right. You need to look at both sides of the picture, and what you've done is miss out one part of it, because you have not fully adjusted for households—

Paul Johnson: I disagree with that characterisation: we haven't missed out one side of it. It is the case that what we have shown is the difference between median incomes now and median incomes then.

Q30 Chair: You may disagree with it, but that doesn't really matter, because you are going to supply us with the data, and then we can have a look and make up our own—

Paul Johnson: I will ask my colleagues what can be done on that. It is a lot easier to do the earnings bit for earnings than the earnings bit for the whole of household income.

Q31 Chair: Wouldn't it have been better for the IFS to have said, "People entering the labour market for the first time are entering it at a bigger differential from the median than they have in previous recessions"?

Paul Johnson: That is true, yes.

Q32 Chair: Yes, and that's what accounts for this effect.

Paul Johnson: Well, that's certainly part of what is happening.

Chair: A very large part of it.

Paul Johnson: But as I say, on earnings, that is exactly what we have done; we have published exactly that.

Q33 Chair: Mr Johnson, is that point made in your report?

Paul Johnson: On earnings, yes it is—exactly that point.

Q34 Chair: But not for households.

Paul Johnson: Not for households.

Q35 Chair: Don't you think that's an omission, Mr Johnson?

Paul Johnson: Well, as I say, we have shown that for earnings, and the point carries across quite clearly.

Q36 Chair: Yes, but don't you think it's an omission?

Paul Johnson: What's an omission?

Chair: It is an omission not to have drawn out the numbers, which we are now asking you for, to show the same calculation for households.

Paul Johnson: I will see what we can do on households, and I will tell you afterwards whether we think it's an omission or not.

Chair: Well, you have pretty well said as much in evidence just now.

Q37 John Mann: On Thursday 19 March, on the "Today" programme, the Chancellor was asked about the savings he had made in the welfare budget and he said:

“We’ve saved £21 billion in this Parliament”. Is he right, or do you think he possibly misheard the question?

Paul Johnson: It depends, as ever, on what you take the counterfactual to be. Broadly speaking, if you take the counterfactual as the set of rules that were in place back in 2010, including the indexation rules, then relative to that counterfactual, the set of policies that have been put in place have resulted in spending now being roughly £20 billion less than it otherwise would have been; but because of a series of other things that have happened, the actual amount being spent now is almost exactly the same as it was back in 2010, so you can take it either way, in a sense. We are spending about £20 billion less than we would have, had no changes been made. We are spending about the same as we were, because we have an ageing population, and earnings have been going down and so on.

Q38 John Mann: I would imagine that the general public are not interested in theoreticals and are interested in actuals, and I would imagine that you are interested in actuals, so what is the actual reduction in the welfare bill since the Chancellor came into post?

Paul Johnson: In real terms, the amount we are actually spending now in total on welfare is about the same as we were in 2010, with about a 6% increase in what we are spending on pensioners and a 6% reduction in what we are spending on people of working age.

Q39 John Mann: So it’s about the same.

Paul Johnson: The total amount being spent is about the same.

Q40 John Mann: So when the Chancellor says that he has saved £21 billion, that is not in fact accurate; that’s entirely notional.

Paul Johnson: I would dispute that. He is accurate in the sense that had he done nothing, we would be spending £20 billion more than we are in fact spending.

Q41 John Mann: He’s now saying he is going to save £12 billion.

Paul Johnson: That’s on that notional measure, I think. That £12 billion is the same kind of number as the £21 billion number.

Q42 John Mann: So what will the actual saving be, in your calculation?

Paul Johnson: I have no idea how he intends to save that £12 billion. The point is he has told us he wants to save £12 billion. He has told us about probably less than £2 billion of that, in terms of what he wants to do, which is essentially to do with freezing some working-age benefit. He told us nothing about the other £10 billion, so I have no idea.

Q43 John Mann: So there's £10 billion where we don't have a clue.

Paul Johnson: True. Correct.

Q44 John Mann: So how confident would you be, looking at his success in cutting actuals in this Parliament, that he will be able to cut actuals in the next Parliament, on welfare?

Paul Johnson: Two questions, I think. Cutting actual spending will remain difficult because the number of pensioners continues to rise, and the amount we are spending on pensioner benefits continues to rise, so that makes cutting the overall budget difficult. It is also extremely difficult to see where you find £10 billion of savings on the working-age welfare bill, which is where he says he wants to find that money. You are not going to be able to do that without substantial reductions to child benefit or big reductions to tax credits, housing benefit or disability benefits. We do not know which of those he is going to try.

Q45 John Mann: Do you think that the £12 billion is net of increases in spending on pensioners?

Paul Johnson: My understanding of the £12 billion is that it is a similar number to the £21 billion number. He would like us to be spending £12 billion less than we are currently forecast to spend, so they are policy changes that will result in us spending £12 billion less in 2018 than we would have spent had he made no policy change.

Q46 John Mann: But he is talking about working-age benefit expenditure.

Paul Johnson: Yes.

Q47 John Mann: So in fact what he is saying, and his projection, is that he will be spending as much on welfare.

Paul Johnson: I do not know how much the increase in pension spending is over that period.

Q48 John Mann: Just so there is no confusion, if we take the increase in projected spending on pensioners in whatever category and deduct that from the £12 billion, that will be the actual saving in welfare spending.

Paul Johnson: Not quite, because that also depends on what the current forecasts are for all the other bits of spending. The £12 billion is the net effect of policy change as yet unannounced.

Q49 John Mann: What hidden nasties will there be? I am talking financially, of course, but if you are taking £12 billion in actual terms out of working-age benefit expenditure, technically how can you do that? What kind of things would have to be done for that to happen?

Paul Johnson: By 2017-18, you could not do that just by freezing benefits for working-age people. That would get you a fraction of the way there.

Q50 John Mann: £2 billion.

Paul Johnson: £2 billion for two years of freezes for those things that he is freezing. It might get you to twice that if you froze everything for working age over that period. For example, you could save £5 billion by abolishing child benefit and only compensating those who would be on universal credit. You could save a similar amount by taking child tax credit levels back to where they were in 2003. It would clearly increase child poverty if you were to do that. You could save an amount by stopping all housing benefit at 90% of the total rent that people get, or by some substantial cuts to disability benefit. Getting £12 billion, which is more than 12% of the working-age welfare budget, in a three-year period would require some really substantial changes to those benefits.

John Mann: The OBR—

Chair: John, just one more question.

Q51 John Mann: It is a question on how difficult you find the OBR's job. The OBR, which has highlighted a history of optimism bias about welfare reforms, is expected to make projections on a whole series of indicators, based on a saving that is not identified and that would appear from historical precedents to be incredibly difficult for a politician to choose to achieve. So how reliable can OBR estimates be when nobody knows what a critical part of the Chancellor's Budget is actually about, because he has not outlined it?

Paul Johnson: To be clear, the OBR numbers do not include any of that. Well, they may include the £2 billion that he gets, but they include none of the £12 billion. The Chancellor has not set out and made a clear policy on what that is going to be, so the OBR numbers exclude all of that. It is one of the reasons why the Chancellor says, "The effects on public service spending will be less than is shown in here, because I am going to find that £12 billion." Because there is no clear policy, the OBR has not included that £12 billion in its numbers.

Q52 Rushanara Ali: Mr Johnson, could you elaborate further on what the £12 billion cuts could amount to over that period? You mentioned rising child poverty and potential cuts in disability benefits. Can you describe once again in what areas the cuts would have to be made?

Paul Johnson: If you are looking at working-age benefits, the very large majority of that, as you would expect, goes to people in the bottom part of the income distribution. There are two significant benefits where some go higher up the distribution. One is child benefit—of course, that no longer goes to anyone earning more than £50,000 a year—and some disability benefits for those who are in work, which is a relatively small proportion. You could not make £12 billion-worth of cuts without hitting people towards the bottom end of the distribution.

If you look at the big bits of the budget for benefits for working-age people, you clearly have significant amounts going on child tax credits. Actually, those credits were made very, very much more generous over the period from 1997, but even from 2003, so you could decide to say, “Let’s return child tax credits to their real-terms level of 2003.”

Q53 Rushanara Ali: So how much—

Paul Johnson: That would save you about £5 billion a year.

Rushanara Ali: If you reduced it to make a saving of £5 billion, what would be the reduced unit cost?

Paul Johnson: We have those numbers in the Green Budget; I don’t have them exactly. That would have a direct knock-on effect on measured child poverty.

Q54 Rushanara Ali: So around what?

Paul Johnson: Again, we have those numbers in our Green Budget, and it would be equivalent to several hundred thousand.

