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with

THE CHANCELLOR OF THE EXCHEQUER

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Witness: Rt Hon Philip Hammond MP

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Members present

Lord Hollick (Chairman)
 Baroness Bowles of Berkhamsted
 Lord Burns
 Lord Darling of Roulanish
 Lord Forsyth of Drumlean
 Lord Kerr of Kinlochard
 Lord Lamont of Lerwick
 Lord Livermore
 Lord Tugendhat
 Lord Turnbull
 Baroness Wheatcroft

Examination of Witness

Rt Hon Philip Hammond MP, Chancellor of the Exchequer, HM Treasury

Q1 The Chairman: Chancellor, welcome to the House of Lords Economic Affairs Committee. Congratulations on your appointment. I hope you have got over your jetlag going to and from China. I gather you want to make a few opening remarks, so over to you.

Rt Hon Philip Hammond: Thank you, Chairman. With your permission, I wanted to make a brief statement and to take advantage of the fact that I am in Parliament to inform Parliament that I have decided to give my first Autumn Statement to Parliament on 23 November 2016. The Autumn Statement will set out the Government's economic and fiscal plans, based on the latest forecasts from the Office for Budget Responsibility. In the run-up to the Autumn Statement I will be engaging with Britain's business leaders and employee representatives through a series of industry round tables, meetings and visits, and of course with parliamentary colleagues.

Q2 The Chairman: Thank you. I am sure that a number of topics we want to ask you about today will be relevant to the Autumn Statement, and we are very keen to hear your thinking and your general approach to some of the key issues.

I will start off with a question on housing. As you know, we published a report on housing just before the summer, and our conclusion was that to meet demand, catch up on unmet demand, moderate house price rises and make house prices more affordable over time for young people who are seeking to buy homes, we would need to build 300,000 homes a year, which is about 50% above the Government's current target. To achieve that, local authorities

would have to play a major role, and there would need to be a shift of emphasis away from houses for sale to social housing to meet a large unmet need in that area. We would very much welcome hearing your thoughts on those conclusions and, in particular, what arrangements you would contemplate to enable local authorities to take advantage of the historically low long-term interest rates to invest in social housing, in partnership with the private sector and housing associations, which of course would generate income over a considerable period.

Rt Hon Philip Hammond: I welcome the central recommendation of your report that we need to increase housing supply. The Government are committed to increasing housebuilding. It will not surprise you to know that this is an area that we are looking at very closely, because it goes to the heart of the Prime Minister's agenda of creating an economy that works for everybody. Too few people are able to get on to the housing ladder, and, indeed, too few people are able to access appropriate housing, whether by purchase or for rent, and there are a number of aspects to that problem. It is also, of course, a macroeconomic problem. It has a huge, distortive impact on the overall functioning of the economy. It is an area that has our full attention at the moment, and in due course we will announce how we intend to proceed. I can confirm that we share the Committee's analysis that there needs to be an increase in the rate of housebuilding. We want to see a diversity of tenure types available. We will bring forward policy announcements in due course. That is all I can really say at the moment.

Q3 The Chairman: Do you share our recommendation and enthusiasm for local authorities to resume their historic role and play a significant part? If so, how would they finance that? The Housing Revenue Account has some rather curious limits on it that enable local authorities to build apparently any number of swimming pools but not build houses, which seems a rather perverse outcome of the current rules.

Rt Hon Philip Hammond: There is headroom in existing housing revenue account authorities. I am told there is £3.4 billion of borrowing headroom underneath the cap, and that a £300 million extension to HRA borrowing limits that was announced in AS13 was undersubscribed, so I am not convinced that it is lack of access to borrowing that is preventing local authorities from building. We will certainly look at local authorities, registered social landlords, the private sector, and indeed the corporate sector, as potential parties who can play a part in dealing with the country's overall housing needs. I think we all know that this is not primarily

a financing challenge; it is a land availability challenge, which we have to address to bring down house prices to affordable levels on a sustainable basis.

The Chairman: That was not the evidence that we heard. We heard that a large number of permissions for homes are granted every year, of which only half are built, and a great deal of public land that could be pressed into service for the building of houses is very slow in becoming available. Again, there is a role for government there, and we felt that the Treasury, with its new National Infrastructure Commission, would be able to play the role of driving that through and hitting those targets.

Rt Hon Philip Hammond: The Treasury does play a role. The Housing Implementation Taskforce, which is the body that oversees the release of public sector land, is attended by the Chief Secretary to the Treasury. I have some experience of this from my days as Secretary of State for Defence, the biggest releaser of land for housing development. The challenge is that many of the sites that the Government have available for release are very, very large strategic sites, RAF airfields perhaps, which might be quite a long way from existing infrastructure. They may over time deliver very large numbers of housing units, but they will require very large amounts of infrastructure and inevitably need phased development.

If I could also make a couple of observations. One of the challenges in addressing the discrepancy between planning permissions granted and planning permissions built is the tendency of local authorities—and I completely understand why they find it convenient to do so—to meet their housing needs by releasing a small number of very large sites, often sites that need very significant infrastructure investment. Inevitably, that leads to a lack of competition in local markets, because you have in effect a monopoly supplier controlling such a site.

The other point is that there is no such thing as the UK housing market. Housing markets are highly local, and overall there is a mismatch between where the planning permissions are being granted and where the hotspots of demand exist. The reality is that we have to address the very challenging question of how we deliver increased housing availability in the areas where the high levels of housing demand exist.

The Chairman: As you go through your consultation process for the Autumn Statement, I humbly suggest that you should consider discussing this with local authorities, who show a great deal of enthusiasm to get building. They obviously have a great deal of local

knowledge, but they do not have the finance to do it and feel that is a pressing question for the Treasury to address.

Q4 Lord Darling of Roulanish: Can I start by referring the Committee to my entry in the Register of Members' Financial Interests? In particular, I am a director of Morgan Stanley. Chancellor, I want to start by asking you about what you said shortly after your appointment in relation to resetting economic policy. I am interested in your view on the balance between what monetary policy can do and what fiscal policy can do. In particular, do you accept that monetary policy has possibly run its course in this country, and probably in Europe as well, and that as interest rates come near zero, or below zero in some cases, if you really want to put money into the economy it is fiscal policy that is likely to shoulder the greater burden? Could I draw you on where you stand philosophically on that point?

Rt Hon Philip Hammond: The comment I made was that we would have an opportunity to reset fiscal policy, by which I was referring to the fact that the Prime Minister has made clear that we will no longer seek to reach a fiscal surplus in 2019/20, and clearly we need to put a new fiscal framework and fiscal rules in place to guide policy as we move away from that target. Clearly monetary policy is the remit of the Bank of England, and I do not want to say anything that might undermine its clear responsibility and independence in this area. The Governor has made it quite clear that he thinks he has further ammunition in the Bank's locker: not only in terms of rate reduction but in terms of unconventional monetary policy. I think that monetary policy can and should operate alongside fiscal policy. The Bank was the first mover, if you like, after the shock to the economy of the referendum exit vote. I will have the opportunity on 23 November to consider whether a fiscal response is appropriate alongside that monetary policy response, and I think that both policy levers are valid and have a role to play.

