Treasury Committee

Oral evidence: Budget 2016, HC 929

Wednesday 13 April 2016

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Watch the meeting

Members present; Mr Andrew Tyrie (Chair); George Kerevan; Chris Philp; Mr Jacob Rees-Mogg; Rachel Reeves; Wes Streeting

Questions 377 -438

Examination of Witnesses

Witnesses: **Professor John Muellbauer**, Professor of Economics, Nuffield College, University of Oxford, and **Professor Christian Hilber**, Associate Professor of Economic Geography, London School of Economics, gave evidence.

Q377 Chair: Thank you very much for coming to give evidence to us this afternoon, and we are particularly grateful to you, Professor Hilber, because I think it is your first time up before a Select Committee, if I am not mistaken. I would like to begin by asking what appears to be a simple question, but might not have a simple answer. We will see. The Government and the previous coalition Government have been intervening in the housing market to an extraordinary degree. We have had so many measures. In fact, I think I will just read out a list of some of these measures. We have had the revitalised Right to Buy, the Help to Buy equity loan scheme, the Help to Buy mortgage guarantee scheme, the Right to Buy for housing association tenants, starter homes classified as affordable housing, the Help to Buy ISA, the stamp duty surcharge for buy to let, the exemption of buy to let from capital gains, the capital gains cut and of course the Lifetime ISA. On top of that, perhaps the biggest of all in a way have been successive tranches of QE, which, although more difficult to analyse, have also been very important in influencing capital values.

First, overall, have these measures increased supply? Secondly, what have they done to prices? Have they increased prices or reduced them, since in this country we are all agreed that the two central problems are affordability and supply of housing? Professor Hilber.

Professor Hilber: Most of these policies are on the demand side, so they push up demand for housing. Since supply is very inelastic, it is very unresponsive in large parts of the country, these policies, in my view, have increased prices and done very little to supply. It is a bit nuanced, in the sense that, in the south east and the Greater London area of the country, the main effect has been to increase prices, and there was a very small effect on supply. In the northern part of the country, there may have been a slightly bigger supply effect and a smaller price effect.

Q378 Chair: What you are saying is that the Government have not been achieving their stated objectives with these policies.

Professor Hilber: It is effectively because the supply cannot respond. We have done some research on this, looking at different types of supply constraints.

Q379 Chair: Is this the rationing of land?

Professor Hilber: It is the planning system, yes. The planning system is a potential driver of this. It is just the fact that some places are heavily developed, so there is little space, and topography is a potential supply constraint. Our research suggests that the main culprit is the planning system, and planning being particularly unresponsive in the south east and the Greater London area. The Government are well intended in helping young households to get on the owner-occupied housing ladder but, given that supply does not respond, prices will rise, which makes it even more difficult for young people.

Q380 Chair: That makes the affordability problem worse. Far from improving the situation, these measures are making it worse. That is what you are saying, I think.

Professor Hilber: To a large extent, yes.

Chair: You are saying, though, that the effect is less severe in other parts of the country than it is in the high-stressed south east and London area, if I have summarised it correctly.

Professor Hilber: That is correct.

Q381 Chair: Let me then turn to Professor Muellbauer. First of all, do you agree or disagree with that analysis? Secondly, when you have answered that, and if you want to qualify it in any way of course do, are there particular measures you want to pick off that you think merit attention by Parliament? I have read out 10, but you may decide that there is an 11th I have forgotten, which you want to home in on.

Professor Muellbauer: Generally, I would agree with that assessment. To be fair, in 2010 we were still in a housing crisis in large parts of the country. There was quite a lot of negative equity and the banking system was under stress. One might be charitable in thinking that, at least at that time, at the very beginning of that period, helping to get credit flows going was beneficial to the banking system.

Q382 Chair: I should have declared an interest. John and I both used to be fellows at Nuffield College, Oxford, so we know each other very well indeed. I just wanted to interrupt you, because I know you well enough to do it. The first of these measures was in 2012, apart from QE.

Professor Muellbauer: Yes, you are absolutely right. QE was the main thing that helped the market and of course there were the interventions in the mortgage crisis. The interventions helped people with payment difficulties achieve more generous income support, so SMI was made more generous. There was pressure on forbearance, so a number of interventions in the early stages were beneficial to relieving the stress on the housing market, but you are quite right that the key policy interventions were low interest rates, the UK having flexible interest rates, as opposed to the US. That meant that these radical changes in interest rates had a very beneficial effect in stabilising the UK market, in contrast to the US. That is a key reason why our housing crisis was much less serious than that of the US. Later on, QE, which improved the credit market extension of the banking system, as a whole, it was very beneficial. The additional interventions directed at the housing market were probably more marginal than those key policy interventions.

Chair: On exactly that last point, I just wanted to ask both of you whether, either now or later, you might be able to supply us with something that gives rough orders of magnitude of the effects that you have just described, rather than for you to try to guess now. I would not be asking you to do new research, but, if there is research available in this area that gives those orders of magnitude, we would be very grateful to see it in written evidence after this hearing, in the context of the preparation of our report.

Q383 Chris Philp: I draw the Committee's attention to my declaration in the Register of Members' Interests. Gentlemen, thank you for joining us this afternoon. Professor Hilber, perhaps I can start with you. You mentioned a moment ago that you felt government policy interventions had stimulated demand. Now, there are clearly several components to demand. One is owner occupiers, and most of the policy interventions relate to them. Can you comment on whether government policy interventions will have increased or suppressed demand from the buy-to-let sector?

Professor Hilber: The most recent interventions have arguably made buy to let less attractive. To the extent that this is the case, it would reduce supply of private rental housing, but might also reduce demand for private rental housing.

Q384 Chris Philp: On the question of the buy-to-let market, the Governor of the Bank of England and the FPC more generally have both described the really quite high levels of buy-to-let new mortgage issuance and stock in general as potentially posing a systemic risk to the UK economy, because they are so elevated. Over 20% of new mortgages are now buy-to-let mortgages. Is that a view you share?

Professor Hilber: That is a difficult question to answer.

Chris Philp: That is okay: you are a professor of economics.

Professor Hilber: Yes, but things are not always that easy.

Professor Muellbauer: The Bank would be right to address leverage issues in the buy-to-let market. There may have been a bit of a bubble building up there. One of my worries is that the pension reforms of last year and the relaxation of the ability of pensioners to take cash will have fuelled demand in that market. One could argue that the recent measures are an attempt to work with the Bank of England to try to reduce demand in that market, which potentially has some benefits for taking a little bit of the steam out of the housing market in general.

Q385 Chris Philp: Looking at the demand side, you are right to point out to the Chairman that, in the owner-occupied market, there have been measures that stimulate demand, such as Help to Buy loans and so on. In fairness, on the buy-to-let side, the 3% stamp duty surcharge and the limit to deductibility down to 20% will help damp down demand on the buy-to-let side and hopefully advantage owner occupiers.