Housing benefit accounts for significantly more than £20 billion of the budget—about £20 billion for people of working age. Again, you would have to make significant changes to get £5 billion off that sum. For example, you could decide to cover only 90% of rent, rather than 100% up to the 30th percentile in the local areas. You would struggle to save that much unless you were also beginning to hit social tenants and social housing. These are significant changes.

Q55 Rushanara Ali: Would you anticipate homelessness going up significantly if that happened?

Paul Johnson: There would have to be some reaction, either in the sense of people not paying their rent and being made homeless, or rents coming down in the long run, or something. My point is not that these changes are impossible, but over a three-year period it is hard to think of changes that would not have a very substantial effect.

Q56 Rushanara Ali: Is the pathway of spending cuts for three years, followed by a rebound in spending in the final year, sensible? Would it not be better to spread those cuts over a longer period? What is the rationale for the final year of increased expenditure?

Paul Johnson: Well, I think that at some point austerity, as it were, or spending cuts, have to come to an end. At some point, you have to move from reductions to increases.

Q57 Rushanara Ali: But is it sensible to do it in that way? Isn't it better to spread it across if you are going to make—

Paul Johnson: You would certainly get a smoother transition if you went in a straight line from where we are in 2015 to where we want to be in 2020, rather than going down and then up again. A straight line may well enable you to do it slightly more rationally. On the other hand, you would end up with more debt at the end, because you would not have cut the spending in the middle.

Q58 Rushanara Ali: But with fewer social consequences.

Paul Johnson: Possibly.

Rushanara Ali: But that is what you are suggesting from your earlier answers.

Paul Johnson: It would clearly be easier to do it on that flat trajectory, but, as I said, you have to move from going down to going up at some point.

Q59 Mark Garnier: To go back to earnings briefly—we do not want to spend too much time on it—if you look at the annual percentage change in medium full-time gross weekly earnings for all employees, and those for continuous employees, the figures look very different. If you look at the figures for those in continuous employment, in nominal terms since 2010 earnings were up 15.6%, and in real terms 3.1%. That is quite impressive, isn't it? That is a lot different from what you are suggesting in some of your figures. I know that they are different from the—

Paul Johnson: As I say, we put out exactly those figures. Over that period, the earnings of the median earner have gone down. If you look at the earnings of those who have stayed in work—

Mark Garnier: In real terms.

Paul Johnson: In real terms, they have gone up slightly. That relationship is constant over time. We have looked at this back to the early 2000s, and, as you would expect, you always find that for those in constant employment, their earnings go up more than those of the population as a whole. That is partly because those people are getting older. For the very large majority of people, at 30 you will be earning more than you were at 25. That effect has several things going on in it, but you are right: for those people who have stayed in work between 2010 and 2014, their earnings have gone up somewhat in real terms.

Q60 Mark Garnier: But if you start off with a working population of 28 million people at the beginning of the period, and by the end you have 30, 30.5 or 31 million people—significantly more people coming into the work force—that will have an effect on the average, won't it?

Paul Johnson: Yes. You've got compositional changes. You have more people coming in, and that is having an effect.

Q61 Mark Garnier: Two figures have been bandied about in a great sort of hot, political debate at the moment. On one side of the Chamber, people are saying that the average worker is £1,600 a year worse off, and on the other side, people are saying that they are £900 a year better off. Some figures take into account tax changes and some do not. Some take into account medians. Some take average or whatever. What is the answer? Are people better off or worse off than they were in 2010? What do you think?

Paul Johnson: Median household incomes in 2015 are very likely to be higher than they were in 2010.

Q62 Mark Garnier: So people are better off? Including taxation deductions?

Paul Johnson: Once you take out all of income and all households, the median income is highly likely to be higher in 2015 than it was in 2010.

Q63 Mark Garnier: In real terms?

Paul Johnson: In real terms. The £1,600 a year worse off figure is a gross median earnings figure comparing April 2014 with 2010. That is not taking into account increased levels of employment, or tax and benefit changes and so on.

Q64 Mark Garnier: So I can happily go away and tweet that the IFS says that in 2015 you will be better off than you were in 2010?

Paul Johnson: Not "you will", but the median household will. You can tweet that the median household incomes in 2015 are likely to be higher than they were in 2010.

Q65 Mark Garnier: Fantastic. The definitive answer is that we are better off. Thank you very much. That is what we were after. Can I get back to looking at the work of the OBR? Obviously, you can criticise them in front of them; they're behind you in the Public Gallery.

Paul Johnson: I wouldn't dream of it.

Mark Garnier: I really want to ask more about the work that they are being expected to do. This will be an opportunity, perhaps, for you to support them. You are quoted as saying, "It is a terrible shame we are going into the election with these big numbers being bandied about, on both sides, without any detail about actually how that is going to be achieved." Is this quite an unusual situation?

Paul Johnson: I don't think it is terribly unusual. I don't think that we went into the 2010 election with any real detail about where spending cuts and so on would come from or, indeed, exactly what was going to happen to spending and tax post-elections. I don't think it is terribly unusual. The slightly odd situation is that, in a sense, we have vastly more data now, but it probably does not relate to anything that is actually going to happen. It certainly does not provide us with detail of anything that is going to happen after the election.

Q66 Mark Garnier: Given the fact that the Budget is a coalition Budget, and then you have the parties going in with their own party manifestos, does that not make it a lot more difficult for the OBR or, indeed, anybody to try to predict what is going to happen over the next five years?

Paul Johnson: You can ask the OBR, but I think that it does make it difficult. We are in this genuinely slightly odd situation in which none of the parties are fully signed up to the things that are in the OBR document. The Chancellor, for example, says that he wants to achieve £12 billion of cuts in the social security budget, but claims that he cannot spell those out as policy because he is part of a coalition. Whether, in fact, he would want to spell them out, I do not know.

Q67 Mark Garnier: What is your view on whether the OBR should be costing political parties' proposals or manifestos?

Paul Johnson: In one sense, the difficulties associated with the numbers in here—in the coalition plans—are illustrative of how very hard it would be for the OBR to do that because they would want hugely more detail from parties than parties are likely to be producing. If they were not to get those details, they would have to make assumptions about what they could or could not do with welfare or with DEL. My sense is that, for that to happen properly, it would involve a bigger change in the way parties behave than I suspect most people appreciate—possibly for the better. But I think we would need to recognise that by asking the OBR to provide these costings, we may be forcing a substantial change in the behaviour of parties in order to provide them with the kind of data they would need to provide detailed, serious and credible numbers. I don't think they could do that on the basis of what is currently being produced.

Q68 Mark Garnier: That is an incredibly interesting answer, because I don't think anyone has come up with that view before. There has been, as you know, a big debate going on about whether the OBR should be given the opportunity to do exactly this for the

manifestos. But you are saying that the expectation for the OBR to do it properly is possibly almost beyond quite a lot of parties. Even the major parties, which get plenty of help from accountancy firms and so on, would be fairly stretched to come up with a manifesto sufficiently well costed that it would enable the OBR to come up with a sensible forecast.

Paul Johnson: Because I think you may well end up with the same kinds of issue that you have ended up with here. Unless you spell out in detail, for example, what your welfare policies are going to be, you end up either saying, “Well, we don’t know so we’ll stick it all into DEL,” or it gets treated as a residual or what have you. It may be a good thing. I am not sure that all of this is technically beyond the parties, but it would change the level of detail that they needed to present to the electorate. As I say, that may be a good thing, but it would be odd if it was, as it were, the OBR tail wagging the political dog.

Q69 Mark Garnier: It could disadvantage a smaller party that does not have that many resources, in terms of there having to be an awful lot of assumptions about what they are coming up with.

Paul Johnson: Possibly.

Q70 Mark Garnier: Presumably, if a political party has, purely hypothetically, a pretty earth-moving policy such as taking us out of the European Union, there will be enormous consequences that are far too hypothetical for many people to come up with, or certainly for the OBR to come up with, in any meaningful period of time.

Paul Johnson: Yes. That would not be one I would want to model.

Mark Garnier: Okay. Fair enough.

Q71 Chair: Changing the behaviour of political parties in response to the fact that they would have the discretion to ask the OBR might strike one as exactly what one wants to see. Would you agree?

Paul Johnson: Well, it might be, but I think you would want to be clear that that was the potential outcome.

Q72 Chair: So, in principle, if we could get agreement between the major parties to do this, that approach might have some merit.

Paul Johnson: I think it would have some merit, but it would have a bigger effect on the way we run politics than people expect.

Q73 Chair: Is that not something we should be looking at very carefully—after the election, since trying to agree such a thing in the year of an election is extremely difficult?

Paul Johnson: I would have thought it was the sort of thing that you would want to work out within the first two years of a new Parliament.

