HOUSE OF COMMONS

Treasury Committee

Oral evidence: Autumn Statement 2016

Wednesday 30 November 2016

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Watch the meeting

Members present: Rt Hon Andrew Tyrie (Chair); Mr Steve Baker; Helen Goodman; Stephen Hammond; George Kerevan; Kit Malthouse; John Mann; Chris Philip; Mr Jacob Rees-Mogg; Rachel Reeves.

Questions 86-197

Witnesses

I: Robert Chote, Chairman, Office for Budget Responsibility, Professor Sir Stephen Nickell, Office for Budget Responsibility, Graham Parker, Office for Budget Responsibility.

Examination of Witnesses

Witnesses: Robert Chote, Professor Sir Stephen Nickell and Graham Parker.

Q86 **Chair:** Thank you very much for coming to give evidence to us this afternoon. We have quite a lot to get through and there may be a raise at 4.00. We may need to resume after 4.00 p.m. but I hope that we can get through the business that we are intending.

Can I begin by asking the question that I have asked you on the dozen or more occasions that you have appeared like this? Have you had any undue pressure placed on you from any quarter to vary this forecast? What confidence can you give us that it was an independent forecast?

Robert Chote: We have received no pressure at all, so it is, as always, a reflection of our views and our professional judgment.

Q87 **Chair:** We have had an episode that could be described as an attempt to influence you from Treasury officials, possibly emanating originally from a Minister last year, which we then investigated; and, as a result, the memorandum of understanding between the Treasury and the OBR will be revised. That has still not been published, which is a bit disappointing, but, in any case, you have published the draft clauses that you are intending to publish.

We still have some residual concern and there has also been an exchange of letters with the Chief Economist at the Treasury about this, which is in the public domain. There is still some concern here on this Committee that we need to have clearly set out in the MOU what the scope and limits of an acceptable request for a factual change really are. Would you take another look at that?

Robert Chote: Yes, we are very happy to do so. On this occasion, in response to your reaction to the draft elements of the MOU that had been suggested to date and in response to the Treasury's request for pre-release access, we pointed out: "The purpose of sharing exceptional pre-release access versions … is to allow the Treasury to reflect its content accurately in the Chancellor's statement and in accompanying documentation and briefing. We welcome factual corrections at this stage but are not seeking broader comments on the drafting of the document or the way in which we have described the forecast or policy measures." If you feel that that needs further elucidation, then we are very happy to look at any suggestions.

Q88 **Chair:** It may do and we may come back to you with some. Thank you.

The second issue that I would like to raise with you, and we are about to publish it, is the letter that I have just had from the Chancellor about Nissan and the continuing liability as a consequence of assurances given when there was a contingent liability. You asked for an assurance about this, or for clarification. What happened then?

Robert Chote: As you know, we routinely ask the Treasury to notify us of any newly created contingent liabilities. On this occasion we specifically mentioned Nissan and said, "Were the assurances that were provided there the sort of thing that would create scope for contingent liability?" The Treasury came back and basically explained the process for notifying this to Parliament but did not address the substance of that question. We obviously gave them another opportunity to re-think that in the form of seeing the draft documentation. They again did not clarify that further. Obviously the letter, which I am grateful that you have given me sight of, does go some way further in setting out their view or at least their interpretation of the Business Department's view.

Q89 **Chair:** I saw this yesterday evening and, for clarity, it says, "The Department for Business, Energy and Industrial Strategy have confirmed"—that is confirmed to the Treasury—"that no new contingent liabilities have been created in respect of Government reassurances provided to Nissan." What conclusions or inferences do you draw from that?

Robert Chote: Obviously I have no further information beyond this and obviously there is an issue there about whether this is simply reporting the view of the Business Department or whether it is reflecting the Treasury's own analysis of what the Business Department has said in this situation. I am not clear which of those this implies but presumably you will be taking that up with them in due course.

Q90 **Chair:** Which of those do you look for when you write to the Treasury?

Robert Chote: Our formal interaction is with the Treasury.

Q91 **Chair:** It is not just an issue of formality, is it? It is an issue of substance.

Robert Chote: Ultimately, the question is: how does this appear in the departmental accounts that are the Department's concern? In that sense, there is a formality to that that would be presumably at the Business Department level.

Q92 **Chair:** On the basis of this, if this had been sent to you, would you be reassured?

Robert Chote: I would be more reassured than having not had anything at all.