The third component to demand is overseas buyers, particularly people from the Far East, so Hong Kong, Malaysia and Singapore, buying UK and particularly London properties off-plan as investments. Some figures suggest that as many as 50% of London new build in some schemes, particularly in places like Battersea, are being snapped up by the emerging middle classes in China, Hong Kong, Singapore and Malaysia. Can you comment on the effect that that is likely to have on pricing in the market in general? Secondly, given that they are arguably crowding out UK owner occupiers, is it a good or a bad thing?

Professor Muellbauer: I agree entirely with the point you are making there. The very favourable tax treatment that expensive properties have in the UK, the zero marginal tax rate paid on expensive properties, is a key part of this problem. It means that a Russian billionaire who buys a £60 million mansion in London pays the same tax as a middle-class person living in Ealing.

Chris Philp: Sorry to interrupt. They will pay higher stamp duty. Assuming they are buying an expensive property, the top rate of stamp duty is now 15%, which is more than you would pay if you were buying a flat in Ealing, clearly.

Professor Muellbauer: I am talking about the long run.

Chris Philp: The capital gains?

Professor Muellbauer: No, I am talking about property taxes, council tax. Council tax is highly regressive and we are the only country in the world that has a council tax where the marginal tax rate for the rich is zero. If we had the same tax rate for the rich as for everyone else, the demand from foreign investors would be substantially less and the knock-on effects on the UK economy, in terms of crowding out, particularly in London, would be far less.

Q386 Chris Philp: I am not sure I completely agree with that point, because clearly you pay higher council tax if you are in a higher-banded property and of course they will still pay capital gains tax on disposal, which is clearly proportionate to the profit. Am I right in thinking that you believe that an excess of overseas buyers is generally unhelpful, first, in terms of increasing aggregate demand and, secondly, in crowding out owner occupiers?

Professor Muellbauer: Absolutely. It is a trickle-down effect on the upper end of the market.

Q387 Chris Philp: Other than making council tax somehow income-linked, which is not an idea that I have heard before, can you think of any other policy interventions that would help rebalance the market back in the favour of the hard-pressed 20-something or 30-something Londoner or UK citizen?

Professor Muellbauer: Since you talk about balance, it is obviously the supply and demand balance that we are talking about. Expanding the supply side would be critical.

Chris Philp: I will come on to that. Before we talk about that briefly, Professor Hilber, do you want to comment on that topic?

Professor Hilber: I would agree with John on this, but I would like to point out that we are talking about the luxurious London housing market, which is quite separate from the rest of the market. I just want to qualify that foreign buyers have been important in driving up prices in the luxurious London market, but now prices are actually coming down.

Q388 Chris Philp: Just on that point, it is important to qualify that there are two different foreign markets. One is the super-prime Arab/Russian money going into Mayfair and Kensington. Separate to that, you have the Far Eastern middle classes buying off-plan flats, which are often a lot cheaper, well under £1 million. Sorry to interrupt.

Professor Hilber: The main effect is on the first market that you mention, the prime market. On the second market, there will be an effect, but it is not very large quantitatively. Again, I would agree that the tax treatment is quite favourable to buy property in London especially and to hold on to that property. I would argue that this is in large part driven by the planning system, because the lack of supply means that prices go up in the long run. That makes housing an interesting investment. As long as that investment is not taxed more, it will remain that way.

Q389 Chris Philp: Of course, the 3% stamp duty surcharge for non-primary residences will affect foreigners as much as UK second-home buyers, so that will help a little bit. On the supply question, because I am sure the Chairman wants to move on, you have mentioned the planning system imposing constraints to UK supply. The McKinsey Global Institute identified this as a drag on the UK economy as long ago as 1998. Do you have any specific measures in mind that the Government could enact that would ease planning constraints? It is clearly a problem and we are all keen to hear ideas.

Professor Hilber: There are three broad areas. One is the fact that the planning system in the UK is a development-control system, which is quite unusual in an international context. It gives particular power to so-called nimby pressures. It creates a lot of uncertainty as to whether you will get planning permission. It generally makes it difficult to build. The first area is to move away from the development-control system towards a rule-based zoning system.

The second area, which is related to this, is the problem that local authorities in this country lack fiscal incentives to permit development. That in conjunction with the development-control system leads to very little new supply. That is particularly true in the most desirable places, such as the Greater London area and the south east, because incentives to protect asset values are greatest there, so more fiscal incentives should be provided at the local level.

Q390 Chris Philp: You would support the retention of business rates by local councils, for example.

Professor Hilber: I have a nuanced view on that. In principle, I was very happy for the business rate to go to local authorities. That was an excellent move in isolation. The trouble is that local authorities now have fiscal incentives to permit commercial development, so they arguably have even fewer incentives to permit residential development. The sad consequence of that good move in principle is that there may be even less housebuilding. The Government should do a similar thing on the residential side to make sure that there are incentives to local authorities to permit development.

Chris Philp: What was your third idea?

Professor Hilber: The third thing is simply that, in this country, most cities are surrounded by large Green Belts. There are height restrictions and much of the inner cities are conservation areas and listed buildings. If you look at inner-city London, there are very few places where you can still build more or less unrestricted. This explains the housing affordability crisis in this country. If you cannot build out, if you cannot build higher up and if it is costly and difficult to adjust the housing stock, because of all the constraints, then house prices can only increase.

I should qualify this: in times of rising demand, house prices can only increase. In periods of bust, prices will fall. In fact, the system creates greater volatility. In a recent paper we wrote, we looked at the last real estate cycle in the US, so the 1980-90 cycle previous to the Great Recession. The city with the most volatile house prices in the US, which was Los Angeles, was significantly less volatile than the UK as a whole. These constraints increase prices in the long run, as long as demand is increasing, but, because we have business cycles, they actually lead to more price volatility, which creates a systemic risk.

Q391 Chris Philp: Can I have one very brief final question? Professor Muellbauer, talking about the demand side, there is one component of demand we have not talked about. That is population increase driven by immigration. Three-quarters of our population increase is driven by net immigration, 300,000 out of 400,000. Is the other solution to this simply to materially reduce net immigration?

Professor Muellbauer: Immigration has consequences, but rising incomes have had a much bigger effect than population increases in the last 30 years. Since 1980, about two-thirds of the rise in house prices has been due to total income growing more rapidly than the housing supply. By “total income”, I mean income per head multiplied by population. When you look at that, the growth in income per head has been much greater than the growth in population. The population has grown by less than 1% per annum whereas, over that period, the income per head has grown by more.

Chris Philp: Yes, but it is a marginal effect. I am not sure that that is quite the right analysis, because it is a marginal effect. Anyway, I think that the Chairman probably wants to move on. Thank you very much.

Q392 Chair: I just want to clarify one point. It really is only a point of clarification. When you talk about the marginal tax rate, on account of the design of council tax, being zero for the very rich, are you saying that, over the top council tax band, the extra pound of income earned or extra pound of value in the property is not taxed at all?

Professor Muellbauer: The extra pound of value attracts no extra tax. Yes, that is correct.

Q393 Chair: I see. It is just so that we have clarification of exactly what you are saying, which is very important. That is an absolutely crucial point and a big distinction between the current system of local government taxation and the one that it replaced, which was the rates.