Lord Darling of Roulanish: I appreciate your point about a reset. I suppose it is making a virtue of reality in the sense that the Government was never going to hit that particular target, I suspect. I want to draw you on the fiscal aspect. I am not asking you to say what you will do, because you have not decided yet, but do you think it is more likely than not, if we are wanting to put more money into the economy to get the economy going and to put the inflation rate up, that fiscal policy will do it rather than what is left in the monetary policy locker?

Rt Hon Philip Hammond: I would certainly agree that fiscal policy can play a role.

Lord Darling of Roulanish: But in relation to fiscal policy, do you believe that if you need to put money into the economy, you ought to be looking at infrastructure projects as well as perhaps targeting tax measures on those people who will spend the money rather than save it?

Rt Hon Philip Hammond: If there is a need at any time to deliver a fiscal stimulus for broader reasons, it has to be well designed; it has to be limited in duration and quick in delivering effect; and given our overall fiscal position, which is still unhealthy, ideally it will contribute to the long-term investment needs of the country and the challenge of raising productivity and growth. Therefore, I would hope that in designing any fiscal stimulus, any sensible Chancellor would seek to do as much as possible through investment that will not only deliver short-term demand stimulus but address longer-term structural problems in the economy.

Lord Darling of Roulanish: Would that be more, smaller infrastructure projects that can be delivered quickly, rather than, say, HS2?

Rt Hon Philip Hammond: I think there is a role for big strategic projects, but they are unlikely ever to be able to contribute to fiscal stimulus because of the timelines involved. I am also a great believer in what I will call for shorthand purposes the Eddington principle: that often it is modest, rapidly deliverable investments that can have the most immediate impact, particularly on the road network but also, in some places, on the rail network.

Lord Darling of Roulanish: Do you think that negative interest rates can ever work?

Rt Hon Philip Hammond: I think that is a question for the Governor of the Bank of England.

Lord Darling of Roulanish: But you must have a view.

Rt Hon Philip Hammond: I probably do have a view, but I think you should ask that question of the Governor of the Bank of England.

Q5 Lord Lamont of Lerwick: I would like to ask a couple of questions about QE. The first is a process question about the involvement of the Treasury. If I understand it correctly, the Treasury, when a tranche of QE is in prospect, gives a general approval over timing. The exact nature of the measures to be taken will be left to the Bank, but the Treasury gives its approval because it has to indemnify the Bank. When the Treasury gives initial approval for the Bank to take a view on QE, does the Treasury itself take a view on the appropriateness of QE for the economy at that point?

Rt Hon Philip Hammond: I can only speak about the specific example that occurred on 4 August. The Bank approached the Treasury and indicated that it would like to seek an indemnity from the Treasury to take further steps of quantitative easing. Of course, the Treasury has to issue an indemnity, but those measures have an immediate impact on public sector net debt and are therefore of considerable interest to the Chancellor in terms of the overall fiscal aggregates. The Bank approached the Treasury, and obviously I took advice from the Treasury, but it is not the Treasury's job to second-guess the Monetary Policy Committee's recommendation; our job is to look at whether we can safely and appropriately issue the indemnity and bear the impact on public sector net debt. In this case we agreed that both were appropriate.

Lord Lamont of Lerwick: Could I follow up where Lord Darling almost went on the effectiveness of QE? It would seem almost as though the primary responsibility for macroeconomic policy is now with the Bank of England in a way that was perhaps never envisaged when the Bank was made independent. In 2008 in America, or 2009 here, when QE was first introduced, people thought of it as a temporary measure. I do not think many people would have quarrelled with it at that time, but here we are eight years further on, and in different parts of the world people are continuing with it. I think it would be fair to say that there is some argument about the results of QE in the recent past, but that on the other hand there is more unanimity about the distorting effects on bond markets, equity markets, high-yielding equities, property prices and pension fund deficits. I think many people are getting a little worried about these effects and feeling that central banks have been pushing things and suppressing volatility, but this is at the price and the risk of all this unwinding and introducing eventually, further down the line, a period of much greater instability.

Rt Hon Philip Hammond: A great deal has changed in the global economy since the point where the Bank of England was given independent responsibility for monetary policy. I can only repeat what I said earlier that I think that monetary and fiscal policy both have a role to play. Following the shock of the EU referendum vote, the Bank was able to move quite quickly with a monetary policy measure, which I think the evidence suggests has had some positive effect in restoring calm to markets and a measure of confidence to the economy. That is not to abrogate responsibility from the fiscal side; it is simply to reflect that the Bank

was in a position to move first. The Treasury will be in a position to deliver a fiscal response, if appropriate, on 23 November.

Lord Lamont of Lerwick: You used the word “evidence”. The Governor claimed yesterday that the action the Bank had taken had probably averted the likelihood of a recession. I am not asking you to comment on whether that was right or wrong, but how would you judge the evidence as to whether actually QE had had an effect on the course of the economy? It is plainly not sufficient to say that it went one way rather than another; post hoc ergo propter hoc—the cock that crows and thinks it has caused the sun to rise. That is not evidence. What evidence would you look for?

Rt Hon Philip Hammond: It is obviously difficult to paint the counterfactual. I was shown some of the Bank’s internal work. It appears to me that the outcome that we have seen is considerably less severe than the Bank’s economists were expecting before the stimulus measure was delivered on 4 August, but I think it will be some time into the future before we can look back in any sensible way and try to determine the contribution of the measures taken by the Bank to the outcomes that we have seen over the last couple of months.

Q6 Lord Forsyth of Drumlean: Yesterday, the Governor told the Treasury Select Committee that he was “serene” about the Bank of England’s predictions in the May MPC report, which told us that we would have higher interest rates, we would risk a technical recession, that unemployment would go up and house prices would fall. Exactly the opposite seems to have happened. Are you not concerned that the whole question of QE and the extent of QE, as you made clear this morning, now reside with the Bank of England, which is having real impact, as Lord Lamont has suggested, for example on house prices? I looked at the numbers, and the house price-to-earnings ratio from the last quarter of 2012 to the last quarter of 2015 has increased from 4.42 times to 6.09 times, and in Greater London from 5.43 times to 9.63 times, which is a huge increase. It is hard to believe that that is not related to the impact of maintaining these low interest rates and the use of QE. For the latest tranche of QE, it is estimated that £100 billion will need to be put in to final salary pension schemes. That huge vacuum of money, which is based on artificially low interest rates, is money that would otherwise be invested in jobs and creating growth in the economy. Have we not got to the stage where the Bank is in effect running economic policy in a way which is to the disadvantage of the Government’s declared objectives, which are to make wider home ownership available and enable wealth to be spread more equally, because the effect

is that it is taking wealth away from—if I dare to use the phrase—ordinary, hard-working people and giving it to people who have substantial assets? As Chancellor, should you not get a grip on QE?