Chair: That was not the question asked. Have another go. The question was: would you be reassured to the point of the test that you yourself have just described: that this would not end up triggering a contingent liability for the purposes of the accounts?

Robert Chote: It clearly remains open to interpretation in terms of this being the Treasury simply reporting their view of the Business Department, as distinct from being their own view. Which of those it is, I would not prejudge, but, as I say, I presume you will be taking that up with the Treasury.

Q93 **Chair:** In which case the short answer to my question might have been "no", because either it does or it does not; and you have just told me it is open to interpretation, so it does not.

Robert Chote: As I say, I look forward to hearing what the Treasury tell you when you ask them about it.

Q94 **Chair:** Was I wrong or right?

Robert Chote: You are right in saying that this can be interpreted as the Treasury simply reporting what the Business Department has said. Whether that is what they mean by that or not, as I say, I cannot be a window into men's souls and I look forward to your line of questioning.

Q95 **Chair:** It therefore falls short of what you would have expected to receive had you had a reply at all. Why did you not get a reply?

Robert Chote: That again is an interesting question that I am sure you will take up. There does not appear to have been anything in this that means that it would not have been possible to say something to us before we published, but I may be missing something.

Q96 **Chair:** In the House of Commons yesterday, Simon Kirby, the junior Minister of the Treasury, said on this point, "It was unfortunately not possible to confirm this to the OBR in time to feed into the drafting process." What, if any, conclusions do you draw from that?

Robert Chote: That could apply, going in the opposite direction: that the Treasury needed the time to establish whether their interpretation was the same as the Business Department's interpretation and they have done so. However, as to whether that is actually what he meant, again, you will have to ask them.

Q97 **Chair:** Given your earlier replies, it sounds like they have not signed for it. There are interpretations of interpretations of interpretations now in play.

Could I take you to the last sentence of the first paragraph of the letter? "We expect any commitments incurring costs to be managed within existing DELs," existing Department totals. What do you think should be read into that?

Robert Chote: It implies that the commitment could incur a cost; otherwise that point would not have been mentioned. The other point, presumably, is that they assume that, if there are costs, they are sufficiently modest that they could be incorporated within the DELs without having to draw on the reserve or do something more dramatic.

Chair: Thank you very much. I have a few other questions but I might come to them later in the hearing.

Q98 **Mr Jacob Rees-Mogg:** Gentlemen, good afternoon. Can I begin with a brief preamble? I think the OBR does its job according to its statute and mandate completely properly, but that does not mean that I think your forecasts are correct. Before the referendum, you would quite rightly not speculate on what might happen in the event of a Leave vote and now you are quite rightly not speculating on what will happen economically if the Government got a fantastic deal in its Brexit negotiations, which is of course what I expect.

After that preamble, can I ask you about uncertainty? Uncertainty seems to be the main driver of downturn in 2017 in the economic forecasts, and I wonder if you have had a look at Kristin Forbes' speech on uncertainty and what you think about that and how you may consider uncertainty in future.

Robert Chote: The short answer is: not in detail. The main reason for the worst of the hit coming in 2017 is not related to the uncertainty but because that is when the inflation hit will be greatest because of the expected time of the feedthrough from sterling to import prices to consumer prices, hence the early and middle part of next year.

In terms of the approach that we have taken to uncertainty, it is no more sophisticated than to say that, given the uncertainty as to where, for example, we are going to end up on the trade regime, on the migration regime and on other policy choices—and exactly the sort of opportunities taken or not taken that you described—that that will lead some firms to delay or cancel investments. We give weight to that in part because there is evidence that it is already happening. If you look at the level of business investment over the first three quarters of the year, it is lower than the equivalent period of last year and it is lower than our forecast was in March. My caveat to that would be that the business investment data is amongst the most volatile and heavily revised from quarter to quarter that you would wish to find, so this will bounce around a lot. However, that was basically the thinking underpinning the judgment.

Q99 **Mr Jacob Rees-Mogg:** Where do you draw your uncertainty assumptions from?

Robert Chote: It is partly the sense that we get from business indicators. As I say, you are already seeing this, to the extent that we can trust the data, showing up as anecdotal evidence to a degree. Moving from this to a precise mapping of where business investment goes on a quarter-to-quarter basis would be a mug's game, but we have to make assumptions.

Q100 **Mr Jacob Rees-Mogg:** Do you draw ideas on uncertainty or indicators on uncertainty in the same way as the Bank of England does or are you using different uncertainty measures?