Professor Muellbauer: One of the sad consequences of the poll tax was that, when it was replaced, we did not go back to the rates, which was a reasonably sensible system. We went to the new system of council tax, which build in much of the regressivity of the poll tax as a permanent feature, which it now seems to be impossible to discuss.

Chair: I will restrain myself from coming out with my own views on this subject, because I was not a complete bystander at the time.

Q394 Wes Streeting: Like Chris, I am a London MP and I have a very similar set of issues to raise. I want to start by asking you about Help to Buy and the impact that that particular policy has had. Shelter has estimated that Help to Buy has led to an increase in house prices of 3%, adding around £8,000 to the average cost of a home, and the OBR estimates that the new Lifetime ISA is likely to inflate prices by a further 0.3%. Do you share those assessments? Do you agree with those numbers?

Professor Muellbauer: Are we talking about the national index of house prices or are we talking about regional and local differences?

Wes Streeting: These are national figures, rather than specific regional figures, but I would be very interested if you could elaborate on some of the regional variations we are seeing, as well, because we do not really have a UK housing market.

Professor Muellbauer: The government figures on Help to Buy suggest that it had a bigger effect in the less expensive regions than it had in London. There is a very good reason for that. Part of the provision of the Help to Buy mortgage guarantee is that the loan-to-income ratio has to be no higher than 4.5 times. In London, prices are so incredibly high relative to median incomes that many fewer properties are eligible for the Help to Buy mortgage guarantee in London. As a result, more of those funds were deflected to Wales and to the north.

Wes Streeting: Do you share that view?

Professor Hilber: Yes, I would agree with that. Those numbers do not sound implausible to me but, to my knowledge, there has not been a really rigorous academic study on this topic yet, partly because we do not have enough data to do this yet. I do think that Help to Buy affected house prices. Although uptake was higher outside of the Greater London area, the price effect may still have been bigger in the Greater London area, simply because supply is so unresponsive here.

Q395 Wes Streeting: On the supply issue, would you expect higher house prices, perhaps resulting from the scheme, but particularly if you think about London and the way in which prices just rocket, to incentivise developers to construct new builds at higher rates than they have been previously, or is that just not how it is working?

Professor Muellbauer: The empirical evidence on supply is that, in the UK, supply elasticity seems to be close to zero. In other words, higher house prices historically, certainly in the last 25 years, have had virtually zero effect on supply.

Q396 Wes Streeting: We are not necessarily going to get some good news off the back of this in terms of supply. I would be very interested to hear your comments on the view that some estate agents have given us, which is that interventions affecting the buy-to-let market, in particular the stamp duty surcharge, might lead to cooling in house price inflation. Might there be some good news there or do you think that those predictions are off?

Professor Muellbauer: Having thought about speculative markets for a long time, my view would be that there was an element of speculation in the run-up to 1 April. There were auctions where buy-to-let investors were desperate to get into the market before the stamp duty increase came through. That would have contributed a bit to a temporary increase in prices. The policy had a short-term perverse effect in raising demand but, over the next six months, one would expect transaction volumes to be down and pricing to be more moderate. In the long run, the effects are more marginal.

Q397 Wes Streeting: Moving on to the rental market, since 2011, average rents have increased by more than 10%. What role, if any, do you think government interventions in the housing market have played in driving this increase?

Professor Muellbauer: It seems to me that the lack of intervention on the supply side and the failure to build more social housing have been major factors in driving up rents.

Professor Hilber: I would agree with that, but would like to add that it is the lack of supply of any housing. It does not matter all that much whether you build social housing, private rental housing or owner-occupied housing. If there is more supply, people who live in more basic homes will move up to less basic homes. This cannot happen if you do not have supply. Yes, I would fully agree, but it is not just lack of social housing; it is lack of any housing.

Professor Muellbauer: I mentioned social housing because the Government had a direct policy lever that they could have used to increase social housing. I am referring to the lack of use of that lever.

Wes Streeting: That is a view that you would concur with, alongside the other points that you have made.

Professor Hilber: I would.

Q398 Wes Streeting: The English housing survey has found that private renters are spending, on average, over 40% of their income on rent. Could you say something about the wider economic ramifications of the cost of housing relative to household incomes being so high?

Professor Muellbauer: Where does one start? The implications are extremely far-reaching. Housing prices in access to many social goods. Access to a good school is typically priced into the housing market. When you drive up house prices, one of the consequences is an increase in social division. You reduce the ability of poorer people and people with less wealthy parents to access public services that should be available to everyone: good transport facilities, education, a healthy environment—you name it. That is one consequence.

Financial stability is another issue. UK house prices are so high in relation to income that, if interest rates were to rise in the future, there would be a potential risk to financial stability, so that is another source of difficulty. Christian mentioned the extra volatility that is created by very high house prices relative to income.

If we think about migration, one of the paradoxes is that the very high level of house prices, particularly in London, probably encourages foreign migrants. If British people cannot afford to move to London because it is so expensive, foreign migrants fill those job slots, because they are willing to live at much higher densities. They are willing to flat share and circulate a room multiple times during the course of a day. It is socially very dysfunctional to have house prices at these kinds of levels.

Professor Hilber: This all started in the 1970s. Since the early 1970s, this country has built too little housing and, over time, this has just increased prices and rents likewise. The problem has become worse and worse. It is not just that housing is very expensive. People live in very small houses compared to the rest of Europe and the rest of the developed world, I would say, so housing is less adequate, especially for young families.

Housing is built in the wrong places. Those local authorities that are most permissive of new developments are those places with higher unemployment rates, which are not necessarily the places where housing is needed. Where housing is needed is in places like the south east, Oxford, Cambridge and the Greater London area, but it is not happening there. This also affects productivity. I am not sure whether we will come back to this point, but there is research coming from the US that suggests that the adverse effect on productivity is really very substantial.

Q399 Wes Streeting: I was also going to ask you about the wider impact of the high cost of renting on consumer demand for other goods and services. If people are spending money on their rents, they are not necessarily spending it on other areas. I am really interested in this productivity point, because it is such a dilemma for this country. Productivity growth is once again being revised down. Could you just elaborate a bit more on the evidence from North America about the impact? In some ways, it is an obvious point, but it is not one that is currently at the centre of the debate about productivity.

Professor Hilber: There is a similar debate in the US. There is a study by Hsieh and Moretti, two well known scholars. They essentially show that there are so-called superstar cities in the US, like New York, San Francisco, Los Angeles and Boston, and they are also the most regulated places in the US. It is similar to the UK, where London is the most regulated place. They show that, if you were to reduce the level of regulatory restrictiveness to the median level of American cities, total output would increase by about 9.5%. That is a huge number.

This may be an upper-band estimate of the impacts for the US. Maybe the true effect is somewhat lower but, on the other hand, the restrictiveness is even more severe in the UK than in the US and these superstar cities. You are talking about a very substantive productivity loss, as a consequence of the unrestricted planning system.