Rt Hon Philip Hammond: Of course, quantitative easing is built upon the principle of causing asset prices to rise. We could have a long debate about what is happening in the housing market. I have no doubt that in the end it is about the supply/demand balance. If the supply of land for housing is increased, no amount of monetary inflation is going to force prices to rise in the way we have seen. The situation in the UK has been a toxic mix of increasing money supply and very constrained resource for building more houses, which is creating artificial asset price inflation.

On the wider point, the Monetary Policy Committee has responsibility for monetary policy decisions but, as we have already rehearsed, reset requires the consent of the Treasury for unconventional monetary stimulus through the indemnity mechanism. It cannot do it without the Treasury's agreement. I think it would be wrong to characterise this as the Bank having seized control of economic policy, which I think is what you were suggesting.

Lord Forsyth of Drumlean: I was responding to the point you made that you could not comment on it because it is a matter for the Bank of England.

Rt Hon Philip Hammond: I do not want to comment publicly on a matter that is the responsibility of the Monetary Policy Committee. I would draw attention again to the fact that there are no steps of quantitative easing that the Bank can take without seeking the approval of the Treasury.

Lord Forsyth of Drumlean: On the housing point, I take the point about the limits in supply, and this Committee has produced an excellent report on the housing market, which I hope you will have a chance to have a look at. As you say, it is very complicated. If the house price-to-earnings ratio has doubled in three years in London, that cannot just be a matter of shortage of supply; there are other factors involved here. Similarly, could you address the point about the pension funds? For example, would you consider extending the period—it is currently 10 years—within which companies have to deal with any deficit, given that we are in a highly unusual period when interest rates are at such historically low levels?

Rt Hon Philip Hammond: Sorry, I should have answered that question. I myself have asked what the impact on funded pension schemes has been, and the advice that I have received is that the additional underfunding is not thought likely to give rise to any particular problems;

that there are no pressures for action coming from anywhere in the sector because this needs to be resolved over a long period and does not require immediate action; and that, in the context of the overall pension deficit, it is not a step change. It is also the case, of course, that corporates collectively have a very substantial amount of cash in their balance sheets, so I would challenge the notion that every pound required to close a pension fund deficit is a pound snatched away from investment in productive capacity. I am afraid the truth is that very often it is a pound taken out of cash and corporate balance sheets.

Q7 Lord Burns: Chancellor, you have spoken about there being a role for both fiscal and monetary policy. For much of the 1980s, when I was advising Ministers, this tended to be put as wanting to have a fiscal policy that supported monetary policy. In those days, the job was to get inflation down; now the problem seems to be to get inflation back up to the target. Is it not therefore the case, given where we are, that monetary policy needs some support? Interest rates must be very close to the limit. We have heard from Lord Lamont about some of the distortions that are being created by QE. Instead of thinking of this as two policy instruments, and fiscal and monetary policy in a sense as two options, is it not the case that monetary policy needs some support now and that the Bank of England is running out of room to pursue the line that it has been pursuing?

Rt Hon Philip Hammond: First, the difference in the 1980s was that we did both monetary and fiscal policy.

Lord Burns: Exactly.

Rt Hon Philip Hammond: As to your point about the turnaround in inflation, it is very important that the Bank of England's inflation target is symmetrical, and we see inflation too low as being as damaging to the economy in the long term as inflation too high. I can only repeat what the Governor has said: that the Bank has further capacity in all three areas that it has used as levers of monetary policy, and that the Bank's view of the floor limit on interest rates is that it is a number that is positive but very close to zero, so there is more the Bank believes it can do if it is seen to be appropriate. Depending on the fiscal rules that we set, we can create, at Autumn Statement, headroom for fiscal stimulus if we believe it is appropriate to do so. Indeed, we can create headroom for fiscal stimulus whether we decide that fiscal stimulus is appropriate in November 2016 or not. It would be perfectly possible to design a set of fiscal rules that provides headroom without necessarily using that headroom at the same time.

Lord Burns: Can I press you on one aspect of this in this world we are now in of low interest rates? Obviously you cannot say much more about fiscal policy at this stage, given we will have the Autumn Statement, but do you have any response to the general idea that has been put forward: that at a time when interest rates are as low as they are, the Government should avoid this pursuit of off-balance-sheet funding which they have tried on a number of occasions—using private finance to do what are public projects, often in more expensive ways than could be done by the Government themselves? Is this not a time when you should be saying that the Government are in a very strong position of being able to borrow on their own account and should not be looking far and wide for various schemes in a sense to lay off the problem of public sector debt measures?

Rt Hon Philip Hammond: Regarding low borrowing costs, the choice between publicly funded and privately funded public sector projects is never going to revolve around the relative cost of finance, because the Government's cost of finance will always be cheaper than the private sector's. In well-designed off-balance-sheet projects, the real win is transferring risk—construction, project and operational—to the private sector partner. Although in theory there are ways of transferring some elements of that risk—to a private sector contractor partner, for example, while financing on balance sheet—the reality is that if you are financing on balance sheet, the risk always bounces back to the financier in the end. For me it has always been the case, and it remains the case, that the argument for off-balance-sheet financing has to be constructed around the transfer of risk rather than simply losing the inconvenience of the debt going on the balance sheet.

Lord Burns: I understand that. I would just comment that we were looking recently at the issue of the sale of the student loan book, and we struggled very hard to see where the risk transfer was that was taking place in this area and very much thought that this seemed to be an approach that was being designed almost entirely to keep the borrowing off the balance sheet.

Rt Hon Philip Hammond: The Government have a certain borrowing capacity. PSND as a percentage of GDP is not an irrelevant number.

Lord Burns: No.

Rt Hon Philip Hammond: Our policy has been, and will remain, that where assets in the Government's balance sheet serve no policy purpose, they should be disposed of to create headroom for policy-driving investment. In the case of the student loan book, the policy is

achieved without the need to have the assets sitting on the balance sheet by the Government in effect underwriting the expected default rate, the expected non-repayment element of the student loan book. So I think the policy intention to dispose of the student loan book remains the right one. Obviously the timing of that decision will be subject to market conditions.

Baroness Wheatcroft: I have a quick question going back to Lord Forsyth's point on the housing market. You believe that it is a question of supply and demand.

Rt Hon Philip Hammond: Partly.

Baroness Wheatcroft: Do you think that the Government's schemes in effect to subsidise home ownership skew the market in a way that is not helpful?

Rt Hon Philip Hammond: The current range of schemes that we have in place is designed specifically to support home ownership. We know that 90% of people aspire to own a home, so in a sense government policy is responding to the desires and aspirations of the electorate, but we also know that although 90% of people may aspire to own a home, in reality far fewer than 90% of people will be able to. It is important that we have a range of tenure types that reflect the reality of the world and not just aspirations. I am very keen to see structures such as shared ownership and rent to buy playing an appropriate role in our overall housing market mix.

Baroness Wheatcroft: But would you agree that subsidising home ownership inflates prices?