Q74 Chair: And the IFS is not going to get upset that part of its monopoly or bailiwick would be trumped by the OBR?

Paul Johnson: We seem to have survived the existence of the OBR so far. If they extended their remit, I think we would hopefully survive.

Q75 Alok Sharma: Your colleague Stuart Adam has rather ungenerously described the Help to Buy ISA as a “rather dubious policy”. Can I ask, Mr Johnson, what is dubious about wanting to help people to get on the housing ladder?

Paul Johnson: I think the concern is—the issue in the housing market is essentially one of supply and the way that supply and demand meet or do not meet. By increasing the amount of money available to purchase houses without changing the supply, and given the inelasticity of supply, I would not expect supply to be affected. A large part of the impact of this will simply be increased prices, which may actually have the unintended consequence of making current house owners better off.

Q76 Alok Sharma: What is the basis of that assessment? You are right—Mr Adam did say in his presentation on the Budget measures that the Help to Buy ISA would “bid up house prices”. Where does that come from? Is that just something he plucked out of the air? What is the basis for that statement?

Paul Johnson: It is plucked out of an understanding of how tax policies have affected prices in the past. For example, we know that previous reductions in stamp duty for first-time buyers and so on have had some effect on house prices. I do not think he was saying that all of the effect would be on house prices, but some effect is likely.

Q77 Alok Sharma: The Help to Buy policy itself is under review by the Bank of England. We had the Governor here a few weeks ago. I asked very clearly whether it has had an impact on house prices, and he said no and that it is kept under review. If the Help to Buy scheme has not had that impact, why are you suggesting that this scheme will have an impact?

Paul Johnson: Because, as I say, if you increase the amount of money available to people without increasing the supply, that is one possible effect.

Alok Sharma: Okay, this is conjecture.

Paul Johnson: It is hypothetical. We don’t know for sure.

Q78 Alok Sharma: No, exactly. Tell me, when do you think this might materialise? At what point do you think this increase in house prices might come through as a result of this policy?

Paul Johnson: Well, it could be from any point from the announcement through to the policy coming into its full effect.

Q79 Alok Sharma: And how would you measure that, then?

Paul Johnson: That is an interesting question, but you would presumably want to look at the difference in, the changes in prices of, those kinds of properties that are affected, between up to £450,000 in London, £250,000 elsewhere, and what is happening to other properties.

Q80 Alok Sharma: Do you think that perhaps the IFS has not really understood this policy? Because Mr Adams said that this would particularly help those who had £12,000 in savings already, but you have to pay that £12,000 in over a number of years before you get the maximum £3,000 benefit; so this idea that it will help people who just have £12,000 sitting there—that is not correct, is it?

Paul Johnson: Well, it is, because that is always the experience of these kinds of savings policies. It is those who have savings in some other form who are able to most easily take advantage of the tax break.

Q81 Alok Sharma: But hang on; if you are looking to buy a house and you want to get a deposit together, are you going to be prepared to wait four years for that extra £3,000 if you already have £12,000 saved up? I am not sure I follow the logic of this.

Paul Johnson: For some people, getting a 25% increase on £12,000 is going to be worth a fair bit.

Q82 Alok Sharma: Okay, so you think people would be prepared to wait for four years and have £12,000 sitting there—they would dollop in a certain amount of money every month, because at the end of four years they would get £3,000; and in the mean time, if you are correct, house prices are galloping away. It has got to be one or the other, surely.

Paul Johnson: Or both. These are possible effects at the margin. I am absolutely not denying that this will be helpful to some people—absolutely. None of this is denying that some people will put it in out of earned income, saving money they would not otherwise have saved; but experience with all of these types of policies tends to be that most of the money that goes into this is money that would otherwise have been saved in any case.

Q83 Alok Sharma: Just two more questions on this. The Government's own estimate is that 60% of first-time buyers will take up this offer. Do you think that is a reasonable estimate? Will it be more or less, in your view?

Paul Johnson: I have no idea.

Q84 Alok Sharma: Okay. If you were designing a policy to help first-time buyers, what would you have done?

Paul Johnson: I think the existing Help to Buy policy, i.e. the one carried out via the Bank, plus anything you can do to get more houses built, would be more effective. It is clearly on the supply side of the market where the problem sits.

Q85 Alok Sharma: The Help to Buy policy, you are saying, is a good policy. It has actually helped to unlock house buying for people who would not otherwise have been able to get on the ladder. Correct?

Paul Johnson: I am not fully across the evidence on that, but I suspect so.

Q86 Alok Sharma: Is the Help to Buy ISA a good policy as a way of getting people on to the housing ladder?

Paul Johnson: It will have some effect, but a lot of that will be dead weight.

Q87 Teresa Pearce: On the Help to Buy scheme, what you appear to be saying is that where there is a limit on the number of houses available and then more people come on to the market who are able to buy, that pushes prices up, in your experience.

Paul Johnson: Yes. That is how the market works.

Q88 Teresa Pearce: So that's why you think it won't help.

Paul Johnson: There will be some sharing here. So there will be some effect in terms of increasing house prices—we don't know how much—and there will be some effect in terms of increasing the capacity for first-time buyers to get on to the market. There will be a share. Where that share sits, I don't know.

Q89 Teresa Pearce: The rules are sketchy at the moment, but it seems to be that these are available per person, not per couple. So two people saving separately would get a double amount of allowance from the Government, wouldn't they?

Paul Johnson: If that's how the rules work.

Q90 Teresa Pearce: The rules are a bit sketchy at the minute.

The Chancellor has said that he would like to raise £5 billion more, through measures on tax avoidance, evasion, aggressive tax planning, by 2017-18. Where do you think those sums might come from? Have you any idea?

Paul Johnson: Well, in truth, not really.

Q91 Teresa Pearce: Do you think it is a realistic figure? Is it just an aim?

Paul Johnson: It is clearly an aspiration. It will be very hard to tell, even ex post, whether it has been achieved. We know that some of these schemes have not achieved what they wanted to achieve—for example, the effort to get money out of bank accounts held in Switzerland. Other policies that you see in every autumn statement and Budget—frankly, it is almost impossible to know what the counter-factual was and therefore how much these things have actually raised.

Q92 Teresa Pearce: Just looking at what can realistically be expected to be raised, the OBR figures, and some of them are costed—they seem to come up with a smaller figure than £5 billion.

Paul Johnson: The £5 billion is things that he has not yet announced that he thinks he might be able to announce, so again, it is like the £12 billion of welfare savings: there is no policy; there is just an aspiration.

Q93 Teresa Pearce: Right, okay. So how accurate have the forecasts of income from anti-avoidance and anti-evasion been in previous years? We are talking about what he plans to do. What about what he actually did? Were those figures accurate?

Paul Johnson: Well, as I say, we know that one or two of them weren't, in particular the one around Swiss bank accounts. For a lot of the others, I do not know actually, and perhaps colleagues from the OBR will have a better sense of that.

Q94 Teresa Pearce: Right. What he actually said was that he needs to achieve £30 billion of further savings: "I'm clear how the £30 billion are going to be achieved—£13 billion from Government Departments, £12 billion from welfare savings and £5 billion from tax avoidance." If he fails in that £5 billion, where else will he get it from? Do you believe that it would then be more from welfare savings or more from Government Departments? Have you any ideas?

Paul Johnson: That will be a choice for the next Government. As we have said a number of times, elections tend to be followed by tax increases, and obviously if he is not

managing to find this from tax-avoidance measures, he may find it through other tax increases, or he may decide to do it through spending.

Q95 Teresa Pearce: There are a number of historic tax liabilities from offshore accounts that people did not know about, like Switzerland, but through HMRC disclosure facilities, much of this has been collected already. Is there some “pot of gold at the end of a rainbow” tax that has been evaded that we can grab; or has the majority of unpaid tax actually been collected now? Do you have any idea about that?

Paul Johnson: There isn’t an easily grabbable pot of gold or it would have been grabbed by now. These numbers are desperately slippery because you are trying to get at counter-factuals. If you add up all the supposed impact of tax-avoidance measures over the last 15 years, you get to a very big number. The idea that that big number represents an amount that we would not have been collecting had none of this been happening seems rather odd. It would be a rather odd world we were living in, so I find these numbers a bit too slippery to make a lot of sense of, to be honest.

Q96 Teresa Pearce: HMRC has issues at the moment with staffing, for a start, so it is meant to collect more money with fewer people. But one of the areas where there is under-collection has meant, according to the HMRC’s and the Treasury’s own figures, there is £500 million-worth of tax that is not being paid by landlords on rent that they collect. Much of that money will be money that is paid to landlords through housing benefit. It is not one of the ones listed as where he is going to get the money in, but surely that could be a double collection. You have talked about the housing benefit bill being quite high. Taking money from housing benefits and then not paying the tax—should that not be one of the things that should be targeted?