Q400 Wes Streeting: Finally, we are in the lead-up to a closely fought London mayoral election. What advice would you give to the next Mayor of London, in terms of the policy levers they should be pulling from the ones available to them at City Hall?

Professor Muellbauer: Bring more public land into use and build up. Surely there are parts of London where the height restrictions could be relaxed without too detrimental an effect on the environment.

Q401 Chair: Earlier, you seemed to be suggesting, Professor Hilber, that we should qualify the inviolability of the Green Belt and look at listed buildings restrictions as well, unless I have misunderstood what you were saying.

Professor Hilber: What I tried to say is that, if we have all these three constraints in place—and the big constraints are really the Green Belt and height restrictions—we will not be able to solve the affordability problem.

Chair: Then there is the listing building point too.

Professor Hilber: Yes. There are good reasons why we have listed buildings and conservation areas.

Q402 Chair: We are all agreed about that. We have a policy dilemma. You have been asked to be the politician for a moment now. What should you do realistically? Professor Hilber, we are asking what you would do. You have complained about it.

Professor Hilber: I would remove height restrictions in parts of the city, where they are really not sensible. I would consider building housing on parts of the Green Belt, and I am talking about very small areas of the Green Belt. If you build on 1% or 2% of the Green Belt, you can build lots of housing. There are some back-of-the-envelope estimates. Look at land that is not environmentally valuable; that is important. I would never suggest that you build on areas of outstanding natural beauty, but there is a lot of land in the Green Belt that does not have a particular environmental value or an amenity value, which is yet closed to job opportunities and closed to transport infrastructure. If I were a politician, I would consider building on those areas to try to tackle the affordability problem.

We are doing some research on listed buildings and conservation areas. Until 1980, most of the buildings were protected for good reasons, but that policy may have gone too far. We may have been creating conservation areas or listed buildings in places where they are not absolutely necessary.

Q403 Chair: You seem to be suggesting that we need to reverse the listing ratchet.

Professor Hilber: If anything, yes. Obviously you would want to add new buildings if they have a historic or architectural value, but one may have gone too far.

Chair: I wish you well at the polls with your three-pronged policy.

Professor Muellbauer: The British Social Attitudes survey has shown a remarkable decline in nimbyism. People asked the question, "How do you feel about housing being built near you?" In 2010, something like 56% of people said they were strongly against it, and that percentage has roughly halved in the latest 2014 survey.

Chair: I saw that too.

Professor Muellbauer: There has been a shift in public attitudes. It is really important for politicians to notice that.

Q404 Chair: You were talking about immigration earlier on and the density of immigration housing demand. I am just trying to get clarification of your views. You also said earlier that the main effect on increasing house prices came not from immigration, but from income. You have said that two-thirds of it came from income, leaving one-third from other sources. How does that analysis relate to the point that you were making about immigration density? I have read at least one study suggesting that each extra person in the labour market generates only a third as much housing demand for immigrant labour as does its domestic equivalent. Is that a figure that is familiar to you?

Professor Muellbauer: I have not seen that figure, but there is evidence that immigrants are willing to live at substantially higher densities. The impact on housing demand from immigration is less than an increase in the population.

Chair: We have another hearing to get through and we have someone else who wants to come in, George, last but not least.

Q405 George Kerevan: Can I go back to the productivity issue, in respect of the housing market? We have seen a significant shift from owner occupation towards a larger rented sector. Has that had an impact on labour mobility?

Professor Muellbauer: The figures on mobility certainly suggest that people in the private rented sector have higher mobility rates than both owner occupiers and people in the social housing sector, so one might have thought that there would be benefits for mobility from the increase in the private rented sector, but one also has to think about the flexibility of the market. If housing is in very short supply, if there are very few properties actually available for rent, that restricts mobility. In the US, the vacancy rate in properties is typically quite a lot higher than it is in the UK, so people are able to move from Chicago to somewhere else, because there are always properties available for rent immediately. That short-term flexibility is just not there in the UK.

Q406 George Kerevan: Do you have data for how much spare capacity there is in the rental market in the UK?

Professor Muellbauer: I do not have comparative data. I am not sure whether you do, but vacancy rates in the UK are typically far lower and certainly recently have been far lower than the US.

Professor Hilber: They are somewhat lower. I would not go as far as saying "far lower", but they are lower.

George Kerevan: Anecdotally, having had to rent a flat in London, I am well aware of the limited supply, but I just wondered whether there was any data where we could see that and actually quantify it. Is there not or do we not know?

Professor Hilber: There is census data on vacancy rates, but that is only every 10 years. The DCLG provides some data, but I think that is for the owner-occupied sector.

Q407 George Kerevan: Pursuing that line of questioning, recent budgets from the Chancellor have clearly moved in the direction of trying to limit growth in the buy-to-let market and have tried to move the emphasis more to owner occupation. How would that impact on labour mobility and therefore on productivity, in your opinion?

Professor Hilber: There is a flipside. We talked about it cooling down the market, which may be a good thing, but also, if there are fewer landlords, there will be less private rental housing. As you suggested, that can make it more difficult to move.

Q408 George Kerevan: If there is no significant increase in housing supply in the near term, what could we do in terms of better allocation of the existing supply to encourage or support labour mobility and so on, as part of the productivity chain?

Professor Muellbauer: It is interesting that the IMF has recently come out with a paper on the UK property tax, as part of its report on the UK economy. I do not know whether you have seen that, but they specifically addressed the question of stamp duty versus property taxes and argued that stamp duty actually has a negative effect on mobility and, furthermore, that the 25% discount for single people encourages single property owners to stay in their houses for longer than is socially efficient. Reform of the tax system, not just in terms of eliminating the regressivity, which obviously has a severe effect on lack of expensive properties coming on to the market, but also eliminating the single person discount, would have seriously beneficial effects on the allocation of the British housing stock. That is one of the points in this IMF paper.

Professor Hilber: We have written a paper on the effect of stamp duty on household mobility; that is available. We confirm what other studies in the UK have found, which is that stamp duty really reduces household mobility very significantly. The question is whether it affects labour mobility or whether it affects housing-related mobility. Interestingly, we have found that the main effect, a huge effect, is on housing-related mobility. The stamp duty appears to prevent short-distance moves, so people who move within a school catchment area or from one part of a local authority to another part. It restricts housing-related mobility.

That suggests that there is potential to free some space by getting rid of the stamp duty. I would fully support would you said, the main effect being on the housing market. Again, this will not solve the affordability crisis. It will help significantly but, in order to really tackle the affordability crisis, we would need to tackle the supply side as well.

Q409 George Kerevan: In summary, then, to what degree do you think that the peculiar nature of the British housing market, with its lack of supply and its inflexibility, has been a contributor to the productivity gap in the UK?

Professor Muellbauer: I think it has been a major contributor, but it is very hard to find the statistical evidence. Where are the counterfactuals? If you compare to other countries, like Germany for example, Germany has a radically differently structured housing market, in many institutional details. It is not absolutely clear whether you can point to that as the main contributor to the outperformance of German productivity relative to the UK. It is very hard to find rigorous evidence on this.