Rt Hon Philip Hammond: If you are referring to the starter homes scheme, as I understand the detail of the scheme, the homes that will be delivered on a site will in effect displace what would have been affordable homes delivered in another way—perhaps affordable homes for rent—by focusing the subsidy that is already implicit in the obligations that developers receive through Section 106 agreements and so forth on delivering homes for ownership.

Baroness Wheatcroft: What about schemes such as Help to Buy?

Rt Hon Philip Hammond: Similarly, Help to Buy, which is helping people to get on to the housing ladder, is a conscious bias in favour of ownership, reflecting the aspirations of 90% of the population to home ownership, but, as I said, we are looking in the round at housing and planning policies. These are very complicated areas and we will announce any policy changes in due course.

Q8 Lord Turnbull: In a policy reset, will the objective of getting to surplus be retained, and you are simply looking at how long you take to do it, or are you looking at the possibility that a surplus is not necessarily the right end point for a society that has poor infrastructure, can borrow at virtually no cost at all and has plenty of people willing to lend to the Government? You have said that PSND needs to be brought down. PSND as a proportion of GDP can be brought down without getting as far as a surplus. It can be done by simply having a borrowing requirement—2% to 3% of GDP perhaps—which is moderate, and smaller than it is now. You do not need to go all the way to generating a surplus to achieve a decline in debt/GDP ratio.

Rt Hon Philip Hammond: If you have a borrowing requirement of 2% to 3% of GDP, unless you have a consistent GDP growth rate above that level, your PSND will not be going down; it will be going up. I suggest that the level of PSND as a ratio of GDP that we are at at the moment we are getting quite close to a level that might make a difference to the willingness of markets to lend to us, so I do not think we should be cavalier about the levels of debt.

Perhaps I can help the noble Lord by reminding him of what the Prime Minister said at PMQs on 20 July. She said, “We have not abandoned the intention to move to a surplus. What I have said is that we will not target that at the end of this parliament”. That might be helpful.

Lord Turnbull: The point I am making is that is possibly a mistake. Can I refer to one other point on the question of housing and the right to buy? If you are trying to get another, say, 50,000 people over the line into home ownership, but the supply of houses by private sector builders does not increase, the only way in which that is resolved is if you get 50,000 people in and house prices rise in order to discourage a different 50,000 from getting on the ladder. If housing supply increases at the same time, this is a self-defeating policy.

Rt Hon Philip Hammond: I have already said that I completely agree with the Committee’s analysis that we need to significantly increase house-building rates in this country. There are many challenges to doing that. There is a planning challenge and there is a capacity challenge in the industry, but it is very clear that this is one of the factors. If you are looking to answer the question, “Why does the UK economy perform differently from other comparable economies, particularly in productivity performance?”, it seems logical to me to look at ways in which the UK economy functions differently from other comparable economies. The way our housing market functions is very clearly very different from the way the housing market functions in France, Germany, the Netherlands, the United States, even

Japan and other major comparable economies, and I think we should probably seek to draw lessons from that.

Lord Tugendhat: Chancellor, I wanted to put this question as a result of your answer to Baroness Wheatcroft, when you said that 90% of people aspire to own their own homes. Would you expect that to change in the light of a prolonged period of low inflation? As you are aware, the propensity to home ownership varies very considerably among western European economies. As a broad generalisation, those that have suffered bouts of high inflation in the period since the Second World War tend to have a high propensity to home ownership, whereas those that have not suffered in that way, such as Germany and the Netherlands, which you mentioned, tend to have a low propensity to home ownership. For much of the lifetime of people around this table, if not at the back of the room, there was a tax incentive to own your own home through mortgage arrangements. That has gone and now we have had some period of low inflation, and we might have a good deal more, judging by what is happening. In the light of that, would you expect the propensity to home ownership to revert to the sort of levels it is in some other countries and was indeed in this country before the war?

Rt Hon Philip Hammond: I do not think there is any evidence that the aspiration to own a home has gone down over the last couple of years when we have had low inflation. Clearly, when you buy house you are doing two things: you are purchasing a place to live and using it as such, and you are making an investment in a store of value, which historically has turned out to be a rather good investment for most people. The factors at work will be people's desire to own the home they live in, which I think is a very strong and deep-rooted instinct, independent of the investment performance of the asset. It will be partly motivated by the likely return on investment in the asset. I do not agree with you that housing is no longer a tax-privileged class of investment. Owner-occupied housing is a highly tax-privileged class of investment.

Lord Tugendhat: I agree, but it is less than it was.

Rt Hon Philip Hammond: It depends. Arguably, the removal of Schedule A taxation greatly enhanced the tax advantages of owner-occupation. The loss of MIRAS somewhat disadvantaged it again, but it is still a hugely privileged asset class. People will also be influenced by alternative asset classes that are available. How often do you go to the pub—I do not suppose the noble Lord goes to pubs, so I will tell him—and hear somebody saying, “I

don't put money in a pension. I stick my money in bricks and mortar"? People will look at the after-tax attractiveness of different asset classes when they are looking at home ownership.

Lord Kerr of Kinlochard: The people I meet in pubs are usually looking for somewhere to rent, which is getting more and more difficult?

Rt Hon Philip Hammond: It depends on the class of pub you go into.

Q9 Lord Kerr of Kinlochard: Going back to your scepticism about whether the borrowing rules on local authorities are a real constraint, the local authorities gave us evidence that suggests that they strongly thought it was. If you do not think it is the constraint, what will you do in the Autumn Statement to ensure that local authorities build more houses, because it is clear, if you look at foreign examples such as France or our own past history, the one thing that has gone badly wrong in this country is that while the private sector is still building roughly the same number of houses, housing associations and local authorities are not. If one is going to crack the supply problem, one has to get them going again. How are you going to do that?

Rt Hon Philip Hammond: I am afraid to say that in response to the question, "What are you going to do in the Autumn Statement?", I cannot tell you what I am going to do in the Autumn Statement, but I recognise the challenge, and I have said already that local authorities, social landlords, corporates and the private housebuilders all have to be part of the solution. I had already noted down the point about local authority borrowing constraints. I have not yet met with the LGA, but I will take that question up. The hard evidence, which is the available borrowing capacity in housing revenue account authorities, suggests that borrowing is not a constraint, but you have suggested that it is, and I will take that up directly with the LGA.

Lord Kerr of Kinlochard: You gave a global number, but that can be disaggregated and you would expect there to be bit of borrowing here and there and places where there is real constraint.

Rt Hon Philip Hammond: Of course I accept that, and it would be important to understand how many authorities were chafing at the bit to build houses but unable to borrow to do so.

Q10 The Chairman: Can we come back to well-designed off-balance-sheet transactions and focus for a moment on Hinkley Point, which seems to be being financed to generate a near 10% return, which is probably twice the level of return expected by infrastructure investors, and the tab is being picked up for the next 35 years by the electricity consumers in this

country. It is one thing to transfer risk to a corporate entity or partnership where you are confident they are going to be able to deliver the goods, but there seem to be many questions hanging over whether Hinkley could ever be delivered, so surely it would fail the test of being a well-designed off-balance-sheet transaction.