Paul Johnson: I am not familiar with that particular number, I’m afraid.

Teresa Pearce: I will send you a copy of the letter. Thanks.

Q97 Jesse Norman: Mr Johnson, you’ve said that the proposal to change the tax system to allow people to cash in their annuities looks like a sensible move. Why do you think that?

Paul Johnson: Given what happened last year—as you know, saying that people do not have to have an annuity when they retire—a sort of symmetric liberalisation might suggest that you would allow people who had an annuity to cash it in without a significant tax penalty, which you would have at the moment.

As you will see, we have gone on to add two rather important riders to that. One is that you may liberalise things to allow it to happen, but it may nevertheless be that the market does not even develop because there is a very obvious adverse selection problem here. The second is that, again as we have shown, you may feel you need to worry about whether people will make appropriate choices, given the information they have available and given that we know cognitive capability falls, on average, after age 65 or 70. In particular, a lot of

tests show that numerical ability just falls over time, so there are risks associated with mis-selling, if the market exists at all.

Q98 Jesse Norman: Right. It's a slightly odd answer because you make it look like a piece of Palladian symmetry, but I am interested in what the economic benefits of a liberalisation would be. What would the economic benefits be of such a thing? Why might one want to do that?

Paul Johnson: In general, you might think that if you force people to do something, which means people being forced to buy an annuity and you think people are the best arbiters of what is best for themselves, un-forcing them, as it were, might increase their welfare.

Q99 Jesse Norman: Right, and that is with the caveats that you have described? That, broadly speaking, is the house view of the IFS?

Paul Johnson: Yes, subject to those important caveats. As I say, I think I may have said to the Committee this time last year that there is a sense in which the economic rationalist in me, which feels that probably the best thing for most people is to buy an annuity, is rather in conflict with the libertarian within me, which says that probably most people know what is best for them.

Q100 Jesse Norman: Right. We will leave you, if we may, to the results of that psychological tussle, but the general view that, as it were, economic benefit flows from people being allowed to do their own thing, provided that they can avoid certain obvious behavioural traps of the kind you described, is well established and it is—

Paul Johnson: I think it is a good place to start, certainly.

Q101 Jesse Norman: It's an IFS view. So then the question is what you think the fiscal impact of the reforms will be.

Paul Johnson: There are some numbers that have been signed off by the OBR in terms of the fact that this might bring some small number of hundreds of millions of pounds of tax receipts in early, but that is one of those sets of numbers that is marked with the “extremely uncertain” badge, because it is extremely hard to know what the actual behavioural effect would be. Clearly, if it does bring that money in early, that means it won't come in later. Certainly, one of the effects of the reforms announced last year, we would expect, will be to increase tax revenues in the short run and reduce tax revenues in the long run, but there is just vast uncertainty around this.

Q102 Jesse Norman: There might be some net economic benefit from bringing the realisations forward?

Paul Johnson: Economic benefit to the Government?

Jesse Norman: Yes.

Paul Johnson: Well, not in the long run. You ought to discount the money appropriately and think that money now is fungible with money in the future.

Q103 Jesse Norman: It's awash? You haven't looked at the OBR numbers? You don't have a house view on whether they make sense or not?

Paul Johnson: We certainly agree with the OBR that they are extremely uncertain. The OBR has put in a positive number. There has to be a positive probability that the actual number will be zero, depending on whether the market springs up or not.

Q104 Jesse Norman: But there could be a positive economic benefit if, as it were, the behavioural concerns that you flagged were more than offset by the net increment in economic activity?

Paul Johnson: If, for example, it allows people to spend money that they otherwise would not have spent, then perhaps.

Jesse Norman: Thanks very much.

Q105 Chair: Thank you very much for coming to give evidence. We are looking forward to one small piece of additional statistical evidence, as soon as possible, and certainly before we see the Chancellor tomorrow, unless you come back to me and tell me—

Paul Johnson: I'd be very surprised if we can do that by tomorrow.

Chair: Well, you have plenty of time between now and then, Mr Johnson, to do something. You did say it wouldn't be very difficult.

Paul Johnson: I really don't think we can do this for tomorrow, but I will speak to colleagues.

Chair: I had better not detain you any longer. Thank you very much indeed, Mr Johnson, for coming to give evidence to us today. Does the IFS normally go home at 5.19? Maybe that's why the evidence was incomplete in your report. We will go straight on to the OBR.

Examination of Witnesses

Witnesses: **Robert Chote**, Chairman, Office for Budget Responsibility, **Stephen Nickell** CBE, Member, Budget Responsibility Committee, Office for Budget Responsibility, and

Graham Parker CBE, Member, Budget Responsibility Committee, Office for Budget Responsibility, gave evidence.

Q106 Chair: Mr Chote, can you assure the Committee that there has been no political interference putting pressure on your work?

Robert Chote: I can.

Q107 Chair: And have you have had all the help that you reasonably might need and expect from the Treasury and other parts of the Government in order to do this job?

Robert Chote: Yes.

Q108 Chair: Have you found there to be more political pressure on you, this being the first time the OBR has had to go through a pre-election period, than in any previous experience that there might have been? For example, Mr Parker might have seen this on the inside, with pressure on officials to alter their views to satisfy political considerations.

Robert Chote: I am not aware of any additional pressure. The knowledge that we remain in the role that we have is quite a good guarantee against that sort of thing. We will treat the analysis in the way that we always do.

Q109 Chair: You have been both sides of this over the years, Mr Parker.

Graham Parker: I have.

Q110 Chair: What's your view of that point?

Graham Parker: I don't see now what I saw then. I only see what comes to the OBR. As Robert said, we haven't really seen any evidence of pressure.

Q111 Chair: We've now been doing this for five years. What have we gained?

Robert Chote: I think we have gained much greater transparency over the content of the public finance analysis. I think we have also gained a greater willingness to discuss and to grapple with the uncertainty that lies around all fiscal and policy projections. If you were to look back at the sorts of data and analysis that were produced when I was at the IFS doing Paul's job in the run-up to the last two elections, the amount of information, supporting data and analysis that underpins the public finance projections has been transformed for the better. That does not necessarily mean that the forecasts will be perfect any more than they would have been under the old regime.

Q112 Chair: We are extremely imperfect, and always will be just one step ahead of guesswork. I want to come back to the phrase you used: understanding of uncertainty. That may be true among the cognoscenti who follow these things, but what about the wider public? Do you think they now have more of a sense that these forecasts are not really what is going to happen, and, if they do not happen, then somehow someone is to blame? In other words, have Government decisions been separated to some degree from the forecasts?

Robert Chote: Yes, but it is obviously always hard to know how widely spread that sort of view and understanding is.

Q113 Chair: Have you tried to do any polling on this?

Robert Chote: No, we don't have the resources to do that sort of thing. As you will be aware, we have the external review of the OBR, which asked stakeholders—the people who are fairly regular consumers of the output, which is not the same thing as the general public—and there is a sense that it has made a difference, and the fact that we are able to explain why. We are not under the same pressure that Chancellors of the Exchequer have been in the past of engaging in what I have always called conviction forecasting. It is easier for us to be candid and up front about the uncertainties and to change our judgments when those things need to be changed.

We have tried to develop a set of tools—ways of presenting the material that we do—that addresses uncertainty. Those tools range from, in our projections, the fan chart scenario, analysis and sensitivity to, more recently, the assessment of uncertainty around particular projections of policy measures, which you were kind enough to say that you found useful. It is nice that members of the Committee draw on that when they look at particular measures.

Q114 Chair: There is also the question of the fact that you have been operating in the unique conditions—virtually unique in modern times—of a coalition. Your recent letter to the Chief Economic Adviser to the Treasury said that you have taken legal advice on the options and constraints that the OBR faces when it is forecasting. Presumably that is what this is a reference to. What was the nature of discussions that led you to take that advice?

Robert Chote: It was basically that at the beginning of the year I was conscious that the legislation, which you kindly provided us with as an underpinning for the OBR's operation, requires us to produce our analysis on the basis of Government policy. My concern was: what is there isn't a Government policy. What does one do under the circumstances that the coalition, for example, could not agree a medium-term path for public expenditure?

The advice that I took was basically to see what the options available to us were, what the constraints were, and what the legal view of how one should interpret Government policy under those circumstances was. It was useful to have that discussion earlier on in the process as both parties in the coalition then knew where they stood. We ended up with them choosing to agree a medium-term spending projection to underpin our forecast. The Liberal Democrats also, of course, chose to set out an alternative fiscal plan of their own.