Chair: Thank you very much for coming to give evidence. Just before we finish, Chris Philp just wanted to say a word or two more about his declaration of interest.

Chris Philp: It is just to say, Chairman, that the declaration related to a shareholding in a business that finances construction projects.

Chair: That is very helpful clarification. Thank you, Chris.

This is a huge subject. We have hardly scratched the surface. You may feel that there are some crucial points that have not been made. In fact, I am sure you will. Please send us what you have written in those areas or summaries of whatever you think hard-pressed politicians might want to look at, in the preparation of a brief on government measures that have come through in successive budgets. We are very grateful to you for giving evidence. Thank you for coming to us this afternoon. We will go straight on to the next session, because we have a vote in three-quarters of an hour, which is on welfare.

Examination of Witnesses

Witnesses: **Professor Andrew Gamble**, Professor of Politics, University of Sheffield, and **Torsten Bell**, Director, Resolution Foundation, gave evidence.

Q410 Chair: Thank you very much for coming to give evidence to us this afternoon. I am sorry that we will be somewhat pressed, with the vote coming. Can I begin with you, Mr Bell? Do you agree with Iain Duncan Smith that cuts to the welfare budget have been targeted too heavily at working-age benefits?

Torsten Bell: It is definitely true that the working-age benefits bill has borne the brunt of all benefits cuts. That was true in the last Parliament and it looks set to be true to an even bigger extent in this Parliament. The question is, if you want to prioritise the level of savings that the Government have set out, of slightly more than £12 billion over the next few years, whether you can afford to continue to protect what will be 50% of the welfare bill by 2018-19.

Chair: What is the answer?

Torsten Bell: The answer is that you probably can in the short term, but you are taking pretty serious risks in being able to deliver those savings, because the pool in which you are fishing for your savings is becoming slightly dried up and, at some stage, you will run out of fish.

Chair: What was the answer to my original question?

Torsten Bell: The answer is, yes, it is overwhelmingly from the working-age population and, overall, that has not been a good thing for the country.

Professor Gamble: One of the things about Universal Credit, when that comes in, and I imagine this is what Iain Duncan Smith was meaning, is that it has been gradually reduced and not just in this budget but previously. When it finally comes in, it clearly will not have the same impact that it was intended to when the plan was first introduced. To that extent, it is probably a missed opportunity.

Q411 Chair: Others will follow up a number of the points that you are making in further questions, but I just want to start us off on a couple more themes. The IFS has said that increasing state pensions by at least 2.5% a year will become prohibitively expensive. Mr Bell, do you agree that, in an era of low inflation, the triple lock on state pensions is unsustainable or do you think it is sustainable?

Torsten Bell: Anything is sustainable within a finite space of time, if you are prepared to tax enough to pay for it, within reason. Is it sustainable over the very long term, 50 years or so? No, not unless you do not want to see anything else left of the welfare budget.

Q412 Chair: We now have a short to medium term of the rest of this Parliament and this very long term of 50 years. Where is the breaking point?

Torsten Bell: That is a very exciting bit of work that the Resolution Foundation intends to be doing over the next 18 months to come up with our own view of that, but I do not have a figure to give a year.

Chair: You think you need an answer, but you do not have one yet.

Torsten Bell: That is a good summary of the situation.

Q413 Chair: Professor Gamble, have you given it any thought?

Professor Gamble: I imagine it is a political breaking point. It will probably be at a general election.

Chair: How many elections hence?

Professor Gamble: I think it is going to come quite quickly. There will have to be some rebalancing of the welfare budget. Pensioners were under-compensated for a long period, but now we are moving to a period when they are being over-compensated in respect to other groups. Some moderate adjustment of that, some rebalancing, is going to be necessary.

Torsten Bell: It is worth putting it into a bit of context. The long-term history is pensioner poverty rates falling from 40%, at the end of the 1980s and the beginning of the 1990s, down to roughly 15% at the end of the 2000s. That is a very good thing and it did not happen by accident. Governments of both parties chose to spend money on it, so that is a good objective. The problem is that, by the end of the next Parliament, we will have seen pensioner spending per head—so not overall pensioner spending, so this is not a demographics issue—10% higher than it was before the crash, while working-age benefits will be 10% lower. That is a 20% divergence over a relatively short number of years.

Q414 Rachel Reeves: It seems to me that, with the pension benefits in particular, there are two challenges. There is the triple lock, but there are also the universal benefits, so the TV licences, bus passes, etc. In terms of sustainability, are both of them unsustainable? Politically, would one of them be easier to do away with than the other?

Professor Gamble: The universal benefits would be easier to do away with or at least to means test or whatever. The much larger cost lies in the other, but I imagine that that is where the rebalancing will start; it will start with some of the universal benefits.

Torsten Bell: If the question is sustainability, the sustainability threat is the triple lock, not the universal benefits, first, because they are smaller and, secondly, because they are not being uprated by anything like the same scale, because they do not have a ratchet built in; to a straight sustainability question, the answer is the triple lock. On political feasibility, clearly you may come to a different conclusion.

Q415 Rachel Reeves: Obviously, we are at the moment in an environment of austerity and there are big cuts to working-age benefits, as the Chairman has already said, and of course to other departmental spending. Would the triple lock be more sustainable if we were in a more normal environment, i.e. one where wages were going up as a long-term trend, inflation was closer to 2%, rather than between 0% and 1%, and we were not making big cuts? Is the issue of sustainability, both political and economic, an issue because of the environment we are in or would it be an issue even if we were in a more normal environment?

Torsten Bell: Clearly sustainability questions on public finances are to do with your receipts and your expenditures. As you will have seen in previous budget sessions, our receipts came down by about £44 billion just in income tax and NICs receipts collectively, because of the downgrade in the earnings forecast in the budget. Some 70% of that downgrade is due to the earnings downgrade, not due to income tax cuts. In that world, a 15% or whatever the increase is in pension benefits over the next five years is particularly challenging; that is true. In the end, though, the macro question comes down to what you believe the long-term trend rate of growth is in the UK economy. That will inform your decision about what a sustainable uprating scheme is in normal times. In general, have countries sustained upratings of half their benefit system at these kinds of levels over 20 to 30 years? No, countries do not do that.

Q416 Rachel Reeves: If the Government were not having to make these cuts—not "having to", because I think it is a choice—but if the Government were not making the cuts to working-age benefits and wage growth was 4%, growth was 2.5% and inflation was 2%, would this be such an issue?

Torsten Bell: That would be a doubling of the earnings forecast in the OBR document and that would definitely make it a lot easier in the short term.

Professor Gamble: That is the key point. If economic growth was much stronger, then all these things would become much more affordable. It is the very peculiar economic circumstances we are in, which we have been in since 2008, that really make all these issues so difficult and the trade-offs so politically sensitive.

Q417 Rachel Reeves: Just moving on to issues of working-age benefits and the welfare cap, when representatives from the Office for Budget Responsibility came in front of us, they confirmed that, including the reversals of the PIP changes from the budget, during the course of this Parliament the welfare cap would be breached cumulatively by around £20 billion. Do you think the welfare cap means anything anymore?