Rt Hon Philip Hammond: As you know, the Prime Minister is reviewing the whole Hinkley Point project and has promised to reach a decision by the end of this month. When I referred to well-designed off-balance-sheet transactions, I was talking specifically about the transfer of risk and the financing of projects. I believe that the assumed return in the EDF model is 9%, but one has to remember that this project as proposed delivers something that has never been delivered by a civil nuclear project anywhere in the world: it transfers the design, construction and operational risk entirely to the operator. There is a very hefty insurance premium in there, which is why the rate of return may look high. But if the project does not generate electricity, it will never generate a penny of return. If it generates late, that will be a penalty suffered by the investor, the provider, not by the taxpayer or energy consumer. Indeed, there is a penalty for late delivery in the price structure of the project. Thus not only will they suffer a deferred return on their capital investment but they will suffer a lower price if the project is very delayed. So I think it does meet the criteria for a well-designed transfer of risk in an area where risk has never been effectively transferred from the buyer to the seller before.

Q11 Baroness Bowles of Berkhamsted: As part of *Making the Economy Work for Everyone*, the Government have said that they are going to have a strong industrial strategy at its heart. I would like to explore with you how much that is a significant change from what was pursued under Mr Cameron's Government. If I may, I will divide that into two. There is a money aspect, which I think lands well and truly in your department, and there is perhaps a broader-brush policy issue of what that means for policy change. Do you have any comments or information on that?

Rt Hon Philip Hammond: First, the industrial strategy is a new departure. It is being worked up now. The Department for Business, Enterprise and—the other thing; the department that has changed its name more than any other department in history is currently working up the strategy. The Treasury is obviously involved, but BEIS is the lead department and a consultation document will be published in due course. The underlying focus is that this economy, although it has done some remarkable things over the last years—it has delivered

2.7 million new jobs, which is a remarkable achievement, especially when compared with the performance of some of our principal competitors in Europe—has not delivered growing productivity, and we need to focus now most urgently on growing the productivity performance of the economy in order to support rising real wages and rising living standards. There is no other way to deliver rising living standards on a sustained basis than growing productivity. We consider that a more active approach to industry is required in order to achieve that objective, including looking at the remarkable disparity between productivity performance in London and the south-east and the other parts of our country, observing that, unlike many competitor countries, our secondary cities have very considerably poorer productivity performance than our capital city. It is not that the UK economy does not know how to deliver productivity—London and the south-east are as productive as any region in the European Union—but we have not worked out how to spread that productivity performance more evenly across the economy. That is the key challenge that we need to address.

Baroness Bowles of Berkhamsted: So it is a bit like the northern powerhouse.

Rt Hon Philip Hammond: The northern powerhouse project seeks to harvest the benefits of agglomeration. It observes that there are four great northern cities that are close enough together, given enhanced transport links—they have pretty poor transport links between them at the moment—to create a single labour market, a single goods market and a single economic geography. Economic theory tells us that we should expect to see a transformation in the productivity performance of that agglomerated economy. That is the principle behind the northern powerhouse. But there are other foci around the country that are equally susceptible to support to achieve higher productivity performance. The gains are eye-watering. I think the statistic is that if we were able to close by 50% the gap between the productivity of London and the south-east and the rest of England, we would increase GDP by £300 billion. That is a remarkable figure and a remarkable potential for us as a nation.

Q12 Baroness Wheatcroft: Chancellor, given what you have said about the lack of connectivity between those four cities, do you think it might make more sense to do the east-west rail line ahead of doing north-south HS2?

Rt Hon Philip Hammond: The two are not alternatives; it is important to do both. My predecessor made clear that the Government want to press ahead with the east-west route

from Liverpool across the Pennines. In fact, a sum of money—I cannot remember if it is £50 million or £80 million—was made available specifically for a detailed feasibility study.

Baroness Wheatcroft: So you would expect them to go forward simultaneously.

Rt Hon Philip Hammond: I cannot say that it will be simultaneously. HS2 is a long-term project. It will take a decade and a half to complete. I suspect that the east-west Pennine railway may be a project of shorter duration, although I am not an expert, and we do not have a validated plan for it yet.

Q13 Baroness Bowles of Berkhamsted: If I could go back to the policy aspects, does that mean that the industrial strategy will not look at things such as attitudes to takeovers and whether sometimes certain companies should not be taken over because the companies that take them over cannot deliver on many of the promises that they make at the point of takeover?

Rt Hon Philip Hammond: We have a much more robust system for securing commitments in the takeover process than we have had before. We applied that system in relation to the recent takeover of ARM by SoftBank, a Japanese company, and those commitments were made in a form that are enforceable through the takeover panel.

I am not going to set out in detail what the industrial strategy is going to include, but the Prime Minister has made it clear that while we welcome investment from overseas in the UK—indeed we need overseas investment in the UK—we are interested in investment that will grow and build businesses here. We are not interested in asset strippers coming in and buying up businesses to take them apart. I think you can anticipate that that view will be expressed in the industrial strategy.

Baroness Bowles of Berkhamsted: As a final point, might you be prepared to find more money for things such as the British Business Bank? Also, would you be extending the sorts of guarantees that are envisaged under Brexit to funding channels that are currently coming in through the EIB and EIF?

Rt Hon Philip Hammond: The British Business Bank is already supporting over £7.5 billion of investment, lending to over 48,000 firms, so it is already starting to do a significant job. We will watch very carefully the lending from the EIB. Britain remains a full member of the European Union and we expect that projects from the UK will be treated absolutely on their merits. Historically, because we deliver strong projects, the UK has done disproportionately well out of EIB funding. We expect that EIB funding to UK projects will continue right up to

the point of departure from the European Union. Obviously, as part of the process of exiting the EU, we will have to put appropriate alternative arrangements in place not just for the EIB but for everything for which we are currently dependent upon an EU structure or institution.

Lord Kerr of Kinlochard: I am delighted that you have raised the European Union, Chancellor, because I wanted to talk to you about Brexit. I did not want to ask you what it means.

Rt Hon Philip Hammond: You can ask me what it means if you like.

Q14 Lord Kerr of Kinlochard: I think I know the answer to that one. I wanted to ask you what you would like it to mean. On Monday, Mr Davis told the House of Commons on Monday that it was “very improbable” that the United Kingdom could remain in the single market. Lord Lawson told *Times* readers last week that it was highly undesirable to remain in the single market; the aim should be to get out as soon as possible and deregulate much further and faster. You told the BBA in July that it was in the interests of the UK and the other member states to keep things as they are for finance, so I deduce that you do not agree with Mr Davis or Lord Lawson and you would like, for financial services, to see us remain in or as close to the single market as possible. Am I right?

Rt Hon Philip Hammond: First, I should make clear that you are quoting my remarks at the BBA party on the evening of 12 July, the day before I was appointed to this role, so I was speaking as Foreign Secretary rather than as Chancellor of the Exchequer.

Lord Kerr of Kinlochard: I am sorry about your demotion.