Q115 Chair: Who did the advice?

Robert Chote: The legal advice? Treasury solicitors¹.

Q116 Chair: Do you feel able to publish that?

Robert Chote: I think I had a conversation. I am not sure—it was notes. Basically, the score was that it underlined—

Q117 Chair: This is very informal.

Robert Chote: Yes. The basic gist was to say what constitutes Government policy and, in the event that there isn't Government policy, what options were available. For example, if there had not been an agreement on what to assume in the medium term, one option would be for us to take the policy that was agreed last time there was an agreement, use that as a baseline, and for the parties to explain any differences from that. As it turned out, that did not end up being necessary.

Q118 Chair: If I can take you back to your letter to Dave Ramsden: "Given the recent desire of the Coalition parties to make their individual positions clearer—combined with our legal duty to produce a single forecast—I felt that it was important to take legal advice on the options and constraints we face." But you relied on a phone call as a piece of legal response to that.

Robert Chote: Well, a meeting with the Treasury's legal chief.

Q119 Chair: You don't think that that was a bit seat of the pants for something that was so important?

Robert Chote: No, I think that it was important to ask that question, to get an answer and to be clear with the parties what the position was.

Q120 Mr Love: Mr Chote, the OBR described as "a rollercoaster" the profile to implied public services spending. That has been picked up by almost every media outlet. Was that intentional and why?

Robert Chote: I think it was important to set out the consequences of what we were just talking about—the medium-term profile for public expenditure that the coalition had agreed as a baseline policy assumption for the forecast and what that implied for the path of public services expenditure. As you will be aware, we basically require the Government to tell us what their policy is regarding how much they want to spend on public services spending and capital investment for those years for which there are not concrete plans. At the

¹ *Note by witness:* Specifically, 'Treasury Legal Advisers'

moment, the concrete plans only extend to 2015-16, so we need to know what the Government wish to assume is their policy thereafter. For some time, the Government have chosen to answer that question indirectly by not telling us directly how much they wish to spend on those things, but saying, “This is our assumed desired path for total public expenditure.” We can then subtract from that the bottom-up forecast that we do for things like debt interest, welfare spending and other annually managed—in other words, not multi-year planned—spending. That leaves you with an implied figure for departmental spending.

The rollercoaster basically refers to the fact that if you carry out this exercise, it shows in 2016-17 and 2017-18 larger real cuts in spending year on year than any we have seen over the Parliament to date and than have been pencilled in for 2015-16, without that swinging round in the other direction in 2019-20. That is because the Government has now dropped the cut in total spending as a share of GDP that it pencilled in at the autumn statement. It had to pencil something in at that point because the autumn statement was the first time we extended the forecast to 2019-20. It is really looking at the underlying profile for public services spending that is implied by those bits of the forecast that we do directly bottom up and by the Government’s chosen fiscal assumption, as they call it—in effect, an assumption for public spending over that period.

Q121 Mr Love: You also complained about the 428 words. You pointed out that they took 428 words to describe their fiscal assumption. Why was that? Why did you think it was important? Is it too complex and difficult?

Robert Chote: For people who are trying to understand why the public finances are evolving as they are over the course of the forecast, it is not a particularly transparent way of explaining that. The nature of the assumption that the Government has asked us to make has got more complicated over time, and it has become wordier for us to explain it. If you go back to 2011, there was not much of the forecast that lay beyond the period for which there were fully detailed plans. Therefore, as you have had more years to explain, it takes more to explain that.

The Government has also chosen to calculate changes in spending by excluding and including particular things and to have a different path in some years than in other years. So we have ended up with this formulation that has grown ever more complicated and is basically a way of backing out a number for which you could simply say, “We would like you to assume, for the purposes of this forecast, that in the following four years, we will spend the following on public services and capital investment,” which would be rather less than—

Q122 Mr Love: So why do you think they did that? Why have they made it so complicated? Why are they making you go down a very complex road to reach a conclusion about what the public expenditure plans are?

Robert Chote: You would have to ask the Chancellor that. I think it is partly because, as I say, when you start out and you only have one year for which you need to do this, it is a relatively straightforward thing. Obviously, the desire to stick with doing it in the same sort of way has become more complicated—rather than saying, “Well, actually, we’re now going

to move away from setting out a rule for total expenditure from which you back everything out,” to simply saying directly how much we should assume has been done on Government spending. There was obviously a desire not to have that sort of change of approach. Sticking with the same approach has necessitated that approach being rather more complicated now than it was back in 2011.

Q123 Mr Love: The Budget document states that in line with the previous policy, the fiscal assumption is that total managed expenditure in 2016-17 should decline at a similar rate to 2012 to 2016, except that it goes into all these assumptions about changes from 2012 to 2016. Why? You must have drawn some conclusion about why they have done this.

Robert Chote: As I say, they have started with a particular approach that was simple when they set out on it. In time, you are trying to achieve more things with the same rule. We are in a world where, subsequent to June 2010, almost every scorecard—the menu of prices of tax and welfare measures that appears in the Budget documentation—has been largely neutral, in the sense that the give-aways broadly balance the takeaways over the course of the forecast.

The assumption about what you do with spending over the medium term has become more important in actually delivering for the Government where it wants the overall fiscal forecast to end up over that path. You can look at a number of things that the Government have achieved, if you want to use that word, in this forecast: they have managed to have borrowing lower in every year up until 2018-19 than it was in our previous forecast; they are achieving their fiscal mandate in 2017 with room to spare; they are achieving—we do not look at this number, particularly—the £30 billion consolidation that was referred to in the previous session; and they are no longer seeing total public spending falling to a post-war low as a share of GDP. For all those things to be true, you need a path expressed in such a way that it ticks all those boxes. From our point of view, if those are the boxes you choose to tick, we have to explain what the consequences are for the moving parts beneath the forecast. The path for public services spending is the most obvious one that comes out of that.

Q124 Mr Love: Mr Nickell, are the Government’s reasons for these adjustments persuasive to you?

Stephen Nickell: I am not sure that I am the person who has to be persuaded. The Government decide what they want to spend over a period of time, and we look at the consequences of that. In my opinion, what is helpful about all this is that there are, published here, the fiscal consequences of all the benefit rules and the path of expenditure that the Government have set out. Coming up to a general election, this is a rather good thing, because people can ask the various participants in the general election how they intend to do things that differ from this baseline, under the assumption that, for one reason or another, they do not like the consequences of the baseline. It seems to me, as a sort of public service, that the provision of this baseline, carefully worked out, is a very good thing.

Q125 Mr Love: The consequence of this baseline is that we have two years of substantially increased cuts in public expenditure, followed by an increase in public expenditure along the lines of the growth in the economy. Is that a sensible, rational way to deal with public expenditure? Should we not, as was suggested in the previous session, have a smoother change in public expenditure totals?

Robert Chote: Obviously, it is not for us to advise on what Governments should do on that, but I think the key point that you come back to from the previous session is that the parties have then explained that they have managed to agree this, as a baseline, for us to set out, for the purpose of this election. There is a degree of agreement about this, but neither party is saying, “This is the way we would do it if we were running things on our own.” The Conservatives have said, “If we were elected and we were governing alone, we don’t think you would need to see the sort of squeeze in those two years, because we would find the additional £12 billion of welfare cuts and £5 billion of tax avoidance measures.” As discussed, we have not put that in the forecast because, first, it is not Government policy, or the agreed policy of the coalition, and secondly, even if it was, we would not put it in until we knew explicitly what measures were going to deliver that. Similarly, the Liberal Democrats have set out an alternative approach to the balance of taxation and borrowing over this time.

As you say, if you look at the profile for the changes in public services spending, it is not the sort of thing that most people, confronted with a blank sheet of paper, would have come up with, but the parties have agreed it on that basis, and are individually explaining how they would do things differently. As Steve says, the important thing is that it is a fully articulated baseline, it is internally consistent, and every party effectively can be told, “Well, if you don’t like how this looks, please explain in as much detail as you can how you would do things differently.” Each party is obviously setting out those alternatives in greater or lesser detail.

Mr Love: You have sort of reassured me that this has some value to it; it reaches a baseline to which every party can suggest its alternatives. Thank you for that.

Q126 Rushanara Ali: Mr Chote, in the welfare trends report, the OBR highlighted a history of optimism bias about welfare reform. Should we be sceptical about the Chancellor’s plans to reduce working-age benefit expenditure by £12 billion for 2017-18?