Torsten Bell: We know what the Government think it means because, on page 26 of the budget, they tell us that they do intend to meet the welfare cap, but only at the end of the Parliament, so they do not care about that cumulative figure. That is their statement of position and was their statement of position prior to reversing the PIP changes. When they said that, they had a gap of about £0.4 billion extra in that final year that they would have had to find, because they had not changed the welfare cap at that point.
They have two choices. That figure is now about £2 billion, after they have reversed the PIP changes. They have a £2 billion gap at the end of the Parliament. They either fill that gap, which is probably not what you thought Stephen Crabb said in the Chamber a few weeks ago, or they change the welfare cap and have a vote on it. That is their choice.

Q418 Rachel Reeves: You think that, to meet that cap, as it currently stands, they would have to make further cuts to welfare spending.

Torsten Bell: If they want to meet the cap that they set out in the summer budget last July, then they need about £2 billion of extra welfare cuts to do it or they need an improving fiscal expenditure forecast that brings down expenditure on benefits for other reasons. Either of those two things could happen. Clearly, £2 billion would be a large revision to welfare spending in particular, but it is not impossible to imagine.

Q419 Rachel Reeves: The OBR already forecasts quite strong employment growth and reasonably optimistic wage growth.

Torsten Bell: Say for example they again changed their assumption about how many people would succeed on the PIP assessment, by a factor of 5% to 6%, which does not sound massive; that would start to get towards those kinds of figures. It is not impossible, but your hand is with the gods to some degree or at least with the OBR.

Professor Gamble: It always seems unwise for Governments to give themselves targets that are then very difficult to meet. It may well be, for the reasons Torsten has said, that circumstances turn out such that the target can be met. I would expect that, by the end of the Parliament, if it is clear it is going to be very difficult to meet it, the Government will just say, "We are not meeting the target", and will just abandon the target.

Q420 Rachel Reeves: In principle, do you think it is sensible to have a welfare cap or do you think that, given it is demand-led, it is not possible?

Professor Gamble: There is a trend in modern Governments to give themselves targets, when there are so many uncertainties about forecasts and the trends of the economy. These are often hostages to fortune and do not end up well. If they are pursued, they can lead to a distortion of other policies. The older rule, which the Chancellor of the Exchequer used to follow, was not to rule out any policy instruments. They gave themselves the space to make judgments about what was in the best interests of the economy at any particular time. That also had its risks, but it tends to produce more mature policy over the long run and it does not get you trapped in the pursuit of targets that circumstances make no longer relevant.

Q421 Rachel Reeves: Professor Gamble, you mentioned the Universal Credit benefit at the beginning. Do you think that Universal Credit will have any incentives on people's desire to seek extra hours or to find work, or do you not think it will change those fundamentals?

Professor Gamble: That was how it was designed. Every time the generosity of Universal Credit is reduced, the likelihood of it actually giving those extra work incentives becomes diminished. It is early days; we will have to see just how it works when it is rolled out fully. The prospects do not look very good. It looks like it is a closing window.

Rachel Reeves: In other words, you are saying that, in the short run, it looks like you are making savings by cutting Universal Credit but, if it does not have those dynamic effects on people's propensity to seek work, it could actually end up costing more.

Professor Gamble: Originally, Universal Credit was going to be more generous than what existed, but it is now going to be less generous. That is what raises the doubt as to whether the ambitions for work incentives will be realised.

Chair: This is a very interesting subject, but we are going to have to move on a bit, mainly because of the pressure of time.

Q422 George Kerevan: The debate about overall welfare spending was really ignited by the Conservative manifesto, which the Chancellor followed up on in his summer budget, which produced a figure of £12 billion in savings on the welfare spend. Do we have any notion about whether there was an objective basis for that £12 billion or was it just an accounting figure?

Torsten Bell: I do not know.

Professor Gamble: It was a judgment about the deficit and what was needed from the welfare budget in contributing to the reduction of the deficit and, therefore, to realising the Government's overall fiscal target. That was not an objective basis; it was a political judgment.

Q423 George Kerevan: It could be justified from one perspective in terms of the crisis and the level of the deficit at the time, but it appears to be an arbitrary figure, in the sense that it is not reflective of welfare needs in the narrow sense. It is to do with a macroeconomic policy decision.

Torsten Bell: Welfare decisions in most consolidations are obviously mixing needs assessments with public finance considerations. That in itself is not unusual. Clearly it is slightly unusual, prior to an election, to set out a figure specifically for welfare decisions. Is the figure not the amount that is required in a particular fiscal event to deliver the same scale of reductions in DELs in the next Parliament as we had seen in the last? Insofar as there was an objective basis for it, it may well be that, i.e. to get a certain DEL residual, the AME reduction that you would need.

Q424 George Kerevan: Is the Chancellor going to achieve his £12 billion?

Torsten Bell: We have four years to find out whether that is the case. It depends on what you mean. Clearly, he is not going to find every aspect of the £12 billion that he set out in the summer budget, because we have already had a reversal of around £3.8 billion worth of tax credit cuts but, because the Universal Credit equivalent of those cuts is going ahead, the red book forecast still includes that £12 billion. It is not the £12 billion that was driving the £1.3 billion PIP savings that were announced in the budget. That is being driven by a complicated set of things: higher disability spending, a welfare cap that he might want to meet and, probably more importantly, a £10 billion surplus target that he would not have met in the budget without the £1.3 billion. He is on course to meet a £12 billion worth of things, if you take the forecasts as given.

Q425 George Kerevan: How dependent is achieving that on Universal Credit being taken up on time?

Torsten Bell: The changing role of Universal Credit in the fiscal consolidation is definitely very interesting. As Andrew said, the original announcement of Universal Credit, on average—and I stress "on average", because lots of different household types have lots of different impacts—was a slightly more generous system than the six benefits it replaced. The current state of play, and we will see what happens, is that it is about £3 billion less generous in aggregate. There are some families better off but more worse off; people are worse off on average. For the first time, the Treasury now has a strong incentive to deliver Universal Credit whereas, if anything, they had been less enthusiastic than the Department for Work and Pensions over the last five years. That is a big change and we will now see how that plays out.

What it tells you, though, is that the speed of rollout of Universal Credit and its geographical mix are now much more important. If the OBR is underestimating in already pushing back DWP's assumptions about the forced move of some people on to Universal Credit by six months, and if that is another year, it will reduce the savings at the back end of this Parliament quite significantly. It also means that where in different bits of the country Universal Credit is introduced for complex cases, with kids and in-work families in particular, will matter for whether people are better off in Sunderland than Newcastle, for example, in similar situations.

Q426 Wes Streeting: I am pressed for time. I want to try to unpick some of this higher wage/lower welfare economic vision of the Chancellor. Do tax credits depress wages?