Rt Hon Philip Hammond: I certainly got a smaller office as a consequence of the change of job. I will not resile from what I said. We have to get away from talking as if there is only the pre-existing model and that we have to use the pre-existing structures and language. The UK is not Norway, it is not Switzerland; it is not even Canada. We are the world’s fifth largest economy. I have no doubt whatsoever that the arrangements that we negotiate with the European Union will be bespoke. The point that I was making to the BBA is that there are very good reasons to think that it is in the interests of the overall economies of the European Union countries, as well as the UK economy, that London, as Europe’s financial centre, remains broadly as it is. I know it has probably become quite fashionable among public opinion to think that banks exist mainly to trade with themselves, but they do not; they exist to support the real economy. Essentially, the financial services market is there essentially to support the real economy, and London’s financial services market supports the real

economy across Europe, not just in the UK. German car manufacturers and Italian manufacturers of consumer white goods use the City of London to deliver finance and financial services, and I believe that the structures that we have in London—this very complex ecosystem of banks, funds, insurance companies, law firms, business services firms—would not and could not be replicated anywhere else, and to break it up, or to try to damage it in the pursuit of some very narrow and hypothetical national advantage, would be a huge mistake for any of our European Union partners. I genuinely believe that London delivers not only for the UK but for the European Union as a whole.

Lord Kerr of Kinlochard: I agree with everything you say, but I was trying to tempt you to be more prescriptive than descriptive. How would you deal with the interesting paper the Japanese Government put out while you were in China, in which they say that if their financial sector is to keep its current presence in London, they will want: their banks to retain passporting rights across Europe and the freedom to provide other services across Europe, their banks and financial institutions in London to be able to move their people in and out of London whenever they want, our financial services regulation to remain harmonised with EU financial services regulation, and transactions in euros to continue to be cleared through London? Is that what you want to see? Do you think you can achieve what the Japanese say they think we should be aiming to achieve?

Rt Hon Philip Hammond: First, passporting is clearly in our interests, and I would suggest in the European Union's interests as well, to have as free and open access to each other's markets not just in financial services but in other trade areas. But we cannot accept uncontrolled free movement of people. That is the political outcome of the referendum decision that was made. I do not think that needs to strike fear into the hearts of Japanese financial institutions, because I would expect that using the control, which we will have, over the movement of people in a sensible way will certainly facilitate the movement of highly skilled people between financial institutions and businesses to support investment in the UK economy. That would certainly be my expectation.

You also mentioned clearing, and maybe I will say a word on that. Various things have been said about clearing, and euro-denominated clearing. I am by no means an expert, although I have spent some time talking to people who are. Clearing in London is a massive business and it benefits from huge economies of scale. The clearing of instruments denominated in different currencies together delivers a huge efficiency in the process. Most of the people

that I am talking to do not believe that you can break off bits of the clearing system. Most of them do not believe that you could persuade clearing to go to any place where it does not want naturally to go, and that actually after London probably the most likely destination for clearing operations would be New York, not Paris, Frankfurt, Dublin or Amsterdam, and anything that split clearing up, or tried to force it to relocate, would simply force up the cost of clearing, with a huge cost to the European economy as a whole.

Lord Kerr of Kinlochard: Again, I agree with you strongly, Chancellor, but you did not pick up all the Japanese shopping list. You did not pick up their reference to the desirability from their point of view, if they were to retain their current financial services presence in London, of our regulation remaining close to or harmonised with EU regulation. Where do you stand on that?

Rt Hon Philip Hammond: Sorry, I thought I had captured that in passporting. Clearly, if we are to have a passporting regime, we would expect to have a regulatory regime that was comparable and well harmonised with the countries into which we were passporting.

Q15 Lord Lamont of Lerwick: Chancellor, do you not agree that there is too much generalisation when it comes to talking about the concept of passporting, and that it needs to be looked at subsector by subsector? Could I just quote a letter that was written to me? I cannot name the author for confidentiality reasons, but he is a very senior figure and head of a very significant institution in the City. He wrote: “No one has come forward with documentary evidence of why the City’s wholesale markets will suffer from the loss of passporting rights—financial services, of course, being tariff free. Which of these services requires access in that sense? Execution of orders on London’s various exchanges? No. Participation in the interbank market? No. Buying reinsurance at Lloyds? No. Raising capital in the City through bond and share issues and syndicated credits? No. Participating in these deals? No. Seeking corporate indemnity advice? No. Establishment of branches of subsidiaries relying on home country authorisation? Yes. But who establishes branches and subsidiaries on the continent for wholesale services in the digital age? I have checked with the big asset managers, none of whom has ever sold a unit trust or investment trust on the continent. Those few in SICAFs in that market already distribute through Luxembourg or Dublin subsidiaries”. He went on to make exactly the point you did about clearing. Can you specify any subsectors that he has excluded?

Rt Hon Philip Hammond: The obvious subsector is banks delivering services to corporate clients in the real economy across the European Union, where they would need passporting rights. I think all I can do is listen to the advice from the sector itself. The sector itself says that passporting is very important, but it also recognises that not all subsectors of financial services require passporting. I do not think I can say any more than that at this stage.

Q16 Lord Livermore: On the same subject of Brexit, you talked about the political imperative of ending free movement, and obviously to end free movement is incompatible with membership of the single market. Would you continue to agree with your predecessor's estimate of a 6% reduction in UK GDP if we were to leave the single market and, if not, what you think the economic consequences might be?

Rt Hon Philip Hammond: There are two strands of economic impact from the referendum decision. We have already seen the uncertainty impact. It is already having an effect, and we are seeking to address it through the measures that have already been announced. We might expect it to continue to exist more or less for as long as the negotiations go on. After an initial shock, the economy has stabilised. Many of the losses in markets have been recovered, but I think we should be realistic and expect that over the period of negotiation there will be ups and downs as the process progresses in the way these processes do. There will potentially be a second impact when we get to the end of the negotiations and have an agreement. Business, investors and markets will look at that agreement, and they will decide whether it represents broadly the assumptions they had made, in which case there will be no further impact and we are home, or they will decide that it is worse than they thought or better than they thought. Broadly, that is the structure of what will happen. I cannot speculate today about whether there will be any further impact, when it will come or what it might look like. That will depend entirely on the progress and the outcome of the negotiations.

Lord Livermore: You are clearly right to say that there could be a subsequent impact, and any subsequent impact, if we were to leave the single market, will be far greater than the uncertainty shock. I think that is self-evident.

Rt Hon Philip Hammond: Not necessarily, but there may be further impacts. We just have to be prepared for this. In setting up our structures we have to give ourselves enough flexibility to be able to respond in a way that supports the economy if it needs support at any point during this process, and that is what I intend to do.