Robert Chote: As we have discussed at length, it is not for us to look at alternative policies. With reference to the optimism bias, what we have talked about there is, in particular, optimism bias as regards reform programmes—changing quite substantially the structure of the system and the way the system operates, not simply changing the value of particular benefits or the rules attached to them. Part of the answer to that question would depend whether on any future Government wanting to make changes wanted to do it in ways that involved a lot of structural reform and administrative change, or whether they wanted to do it by simply making a particular benefit worth more or less. Clearly, the latter is much less likely to be subject to that particular sort of optimism bias than something that is a substantive structural reform programme.

Q127 Rushanara Ali: How realistic is it, though, to make the assumption of a £12 billion cut? Do any of you have a view on that? The public will want to know more detail, but the OBR has not had much detail to work on. What conclusion should the public draw from that?

Graham Parker: None.

Robert Chote: You have told us only to look at the current policy of the current Government, by which we mean the coalition. This is Conservative policy, and it is not for us to look at that. In terms of changes, if you change the value of particular benefits, you can change how much they cost.

Rushanara Ali: Does anyone else want to comment? Mr Parker?

Graham Parker: No—as Robert said, we just cannot look at it, not that we have seen anything, because it is not Government policy.

Q128 Alok Sharma: Mr Chote, you heard the exchange with Mr Johnson earlier on Help to Buy ISAs. What is your view on the assumption of 60% of first-time buyers taking up the offer? You have assigned a very high uncertainty rating to this. What do you think is the background for that 60% in the discussions you have had with the Treasury?

Robert Chote: Graham, do you want to say something about that?

Graham Parker: Clearly, we gave it a very high uncertainty rating because of the enormous uncertainty about the take-up. We asked the Treasury quite a lot about this but, on balance, we thought that 60% was probably central. It could be a wide range around that 60% but, as I think you said—certainly as Paul said—a lot of people will have the savings already available. All they have to do is to put the savings into a new account and, over time, they will gradually build up this bonus, so why not take it up?

Q129 Alok Sharma: That is of course what Mr Johnson said. I am not sure that is quite the way this policy works. If you want to get the £3,000 benefit, you put in a certain amount every month, and so you will effectively be saving for four years.

Graham Parker: You can put in a bigger amount up front, and then a certain amount every month. People will not wait the three years, but they might wait a bit. Other people might actually bring forward their purchase, because if it helps them get a bit more deposit, they might be able to buy a few months earlier.

Q130 Alok Sharma: If you are a rational buyer, how long do you think you might be prepared to wait?

Graham Parker: It all depends on what stage you are in the savings process. If you already have enough for the deposit and you don't need the extra money, you are not going to wait another three years or so, but some people will use this; there will be partial take-up. If you are going to buy a house in six months' time or six months after the start of this measure, you should put some of your existing money into an account and get some money from the Government. We are not assuming that everybody takes up the full amount, and we are not assuming a 60% take-up all from the start. It builds up to 60%; it is much more complicated.

Q131 Alok Sharma: But you think 60% is about right.

Graham Parker: Well, it is central—

Robert Chote: Central and reasonable.

Graham Parker: Central and reasonable, but there is a lot of range around that.

Q132 Alok Sharma: Okay. The other part of the discussion I had with Mr Johnson was about whether the scheme would lead to house prices going up. His colleague, Mr Adam, made the point about how it would “bid up house prices,” but that has not happened under the Help to Buy scheme, because that is kept under review by the Bank of England, so do you think house prices will be bid up as a result of this particular scheme.

Robert Chote: I think our working assumption is that it is likely to push up house prices, but what we said explicitly in the document is that we did not think, given the size of the scheme, that that was likely to have a material impact, so we have not adjusted our house price forecast on the basis of that. Although the logic is impeccable, the magnitude is not likely to be great.

Q133 Alok Sharma: So if there was indeed an increase, it would not be a material increase?

Robert Chote: For the economy, no. That is our judgment.

Q134 Alok Sharma: Okay, fine. The other point on this was that the IFS has also noted that the Government have not produced any separate costings for its changes to the taxation of savings income and for the increase in the flexibility of ISAs. Do you think this should have happened? Did you look at this?

Graham Parker: We saw separate information on each measure, but it is the Treasury that decide what to do and how they present these numbers in the scorecard.

Q135 Alok Sharma: Right. So you are saying that separate costings have been produced?

Graham Parker: Yes.

Robert Chote: You look at analysis. Often, with these sorts of measure, it also make sense to look at them because of the likely interactions—the fact that you have some things that may be having an offsetting effect. So the annuities measure: does that make it more attractive for some people and less for other people? It can make sense to look at them in total.

Graham Parker: Clearly, ISA flexibility would have had much more impact if you had not done the savings allowance.

Q136 Alok Sharma: So as a percentage, what percentage would the ISA flexibility be, as opposed to the savings measure?

Graham Parker: Assuming they both go ahead?

Alok Sharma: Yes.

Graham Parker: The ISA flexibility is pretty small. If people are worried about that kind of thing, they are probably not going to have more than £1,000-worth of savings income.

Q137 Jesse Norman: Mr Chote, a general question: what are the lessons you think you have learned from the OBR since 2010?

Robert Chote: Gosh, there's a whole session in there.

Jesse Norman: Just take a minute or two.

Robert Chote: Well, as I said, I think the key thing, and what we have tried to do, is to increase the transparency of the exercise.

Q138 Jesse Norman: Yes, but what I mean is: what are the things that have gone wrong that you wish you'd known?

Robert Chote: As we had gone along?

Q139 Jesse Norman: A candid sense of mistakes one has made and things one might have done differently—that kind of thing. Let's take for granted that lots of good things have happened as well.

Robert Chote: Well, in terms of the forecast issues, the puzzle that has confronted all of us for so long has been the productivity puzzle. We have in successive forecasts had to push back the point at which you will assume that productivity growth is going to pick up again, that being they key to getting real wage growth going again. Putting hand on heart, if you went back and looked at the same set of information we have been looking at in the past,

I would be lying if I said I would be confident that you would have caught that earlier and assumed that things would have been later. That is obviously one of the linger things that we have been assuming would happen at some point and that hasn't happened in the forecast. That difference in terms of the way in which the labour market has behaved is the obvious one there.

On the public finance side, it took us a while to catch on to the fact that relatively substantial public service cuts in nominal terms would not have the dramatic effect on real GDP that one might have anticipated. It took us some time to catch up with the importance of the way in which the volume output of public services is measured in the national accounts. Quite a lot of it is measured through direct things such as number of pupils being educated and number of operations, that don't actually respond very much to cuts in nominal spending. So that's something that—

Q140 Jesse Norman: But that was a very widespread view, wasn't it? Lots of people made that mistake.

Robert Chote: The number of people who pay close attention to exactly how those sorts of things show up in the national accounts is small, so that would be true. The thinking about the way in which we deal with underspending in the public services spending—it took us a while to get on to that, to realise what was going on with local authorities. There's a lot of variety.

Q141 Jesse Norman: That's really interesting. Take the second point. There was a whole strand of thought that said, "These changes in nominal spending are going to be ruinous for GDP growth," but you are suggesting that there is a misunderstanding there. You had an insight, as a result of the work that you did, that suggested that line of thought was wrong.

Robert Chote: There is an important distinction here. We are talking here about the direct impact of changes in Government consumption of goods and services on measured GDP—that is, the G bit of national expenditure. There is a separate issue about whether the fiscal consolidation had this sort of impact on the pace of economic growth. As you know, the set of multipliers that Graham and his colleagues in the interim OBR came up with to begin with were implemented in the June 2010 Budget. There has obviously been a lot of debate as to whether the impact of the fiscal consolidation was greater than, less than or roughly what was implied by those sorts of numbers. We have taken the view that there is no strong evidence base to depart from those sorts of things; but as ever, there is huge uncertainty around that, so I would draw that distinction between the direct effect of changes in Government consumption on measured GDP and the broader effect of fiscal consolidation on aggregate GDP growth.

Q142 Jesse Norman: That is very helpful and interesting; thank you. Will you do some kind of analysis that makes that kind of introspective question about the last five years a bit more formal? Could you include in some of the work you do in the future—

Robert Chote: On the—

Jesse Norman: Just a slightly more reflective—

Robert Chote: On the multiplier issue?

Q143 Jesse Norman: On any of the three or four areas you have sketched. I am talking about a little bit of reckoning as to the last five years—the things that we in retrospect—

Robert Chote: I have done a couple of “When we were one,” “When we were three”—backward-look things—on some of these sorts of issues.

Q144 Jesse Norman: Sure, but you’re going to do that again for the last five years.

Robert Chote: Well, on the forecast stuff specifically, as you know, we do that annually in the forecast evaluation report, addressing exactly these sorts of issues about the multipliers. That is where we picked up and identified the underspend and local authority issue.

Q145 Jesse Norman: Right, but we don’t have the consolidated five-year verdict. That would be quite interesting.