Torsten Bell: There is limited literature on this, but the literature that does exist tells us that 70% of every extra pound in tax credits goes to the employees; i.e. there is a 70% incidence of a tax credit spend on employees' incomes. In that sense, no. Prior to my tenure, in 2012, the Resolution Foundation did some work looking at whether earnings growth in the parts of the income distribution that are relevant to tax credits, so broadly the bottom half, were different to parts of the income distribution and people within the income distribution who did not receive tax credits, i.e. did you see an effect of tax credits suppressing wages on those bits of the population that were entitled to tax credits? The answer is, no, that is not the case. That is the same in the United States, where obviously EITC is a similar scheme.

There is a slight irony here, which is that nobody says that a tax cut is going to suppress wages. Tesco does not respond to seeing the personal allowance going up by saying, "Ah-ha, I am going to cut all your wages because your tax has come down", do they? If you talk to firms, they have very little visibility of the different benefit entitlements. They are complicated. We are lucky if the individual understands it, let alone the employer. We have all done very well if they have managed that. In general, the overall evidence is that that is not the case.

Q427 Wes Streeting: Let me ask a slightly different question then. Are tax credits effectively subsiding low-pay employers? If they are, is this a good thing or a bad thing?

Torsten Bell: What are tax credits doing? Tax credits are a political judgment that says that we have an economy that is very reliant on low-paid work compared to other economies considered similar. That has very serious outcomes, in terms of the incomes of families reliant on that work. Governments at different times have decided that that is not desirable and have therefore topped up those incomes.

Subsidies obviously carry with them a pejorative argument about whether they are encouraging it or not. I would take a separate view, which is that earnings and income are different things. Earnings we affect through the market and through the economy. That is what we have the minimum wage for; it is what we have progression policies and skills policies for. You then have to take a view, given those market outcomes, as to what a desirable set of post-tax and benefit incomes is. Tax credits are a response to that. We do not think that we are prepared to accept the income implications of the earnings distribution that we have in this country.

Q428 Wes Streeting: Think about the changing nature of the employment market and how it might change in the future in the way that, frankly, some jobs may no longer exist and will be automated. I am not going as far as some colleagues in talking about the robot industries: we will all be unemployed and servants to machines. But there is a genuine long-term challenge to the country about the nature of work, the shape of the economy and what sort of labour market we might have. What work have you done to anticipate the futurology around that and do you think that that might necessitate a more active role for the state in any case, when it comes to supporting people who might be on low pay or under-employed for the purposes of meeting their goals?

Torsten Bell: That is a very big question. That is incredibly large. What is actually happening? What do we know is definitely going to happen over the next five years, which public policy should be paying attention to, as opposed to what some books suggest might happen in 50 years when all the robots take over? In general, the problem in Britain is not enough robots, rather than too many of them. There is no evidence that Britain is so heavily investing in capital to go along with labour that we have some kind of excess of robots, but that would be a less interesting book and would probably sell less. The books are what they are.

What people should be focused on is that we are about to have an exercise in introducing one of the world's highest minimum wages over the next four years. We are in favour of that. That is a very good thing to do, but it is clearly not risk-free. It requires faster productivity growth than we are currently seeing. More robots would actually help with that, but that flags up a big problem that the British labour market has that we are not addressing at the moment, which is that we have a progression problem. On current trends, that progression problem is likely to become a progression crisis by 2020.

If we end up with 13% of the British workforce on the minimum wage, with the British state via the LPC or the Government, depending on your view of what is actually happening, setting their wages, we are going to have a serious problem for sectors like retail, hospitality and others, in how they motivate their workforce and how they improve productivity. That productivity challenge in our low-paying sectors is definitely going to happen. We would be better off focusing on that than on worries about robots. If anyone finds them, then I would be very interested to see the robots doing your jobs.

Q429 Wes Streeting: I am interested in the link you made between minimum wage and productivity. There are lots of people who argue against minimum wages, on the basis that the wage will reflect employees' productivity and so, by lifting the minimum wage, the incentive to be a more productive worker and to earn a higher wage is lost.

Torsten Bell: Not many serious economists would argue that anymore, although I agree that some people do say that. The overwhelming view of the experience of the minimum wage here, but in other countries as well, is that that has not been the case and that is because you do not have a perfectly competitive labour market in the first place, obviously. Most people are not prepared just to walk out of a job today and to try to find another one tomorrow. They are trying to pay the mortgage and look after their family, so that has not been the experience.

Does that mean that there are no risks from the minimum wage going up to any level? Clearly not: in the end the money has to come from somewhere. Even at the end of the 1990s, a black and white view like that was an extreme position. None of the evidence from the States would support that. Card and Krueger's work and others would not support that position.

Q430 Wes Streeting: When the minimum wage was introduced and virtually every time the minimum wage has been increased, there have always been people who argue that higher wages would increase unemployment. The minimum wage is rising particularly quickly over the course of this Parliament, it seems. I agree with you that it is a good thing, but might the critics be right this time that there may be a price in unemployment?

Torsten Bell: Anybody on either side of this argument who tells you that they know exactly what will happen when the minimum wage in Britain reaches 60% of the over-25 median wage, not 60% of the median full stop, so a high minimum wage, is basically talking nonsense. Look, we are engaged in an experiment. We have a low-pay problem. We are either a country that decides that that is a problem, we are going to try to deal with it, we are going to raise the minimum wage over time as we planned and we will see what happens; or, if it looks like it is causing problems, we back off, and, if it does not, we get to 2020. That seems slightly experimental, but a pretty sensible way to start making policy. Nobody ever made a big change at the bottom of the labour market without taking some risks.

Q431 Chris Philp: I will be fairly brief, given the imminent vote. I would like to pick up on some of the questions that Wes was just asking. Torsten, a few minutes ago, you said that we disproportionately rely on a low-paid workforce in this country, which is generally speaking a bad thing, I would say, for the people in receipt of those low wages. Could you comment on why you think that is? What is the cause of this disproportionate reliance on low wages? I would be interested in hearing both witnesses' views on that.

Torsten Bell: Again, that is a big question. What is different in the UK that we know? Our productivity clearly now has a bigger gap from the rest of the G7 than at any point in the last 20 years. The components of that are complicated and varied, but they range from British management being seen to be pretty poor in general, which is a large component of our productivity gap. Clearly, we need to see more investment in machines and others, but we are pretty bad at managing our workforce, not just in politics, but actually in the real world as well. We have too low levels of investment.
None of this is black and white. For example, if you go on holiday to France and you walk into a supermarket, you will see electronic tags with the prices on underneath your bottle of red wine. That is not the case in any mainstream British supermarket. You will see a paper tag that has been put in by workers, not every morning, but large volumes all over the country.

Chris Philp: I used to do that when I was 16.

Torsten Bell: That may have been good for you when you were 16, but is it brilliant for Britain's productivity? It is probably not. That is why you will see half the hospitality sector being affected by changes to the minimum wage, become that sector has become very reliant on that form of employment.
For a bit of optimism, we will have to wait to see this come through in the data, but our surveys of employers show that the most common approach they are taking to dealing with the minimum wage is to try to increase productivity. Are they absolutely clear how they are going to do that, in some cases? No. But is that what they are trying to do? Yes. Are those employers starting to think about whether their approach to low-skilled labour is the best thing for them? They are starting to think about it.