Q17 Lord Forsyth of Drumlean: Chancellor, I was much encouraged by the Governor of the Bank of England's remark to the Treasury Select Committee in the other place yesterday when said the financial system has "sailed through an unexpected result". Can I go back to passporting? I do not really understand what the problem is with it. Lord Lamont has explained the whole range of areas where there is no problem. My reading of MiFID II, which is a European directive, European law, that comes into effect in January 2018 I believe, is that it requires the European Union to recognise countries that have systems that are compliant. As our regulatory system is not just compliant but identical, where does the problem reside? Does it reside in a fear that somehow Europe might change the requirements of MiFID II, or in a belief that MiFID II does not cover every single type of transaction? If that is the case, what are these transactions and what is their value, which seems to me to be miniscule relative to the overall income and value generated by the City of London?

Rt Hon Philip Hammond: I cannot answer the detailed question about classes of transaction that are not covered by MiFID II. I am sure I can write to the Chairman with some examples, if that would be helpful. More generally, the concern is that the UK, as the home of the majority of Europe's financial services business, has been influential—some would say hugely influential—in the design of European regulatory structures, and once we leave the European Union we will not expect to be able to have the same direct level of input, so there is vulnerability to a future potential divergence. Of course, we always have the option of mimicking rules made elsewhere without our input precisely in order to maintain regulatory equivalence, but that would not be without risks because a European Union without Britain will not necessarily think exactly the same way as Britain does on these questions.

Lord Forsyth of Drumlean: But that would apply to every other country or continent in the world, would it not? You are saying that it is not a problem for the present but it might be in the future because they might change the rules.

Rt Hon Philip Hammond: I think it is more a problem of the future and of future-proofing the system. Remember that we are inviting private financial institutions to decide that their long-term future is indeed in London and that London's financial markets will remain the premier financial market in Europe.

Lord Forsyth of Drumlean: So what was all the stuff about all these jobs being lost in the City if it is a future problem and not a present problem?

Rt Hon Philip Hammond: When one looks at impact from a decision, one does not only look at immediate impact; one looks at the impact over time.

Q18 Lord Darling of Roulanish: Chancellor, you have made a very strong statement about where you see the UK within the single market, which I strongly support. The problem is, though, that your Cabinet colleague, the Secretary of State for leaving Europe, gave rather a different impression at the beginning of this week. When do the Government expect to set out the whole Government's position in relation to the single market, immigration, and to just about everything else, either in a White Paper or by some other means? This is going to be a long and tortuous process, and I do not think anyone would suggest that you just rush into it, but at some stage, given that the alternative to being in the European Union in detail was never on the ballot paper, so nobody knows what it looks like, and there was no plan B, when can we expect the Government to spell this out so we can all debate it?

Rt Hon Philip Hammond: Let me be clear what the Government's policy is. We want to see the greatest degree possible of free access to European markets for our businesses to sell their goods and services and for that to be on a reciprocal basis, but at the same time we cannot accept the uncontrolled free movement of people. Those are our two key principles in approaching this negotiation. We are doing the work that you would expect us to do at the moment. In due course, it will be appropriate to serve an Article 50 notice and start the negotiating process. As the Prime Minister said yesterday, we do not intend to give a running commentary. While I understand the thirst for detailed information and answers in the House of Commons, there is an intrinsic tension between the democratic accountability of the Government and effective negotiation with a third party. Our paramount objective must be to get a good deal for Britain, and I am afraid that will not be achieved by spelling out the detail of our negotiating strategy every Wednesday at Prime Minister's Questions.

Lord Darling of Roulanish: It just seems to me that we are getting a running commentary from various Ministers and from briefings and so on. An issue such as this is rather different from negotiating some treaty or deal with a third party. Surely it would be impossible to negotiate in secret on issues such as the single market and what trade-offs we might make in relation to free movement, accepting something less than we have just now in return for getting access and so on, not least because people would talk, and if we do not talk there will be 27 other people around the table who most certainly will be doing quite a lot of talking because many of them have a vested interest in making things difficult, if not for us

then for others so they can get a better deal themselves. Surely you are not suggesting that this can be done and then presented as a *fait accompli* to Parliament.

Rt Hon Philip Hammond: Let me say first that part of our job is to make sure that over the coming weeks and months as many as possible of those 27 other parties realise that it is not in their interests to make this difficult and that their trade with the UK is important, their access to London's financial markets is important, and getting a deal that works for all of Europe—UK and the European Union countries—is going to be to the benefit of all of Europe at a time when European growth rates are fragile and we can all do without something that is going to cause any further depression of them. The work that is going on inside Government at the moment in the Department for Exiting the European Union is designed to inform the kinds of decisions that you are talking about and enable the Government to make informed choices about its approach to the negotiation and the trade-offs that will be involved in that negotiation. In many areas, those trade-offs will be about looking at the economic costs and benefits of different outcomes. It is fair to say that in one area—free movement of people—we have a clear mandate through the referendum result that says that we can no longer accept uncontrolled free movement of people. We have to take that as a political given and then look at how, within that constraint, we deliver the very best possible arrangements for reciprocal access to markets across Europe.

Lord Tugendhat: I must take up your response to Lord Darling, which was not my original intention. You are saying that you are going to persuade everybody that it is in their interests to come to deals of various sorts and that you are relying on their good sense and self-interest to reach a rational solution. I very much hope that you succeed. But as you made clear in your last answer to Lord Darling about the constraints on the United Kingdom's position, people do not always put their rational economic self-interest at the top of the list. It could be argued that in this referendum and in your answer we have decided in this country to put another factor at the top of the list and that politics has trumped economics. Our colleagues on the other side of the Channel might also decide that economic self-interest is not the determining factor and that they too will put something else at the top of the list. I hope not, but in the light of our decision I am sure you would accept that others may behave in a similar way.

Rt Hon Philip Hammond: First, I do not know if I am going to succeed in persuading people. I firmly believe that a solution that allows European businesses to continue to trade freely

with the UK, and British businesses to trade freely with our European neighbours, is very much in the interests of both. I believe that, so I am not trying to pedal them anything; I am simply trying to draw their attention to the economic facts. Of course you are right that, in the immediate aftermath of the referendum, part of the response was emotional—extremely emotional in some cases—from some of our European partners. There are now far more rational voices looking at the economics and, saying ‘what must we do now’, although they would see it as a suboptimal outcome, saying that they want to make the very best they can of it and to protect their own economies and the economy of the European Union in the best way they can. I would argue that logic dictates that that is done by having the most open possible trade arrangements with the United Kingdom.

I am tempted to indulge myself by commenting on the motivation of people in this country who voted to leave. I suspect for some of these people—not all—they will have felt that they were indeed making a rational economic decision, because many people will have a feeling that the benefits of globalisation and openness and the advantage of influxes of migrant workers offering to work for low wages have not worked for them and have meant that they have seen their living standards stagnate even while the economy has been growing. It would be dangerous to assume that those who voted to leave automatically did so for irrational non-economic reasons.

Lord Tugendhat: Of course I agree with that. Indeed, I made a speech along those lines in our debate. All I am saying is that other Governments may also find themselves influenced by similar considerations that will lead to a result that is not in line with your assessment of their rational self-interest.