Robert Chote: You can only do that sort of analysis by looking back, so we are often trying to understand why the outturns over the last five years have differed from the forecast that you did five years ago, which is precisely that sort of exercise. More broadly, pondering the lessons of how the OBR has gone for the last five years, yes, obviously I would like to return to that issue.

Q146 Jesse Norman: But if, for the sake of argument, you then were not renewed, Mr Chote, or decided not to renew yourself, you would want to have something to give your successor that gave them some guidance as to the things you had learned or not.

Robert Chote: I’m sure that would be welcomed enormously by my successor.

Q147 Jesse Norman: I’m sure they would be very pleased. On the issue of annuities, can you say a little about whether you think there’s going to be a shift in household asset allocation as a result of the changes to annuities policy that have been announced?

Robert Chote: Again, Graham may want to say something on the costings. There is the issue that Paul raised. Obviously, this is a slightly unusual costing and therefore set of assumptions around this, in terms of whether this market springs up at all. It is a slightly bimodal distribution for the forecast, in the sense that there is a possibility that this is not something that the market feels—

Jesse Norman: Sure. It's a kind of—

Robert Chote: We have made an assumption that does assume that there is a market there, but obviously there is the question of how much demand there is going to be from the people who would want to sell these things—to turn their flow into an up-front sum—and then what discount rate purchases of that would require, given the asymmetric information that is involved, so there is enormous uncertainty around it, but certainly there is the possibility of asset reallocation if the market takes off—

Q148 Jesse Norman: But you don't have a particular view as to what that asset reallocation might look like, because it's too contingent.

Graham Parker: What we did think—this is the same as the measure last year—is that the people most likely to take this up will be people with debts. In that case, what would happen is that they will get the cash lump sum from their annuity but use it to pay off debt.

Q149 Jesse Norman: Because they have a very high cash appetite.

Graham Parker: The incentives are greatest for them.

Robert Chote: Given all the interest they are paying on their debt, the cost-benefit analysis can work a lot better for them.

Q150 Jesse Norman: Just a final question: it is interesting that you said that you think the effect on consumption will be relatively small.

Robert Chote: That's our working assumption. We haven't changed the economic forecast for the magnitude of those measures. Clearly, when you have a variety of saving measures, they can be pushing things in opposite directions. Does freedom on the annuity make it more likely that people will save, knowing that they have that freedom in the future? It can go both ways.

Q151 Jesse Norman: But it has been quite a widespread view that a lot of people will simply say, "What the heck," cash it in and head off to the Bahamas. What you are saying is that that is not your particular view.

Robert Chote: We've not made a material adjustment to the economic forecast for that sort of behaviour.

Jesse Norman: Nicely put. Thank you.

Q152 Teresa Pearce: Back to anti-avoidance, there were announcements about tougher measures and further measures, but you have not been able to cost them all. Do you think you will be able to do that? Have you just not got around to it yet, or is it impossible?

Robert Chote: We cost the measures that are brought to us in concrete enough form to go into the Red Book. If we have signed them off, we have signed them off as being what is, in our view, essential and reasonable, but we don't sign off aspirations.

Q153 Teresa Pearce: Okay. The general anti-avoidance rule has been in place since 2013. Do you think that has had any effect on your forecasts for income?

Graham Parker: If I remember the costing—it was a while ago—it was never expected to have that much of an effect yet. There was partly a deterrent effect.

Q154 Teresa Pearce: If it has an effect on behaviour, how will it be possible for you to model that effect with confidence, or isn't it possible?

Graham Parker: The way we normally do the forecast is that we always base it on the previous year's receipts. If there is any change in compliance from year to year, we may not necessarily pick it up in the normal forecast. All we do is add on the measures that we have previously certified. On the actual base, we have to assume—

Robert Chote: You'll pick it up. It is just whether it will be explicit or implicit.

Graham Parker: If it is happening in one year, we will assume that its effects are going to happen in the following year. If we get the forecast wrong, or when we get the forecast wrong, we will try to explain why. It normally goes the other way.

Q155 Teresa Pearce: So you're being asked to forecast something that is unknown?

Graham Parker: If I remember correctly, the general anti-avoidance rule was not expected to have that much direct effect.

Q156 Teresa Pearce: It was to encourage the others.

Graham Parker: Yes. There have been various targeted anti-avoidance rules since then that pick up on particular aspects of that, which we have looked at. The general one was never expected to have that much of a direct effect, but I have seen so many costings since 2013.

Q157 Mark Garnier: May I start by asking a couple of philosophical questions on Government expenditure?

Robert Chote: Isn't that Mr Norman's territory?

Mark Garnier: I follow at the feet of the master. There is obviously a big debate about Government expenditure as a percentage of GDP. Your memory for numbers will be much better than mine, but we are looking to get total managed expenditure to 36% of GDP

by 2019-20. Somebody came up with the figure that the last time it was at that level was back in 1932 or something, but is it not the case that in 2002 total managed expenditure was around 36% of GDP?

Robert Chote: If you want to look at the picture, it is on page 170, which shows total spending as a share of GDP back to 1919. You are right that, basically, the spending assumption that we were discussing earlier gets you to 36% of GDP. As I recall, it is fractionally higher than it was in 1999-2000 and 1957-58, whereas in December it was the lowest since 1938, which is where you are probably getting your 1930s.

Q158 Mark Garnier: Sure. The interesting thing is we are looking at the receipts as a percentage of GDP. So you have got the national accounts taxes, which seem to be between 2013-20, and the big figure seems to be 33%. Then you add in interest and dividend receipts and other receipts, so that on current receipts the big figure seems to be around 36%. In your experience as economists, what, generally speaking, could a British Government expect as a percentage of GDP to get in total current receipts—going back over 20, 30, 40, 50 years?

Robert Chote: If you look at the same chart, on page 170, what you see is that the current receipts as a share of GDP move around a lot less than total spending does as a share of GDP. Obviously, because we are moving to a small budget surplus at the end, you have got receipts also pretty close to 36% of GDP, and that is pretty much in line, from eyeballing this, with the average since the 1980s over that period. The interesting thing is that, during the course of the crisis, you had a dramatic pick-up in spending as a share of GDP, which is now being brought back down, with receipts remaining relatively constant.

The key thing to bear in mind is that the cash size of the economy ended up being a lot smaller, so if you were looking at this chart in terms of receipts and spending in cash terms, it would look like the problem was that receipts fell away dramatically and are now getting back. If you look at it as a share of GDP, spending shoots up, particularly on public services. On the spending plans that were set out in 2007, which looked pretty affordable at the time, the spending in cash terms was not dramatically higher, but, because the economy was smaller as a share of GDP, it shot up.

Q159 Mark Garnier: This chart neatly illustrates, if we forget the war, that generally speaking Governments spend more than they generate in income.

Robert Chote: That's right. There are deficits in many more years than there are surpluses.

Q160 Mark Garnier: So eventually there comes a point when you have to resolve that deficit. You can obviously live for ever with a significant amount of Government debt, but if your net Government debt is increasing year on year, that surely ends up restricting the Government.

Robert Chote: The debt does not necessarily rise as a share of GDP if you are running a budget deficit. It depends on the profile of the debt—

Q161 Mark Garnier: As we are getting to with the use of cards over the next few years.

Robert Chote: Exactly. It depends in part on the relationship between interest rates and growth. In the early period, you had debt falling very sharply as a share of GDP from the post-war period.

Q162 Mark Garnier: Ultimately, though, for the average punter such as myself, who is not really a brilliant economist but understands it a bit, it does not make sense. You end up running a permanent deficit. Ultimately, you are going to be increasing your debt, maybe dropping as a percentage of GDP. None the less, you have to balance the books at some point in order to get back to some sort of equilibrium. Is that fair?

Stephen Nickell: You don't have to quite balance the books. You can always spend a bit more than your revenue.

Q163 Mark Garnier: As long as you are happy to always run the risk that if interest rates start going up, the cost of your debts will, too.

Stephen Nickell: But in a steady state, you can always spend a bit more than your receipts without debt rising as a share of GDP.

Q164 Mark Garnier: Okay, but you have to manage it pretty carefully to make sure you stay in that band, don't you?

Stephen Nickell: Well, yes. Obviously, what happens in practice is that, as you see here, expenditure fluctuates as a proportion of GDP, because GDP itself fluctuates, which generally leads to those sorts of fluctuations. But you want to get back; that is the general idea.

Q165 Mark Garnier: The last time we spoke, we spoke about immigration.

Stephen Nickell: Oh, God!

Mark Garnier: Can we carry on?

Stephen Nickell: I don't know about that.