Q432 Chris Philp: You have pre-empted my next question, which was going to be the optimistic version of the one that Wes asked. Will the increase in the minimum wage force employers to increase productivity in order to pay for it?

Torsten Bell: "Force" is strong, but it will definitely have an incentive in that direction, yes. People will invest more than they otherwise would have done.

Q433 Chris Philp: Perhaps Professor Gamble could answer both of those questions. First, why do we have an over-reliance on low-paid workers in this country? Secondly, do you think that the increase in the minimum wage will, if not force, strongly incentivise people employing low-paid workers to increase productivity?

Professor Gamble: Historically, the problem goes back quite a long way and is to do with the shift away from manufacturing and the high-paid, high-productivity jobs that were much more common in the British economy at one time. Historically, one of the negative features of the kind of economy that was built through the 1980s and 1990s, with considerable success, was the multiplication of low-paid jobs.

I agree with Torsten that there are uncertainties and risks attached to the minimum wage. On the other hand, it is one of the most interesting policy innovations that has been developed at the moment and it offers some prospect of dealing with this problem of low pay, but it has to be linked to increasing productivity. It only works if it kick starts improvements in productivity. If it can do that and it is also associated with investment in the skills of the workforce, then you could get a virtuous circle, but it is the sort of thing that has been tried before and we have not been very successful in doing that.

Q434 Chris Philp: What do you think will happen? Do you think you will get a virtuous circle with more investment in skills, automation and IT support or the other, which is that it could just drive up unemployment, as employers simply cannot afford to pay people more than their productive output?

Professor Gamble: If that happens, it would be the worst of all worlds, because it would also increase the welfare budget.

Chris Philp: Which of those two scenarios do you think will happen?

Professor Gamble: At the moment, I am relatively optimistic. I think it will help to drive up productivity. We are in such new economic circumstances that we need some radical new policies that break out from the past conventional wisdom, if we are to get back to long-term prosperity. It seems to me that the minimum wage and living wage ideas are an important element of that.

Q435 Chris Philp: Finally, I would like to ask a point of factual clarification to Torsten. We have in our paper some distributional analysis published by the Resolution Foundation, looking at the effect of benefit changes, tax cuts and the national living wage. Would I therefore be right in saying that this distributional analysis does not include the effect of things like additional free childcare or, indeed, the fact that things like the pupil premium have been introduced, which disproportionately affects people on lower incomes?

Torsten Bell: This is an analysis of the tax and benefit changes announced in budgets since the election. It clearly does not include everything else. It does not include cuts to public spending, which would obviously be a drain, particularly on the bottom half, but on the whole income distribution. It does not include the pupil premium or other things that are subsets of public spending. This is an analysis of what the tax and benefit changes do to different parts of the income distribution, with the specific addition of the national living wage, because that was a central part of the debate.

Understandably, people who do not like whatever the outcome is will say that there is this other one little thing that it does not include. Extra childcare is a few extra hours for three and four year-olds. There are not enough three and four year-olds in the country for it to make much difference, so I would pick a different one to use as my example of why it might not look like this.

This is the shape of what is happening to tax and benefit changes over this Parliament. This does not include, for example, a further large rise in employment over the next few years, which is what we would all like to see. We have produced other work showing what happens if employment rises. Employment rises are progressive things in general, because they tend to bring people at the bottom of the labour market into work. No analysis is looking at the entirety of things, but there is not a strong critique that this is missing a minor thing out that would give you a different distributional effect from tax and benefit changes. The decision the Chancellor has taken is to give quite large tax cuts to the top half of the income distribution, over the next five years, and to take quite large chunks of benefits, the £12 billion we have been talking about, away from the bottom half of the distribution. Everything else is relatively marginal to that.

Q436 Chris Philp: You have also just answered my last question. You seem to be clairvoyant. I was going to ask if the Chancellor was correct to say that inequality has declined since 2010 and how that is consistent with the distributional analysis. You have answered it by saying that increases in employment, and we have seen 2.3 million more jobs, have a progressive effect.

Torsten Bell: In general, people on both sides of the argument would probably tread carefully on the inequality answer. Inequality in Britain took a large increase in the 1980s and has been basically flat since, with small movements up and down over time. In the last Parliament, since the financial crisis, income inequality—this is income inequality—slightly fell. The reason income inequality fell, which is why the Chancellor will probably talk about it a bit less, is that the richest lost the most. Everybody was having their earnings and their incomes hit over that Parliament, in an unprecedented fashion, and the very richest lost the most. As a result, income inequality falls.

The question now is how we link the graph you are talking about, of tax and benefit changes and employment changes, to what we expect to happen to inequality over the next five years. We have done that analysis. That was published in our living standards audit in February this year. It shows that, if we take reasonable assumptions about employment growth and reasonable assumptions about other things, adding to them these tax and benefit changes, and the national living wage, our worry is that inequality will rise. That is because the employment growth that we all want to see at the bottom of the income distribution will be massively overdone and taken over by these benefit cuts that we are seeing at the bottom. Inequality, yes, has fallen slightly, because people are poorer, particularly at the top. The question is what is going to happen over the next five years. We do not know, but the tax and benefit changes are making it more likely that inequality increases and not less.

Professor Gamble: I just have a very quick point. Yes, income inequality has declined. Asset inequality has increased. One of the by-products of quantitative easing was to hold up asset values, which is obviously something that would need to be taken into account to have an overall view of inequality.

Q437 Rachel Reeves: I am interested in the discussion between Chris and Torsten Bell about what has happened to inequality. The discussion you were having was a backward-looking one, but we are discussing the budget. That cannot affect what happened in the last Parliament, but it can affect what happens in this Parliament. I was wondering, Professor Gamble or Mr Bell, what expectation you have of child poverty, pensioner poverty and inequality in this Parliament, as a result of the measures that we have seen so far?

Torsten Bell: When I was talking about inequality there, I was attempting to talk about the future. I may or may not have succeeded. Our central forecast is that inequality will increase over the next five years, as I say, because of these changes to the tax and benefit system, but it will be compensated for by any employment growth we see. Clearly, we are already at record employment levels.

Poverty levels are harder. Our general expectation is that child poverty and working-age poverty will probably increase quite a lot over the next five years, driven by exactly the same things. Pensioner poverty and working-age non-parent poverty are likely to be broadly flat. That is the consensus of those people like us, silly enough to try to do forecasts of that.

Q438 Rachel Reeves: When you say "increase quite a lot", do you fancy putting any numbers on that?

Torsten Bell: We have published a forecast for it. We published a rise back towards, but not quite reaching, some of the heights seen in the 1990s.

Professor Gamble: Torsten has the figures. I do not have a forecast but, given the nature of the budget measures, that is broadly what you would expect to happen.

Chair: Thank you very much for coming to give evidence to us this afternoon. If there is anything big that you feel we have not touched on, which is crucial to the way that we present your evidence, we would be very grateful if we could have it in writing as soon as possible, because we will be writing a report soon. Thank you very much indeed for coming.