Rt Hon Philip Hammond: Of course you are quite right. One of the advantages of allowing some time between the referendum and serving the Article 50 notice is that a debate has started in many European countries. European confederations of industrial producers, trade bodies and associations and financial sector regulators will be talking with Governments about the impacts of possible different outcomes, and I would expect those people, who are generally in the majority, to be arguing for following rational economic interest rather than emotional responses to what has happened. Our challenge is to ensure that when we come to the negotiations we are negotiating with people who are seeking to achieve the best possible economic outcomes for their nations, because I am confident that the best

economic outcome for our 27 European neighbours will be the best economic outcome for us as well: free and open trade between our countries.

Q19 Baroness Wheatcroft: Chancellor, could you tell us about the additional costs that are likely to be incurred by the Government as a result of pursuing Brexit? Is there a budget for the negotiators who are being hired, for instance? After Brexit, although I understand that you do not know exactly what form it will take, there will be additional costs incurred by government. Defra, for instance, will have to take on a lot of responsibility currently outsourced to Europe. Is there any foresight as to what these numbers might look like?

Rt Hon Philip Hammond: You will remember that those campaigning to leave told us that there would be a huge surplus resulting from the ending of a budget contribution to the European Union. Regarding process, you would expect me to say as Chancellor that my starting assumption is that machinery-of-government changes will be neutral overall but that any additional costs will be very modest in the context of overall government spending. Looking beyond our exit from the European Union, and you mentioned Defra specifically, clearly the UK will have to devise a system of support for farmers, but it will be a system that recognises the needs and the particular attributes of British farmers, not one that is designed to fit the whole of the European Union. It will be a matter of policy decision for the British Government and the British Parliament whether we should spend more, less or the same amount on farming support after 2020. I have already given a commitment that, after 2020, if we leave before 2020 we will continue to spend at the anticipated CAP levels in support of British farmers. We will have those choices, but given that we are currently a net contributor to the European Union budget, I would not expect the process overall to lead in itself to additional fiscal pressure. The greater risk of fiscal pressure is any incidental effect of this process that slows down the growth of the economy. That is what will deliver the fiscal pressure that we need to think about.

Q20 Baroness Bowles of Berkhamsted: There are various levers you have to pull that are somewhere between full on and full off, and the negotiations will let you find out where those are going to be. Let us say that there is success and you get the kind of free trade arrangements with the EU that you want, where does that leave us with trying to make our own free trade agreements with the rest of the world? Will it mean that we will have to stay in the customs union and give that up, or would that be yet another lever, depending on

how good the free trade arrangements are? Would you take on board the extra costs for our businesses of the country of origin stuff and so forth?

Rt Hon Philip Hammond: That is a separate area of consideration, and we have not reached a conclusion yet on where the costs and benefits overall are for the UK. But you are quite right: there are complex issues around the customs union, trade agreements, rules of origin, and so on, and those are all part of the preliminary work that is being done right now in the Department for International Trade and the Department for Exiting the European Union, with Treasury input and support in both cases.

The Chairman: Lord Kerr, would you like the last word on Brexit?

Lord Kerr of Kinlochard: I would like to raise three tiny points on things you have said. On process, you implied, Chancellor, that the financial services negotiation would be conducted by the department led by Mr David Davis. I would be horrified and astonished if that were the case.

Rt Hon Philip Hammond: I am sorry if I did. I do not think I did, and I certainly did not mean to. The Treasury has responsibility for the financial services sector and discussions around financial services regulation, and our negotiations with the European Union on financial services will be led by the Treasury.

Lord Kerr of Kinlochard: I am greatly reassured. Secondly, on passporting, we do not know who Lord Lamont's mysterious correspondent is, but could you tell us the tenor of the views of the City grandees whom you saw yesterday on the issue of passporting? Did they agree with Lord Lamont's correspondent or did they agree with you? My third point is a diary point. You have spoken interchangeably about London and the City. I am a Scotsman. Edinburgh is the second city for financial services for the UK and in some subsectors for Europe as a whole. I believe it would be very good not just for you to pick up wise counsel but very good in the interests of the union, if you could be seen to have the same kind of meeting you had yesterday in Edinburgh with Scottish Financial Enterprise.

Rt Hon Philip Hammond: Absolutely, and I am very happy to arrange that, although of course the Scottish financial institutions are well represented anyway in the kind of discussions that we are having.

In relation to Lord Lamont's point, I thought I said in response to him that the message I got yesterday from the group that I met was that they would look for passporting arrangements

but recognised that there were significant subsectors where passporting was not relevant, or at least not particularly important, and there were ways of living without it.

You are quite right to pick me up on the sloppy use of the terms “London” and “the City”. Of course, I mean the UK financial services industry, two-thirds of the jobs in which are outside London. Inconveniently, however, we will find that almost all our interlocutors in Europe use the term “London” when they mean the UK financial services sector, and of course a significant part of it is in Edinburgh and other significant bits of it are in other cities around the United Kingdom. It is a genuinely UK-wide business that goes under the banner of the City of London.

Q21 The Chairman: Could I finish on a rather narrow parochial point? When we conducted our investigation into HS2, where we concluded that the case was not made—perhaps you will consider hitting the reset and pause button on that as you have done on Hinkley—one of our concerns was that the process within the Government to evaluate these sorts of projects left much to be desired. Therefore, we took great comfort when your predecessor announced the National Infrastructure Commission, which would be a separate statutory body with responsibility for looking into these things and reporting separately to Parliament and to the public at large so that support can be built based on a factual analysis. Does it remain your intention to put the National Infrastructure Commission on to a statutory basis?

Rt Hon Philip Hammond: It remains our strong intention to work with the National Infrastructure Commission and to use it to drive a new approach to infrastructure in the UK, but right now we want to look at how that commission will play a role in the industrial strategy. Clearly there is going to be an interface between what the National Infrastructure Commission is doing and some of the strands of work in the industrial strategy. We are doing that right now as part of the industrial strategy work, and if there are any changes to our approach, we will announce them in due course.

The Chairman: That sounds like a no.

Rt Hon Philip Hammond: As with many things, I am afraid, inconvenient as it may seem, a new Prime Minister and a new Government want to look at many of the paths that we are embarked upon and look at how they are going to work. The industrial strategy is an entirely new strand to the Government’s policy agenda, and where there are interfaces between it and other bits of pre-announced policy we just need to look at how those are going to work effectively.

The Chairman: But you would agree that rigorous analysis, independent of those who are promoting it—the Ministry of Transport in this case—is an important part of government process. It is important to Parliament and to the public, and it needs to be as strong and independent as possible, particularly as you have indicated that your plans are to increase the level of infrastructure investment in small and large projects.

Rt Hon Philip Hammond: Yes, I would agree with that. You may or may not recall that I am a former Transport Secretary, as are others in the room, and I think it is fair to say that the Department for Transport has a good project evaluation team and is regarded in the Treasury as being at the upper end of capability in departmental terms in evaluating capital projects. Of course, it cannot do any harm to have some additional scrutiny and oversight of anything.

The Chairman: I always got rather higher marks when I marked my own homework as well. On that note, thank you very much indeed, Chancellor, for a very interesting and illuminating session.