Q166 Mark Garnier: It is just rather interesting. On 19 March, *The Guardian* made quite an interesting point about net migration fuelling the growth of the economy. To what extent do you agree with that?

Stephen Nickell: Sorry; net migration—

Mark Garnier: It is fuelling the growth in the economy. Without net migration, the growth in the economy would be 0.6 percentage points lower than it is now.

Robert Chote: The exercise that we did was to show that we have revised up our estimate of cumulative growth in the potential growth of the economy: the amount of output you can produce without running into inflationary difficulties. We have pushed that up by 0.6 percentage points from about 13.3% cumulative growth over this period, I think, to about 13.7%—that may be actual GDP. Anyway, that is primarily because we have now assumed that net inward migration will be at higher rates over the course of this forecast than we assumed back in the autumn. That is sufficient, in terms of higher population, to deliver 0.5 of that 0.6. So that is increasing the size of GDP, but you are also increasing the size of the population, so you are not doing very much to GDP per capita.

You also get a 0.1 percentage points increase because the employment rate is higher as a result of higher net inward migration. That is because net inward migrants tend to be more likely to be of working age than the rest of the population. So within all of this, GDP per employee is unaffected, GDP per capita goes up a bit because the employment rate goes up a bit, and GDP in aggregate—ignoring the size of the population—goes up by that bit more.

Basically, the assumption was that if you looked at the last couple of data points for the size of net inward migration, the previous assumption we made that it would fall relatively swiftly back to about 105,000 just did not seem to be tenable in the face of the more recent data, so we have now moved from Office for National Statistics low migration population variance to its principal population variance as an underpinning for the whole forecast.

Q167 Mark Garnier: One thing that *The Guardian* goes on to say is, “it is time the politicians stopped pretending that you can have a flourishing modern economy and”—at the same time—“deep cuts in mass migration.” Do you agree?

Robert Chote: That is a very interesting policy question that I think takes us beyond our remit. But if you look at growth over extended periods—I am sure that Steve can add to this—you can see the differences that migration can make. But it is always worth looking at the difference between GDP growth and GDP per capita.

Stephen Nickell: If you think back to the '50s and '60s, growth in the UK was quite buoyant and net migration was nothing.

Q168 Mark Garnier: So it can be done.

Stephen Nickell: Yes.

Q169 Mark Garnier: Okay. You probably will not have had a chance to see this, but Open Europe published a report today looking at the economic impact of the UK leaving the EU. In one interesting bit it looks at the worst case scenario and the best case scenario. This is a difficult question, because you will not have had a chance to go through the numbers, but it would be interesting to get a gut feeling.

In the worst case scenario, described as “where the UK fails to strike a trade deal with the rest of the EU and does not pursue a free trade agenda”, GDP would be 2.2% lower by 2030 if we leave in 2018. In the best case scenario, described as “where the UK strikes a free trade arrangement with the EU, pursues very ambitious deregulation of its economy and opens up almost fully to trade with the rest of the world...GDP would be 1.6% higher in 2030 than if it had stayed within the EU.” They also go on to say that a realistic range would be between 0.8% down and 0.6% up. Do you think that that is a fair rule of thumb?

Robert Chote: I think as Parliament has instructed us only to look at the current policies of the current Government and, as it is not the current policy of the current Government to leave the European Union, I will wait until it is.

Mark Garnier: It was a fast ball, but you passed on it nicely.

Robert Chote: I lifted the bat away.

Q170 Steve Baker: Looking again at chart 4.9 on total public sector spending and receipts, when David B. Smith produced similar charts for the 2020 Tax Commission he used factor cost GDP and non-oil measures. From memory, I observe that the lines were much flatter in particular in terms of receipts, with the line for now much more consistent with the '70s. Do you ever do non-oil figures, factoring out the revenues we get from oil?

Robert Chote: You could probably calculate them.

Graham Parker: Clearly, in the '70s and '80s the North sea oil receipts were quite a lot higher than they are now.

Robert Chote: Yes. There have been two periods in which North sea receipts have peaked at roughly £11 billion to £12 billion, and obviously that was a much larger share of GDP back in the 1970s and '80s than it is now.

Q171 Steve Baker: What I am driving at is that we now have much lower oil prices—at least for the moment. What long-term effect does that have on revenues, and is the past any guide to the future in terms of the taxable capacity of the British economy?

Robert Chote: We're certainly assuming over the remainder of the five years of this forecast that there is not much oil revenue coming in. It is £1 billion or so, I think, in each year. That is based on an assumption that the oil price basically moves in line with the futures curve, as of a couple of weeks prior to us finishing the documents. Essentially speaking, you had the spot price about 27% lower than it was when we did the previous forecast in December, but the medium-term projection about 17% below where it was in December, so

some of that recent decline assumed to reverse itself, but by no means all of it. That has had quite an impact on oil production. We have made assumptions about expenditure in the industry and that has feed-through effects to receipt.

Q172 Steve Baker: Is there any reason—looking at this chart back to about 1990—to believe that the taxable capacity of the British economy is any more than about 36%?

Robert Chote: Well, it depends what you mean by taxable capacity. Different Governments have choices about what tax rates and rules they wish to set.

Chair: That is not what taxable capacity means, as you know. Taxable capacity means, can you get the money in whatever you want?

Q173 Steve Baker: What I'm driving at is that when I look at David B. Smith's charts, which are rather flatter in the period of high oil revenues, it appears that in the long term, you cannot get more than about 36% GDP out of the British public. Is that about right or do you think—

Robert Chote: Governments have chosen to set policies that have kept the receipts ratio within, even on this chart, a relatively—

Stephen Nickell: You can obviously get more than 36%. There is a slightly deeper question as to whether you can get 36% and more and be re-elected.

Q174 Steve Baker: Are you saying that Art Laffer didn't have a point? There is no Laffer curve effect where people are just—

Stephen Nickell: We know plenty of other countries that get a lot more than 36% and exist perfectly happily. The question is not technical matters about whether you can set taxes to get more. The question is, in some sense, whether people will put up with it.

Robert Chote: I'd be more inclined to look at Laffer curves for individual taxes than for the overall tax to GDP ratio. I am wary of studies that imply that sort of relationship. If you look at something such as income tax and the higher rates of income tax, you can have a very good, articulate discussion about what the Laffer curve is for that.

Q175 Chair: Why are you wary of it when there is evidence of countries where tax rates have gone higher and higher, and more and more people have fled?

Robert Chote: I think it depends as much on how they are taxed, the choices that you make about whether you tax and whether you are more likely to tax mobile or immobile factors. If you tax mobile factors, you are less likely to get the revenue in than if you tax immobile ones.

Q176 Chair: But that's not a reason for being more wary than you would be of income tax.

Robert Chote: The argument that you could not get more than 36% of GDP—

Chair: That is not the question I asked. The question is: why are you so much more cautious about looking at aggregate Laffer curves than you are with individual tax Laffer curves?

Robert Chote: Because much of it comes down, as Steve said, to the political acceptability of this. You can regard all of this as being behaviour and, therefore, the response of behaviour to tax rates. However, looking at whether you believe that a change in a particular income tax rate is likely to have income and substitution effects that will move things in different ways gives you a different sort of analysis from saying, "In a country like ours, no Government can claim to be re-elected if it raises more than x in tax."

Q177 Steve Baker: Finally, one of your key assumptions is that monetary policy does not tighten until 2015-16 or possibly 2016-17. To what extent do you model monetary policy in the longer term and how important is it to your forecasts?

Robert Chote: We simply take the futures curve as being the path of monetary policy and base it off that, rather than doing our own model of, for example, what would be consistent with achieving the inflation target. Implicitly, we have inflation moving back to the target over the medium term. Implicitly, that is assumed to be consistent with the path that is in the markets.

Q178 Steve Baker: That sounds very sensible. Is that the full extent of the modelling of monetary policy?

Graham Parker indicated assent.

Robert Chote: Yes. If you end up with substantial changes in fiscal policy that you have to look at, you would need to worry about the reaction function for that, but we have basically had a series of relatively neutral score cards that have not produced an up-front change in fiscal policy that would require you to think too much about the monetary offset.

Q179 Chair: Thank you very much for coming to give evidence this afternoon, and for the evidence you have given over the past five years. This is the last time you will come before us in this Parliament.

Robert Chote: It's flown by.

Chair: You've always given lucid, responsive answers and have done a lot, collectively, to help to construct the OBR's credibility from scratch, to establish the scope and limits of what can be achieved by forecasting and, as you said in response to earlier

questions, to do something to demonstrate the difficulties of attaching too much credibility to any of these numbers, which, curiously, is central to the original purpose of the OBR's creation.

Robert Chote: Thank you very much indeed.