Robert Chote: You can certainly look at those. There is a lot of work that Nick Bloom at Stanford, for example, has done in terms of some fairly sophisticated empirical work in the area of uncertainty. We cannot place a great deal of weight on that sort of measure particularly. You can look at Google searches of the relevant phrases.

Q101 **Mr Jacob Rees-Mogg:** To go back to Ms Forbes' speech, she is referring to uncertainty as the Bank of England seeks to measure it, but am I right in thinking that you are using "uncertainty" as a catch-all term for parts of economic activity that are moving about quite a bit with a degree of volatility and that you are not using it necessarily in the same defined way as she is?

Robert Chote: It is not simply in the sense of greater volatility. We are presuming a clear direction to this in that there are particular circumstances now that would lead some decisions to be cancelled or delayed that would not happen under normal circumstances; obviously the nature of businesses making decisions on that is that there is uncertainty all the time and there are degrees of volatility and it is imperfectly measured in the way that these things are picked up. However, it seems consistent with a greater degree of it.

The other thing to be wary of is that we are not looking over the horizon of the Article 50 negotiation period and we are not trying to be clever and say, "The period of greatest uncertainty or difficulty or drag is at this particular point in the next five years, etc." We have made a broad-brush judgment that weakens business investment across the path of the forecast. The particular hit next year is not about Article 50 or some later point; that is the inflation feedthrough.

Q102 **Mr Jacob Rees-Mogg:** Right. The Bank of England has eight uncertainty indicators that they use.

Robert Chote: Never knowingly under-indicated.

Q103 **Mr Jacob Rees-Mogg:** That is not what you are using. You are using your own judgment of uncertainty.

Robert Chote: We are using our own judgment but obviously the Bank is able to bring a lot more resources to this and, to the degree that they are willing and able to share it, we happily draw on that.

Q104 **Mr Jacob Rees-Mogg:** Her speech was very interesting. The other interesting speech from the Bank of the England was Mr Haldane's on economic forecasting and the tendency of forecasters to essentially club together and all come to a fairly similar figure and therefore all be right or wrong together. He points out that, in 2008, there was an 8% inaccuracy by the average of 27 forecasters and that, more recently, that has been 0.5% over one year and 1% over two years. Are you concerned by what he outlined in this speech: that there is essentially too much group-think and perhaps also, rather more than group-think, if people use the same models and the models are inaccurate, then inevitably they will all come up with wrong answers?

Robert Chote: I do not think that we should blame models for this. Models are not what tend to end up making those sorts of mistakes; it is judgment. The model is a toolkit for ensuring that the judgments that you make, broadly speaking, are internally consistent and add up. I am not blaming the computer for this.

On the group-think, we know that economists are not good at spotting when turning points are going to happen. If you go to the Treasury's compilation of independent forecasts in March 2008, there was only one out of 40 who predicted that real GDP growth would be negative in either 2008 or 2009 and he had been predicting that consistently for the previous four years and had over-estimated GDP growth by about three percentage points over that period.

In terms of the amount of group-think, in chapter two of each publication we do we compare our forecast to the average of the outside forecasts and to the range of outside forecasts. It would certainly be the case that we are generally pretty close to the average line but it is often striking quite how wide the range is. That range can be quite wide in part because a forecast might be quite out of date and therefore you can shift the boundaries quite a bit. Economists are disputatious people: seeking agreement is not always natural.

Q105 **Mr Jacob Rees-Mogg:** Unlike politicians, who always spread sweetness and light. You were saying in the OBR report that there is a 35% chance that in 2019-20 the Government will in fact be in surplus and a 65% chance that it will meet the cyclical deficit of being no more than 2% of GDP.

Robert Chote: Yes; with pleasing symmetry, there is the same chance of missing the new rule as there is of hitting the old one.

Q106 **Mr Jacob Rees-Mogg:** Yes, and that is basically humility in your report: that you are accepting that the likelihood of everything being spot on what you are saying is relatively small. As I said at the beginning, it is an honest and fairly constructed forecast in accordance with your statutory mandate, but that is not the same as even you saying that you are confident that it will be right.

Robert Chote: This is another thing that complicates comparisons of our forecasting records to other outsiders: you, as in Parliament, have not told us to come up with our best forecast of what is going to happen but our best forecast of what is going to happen if the Government does what they say they will. Let me take one small example. If you ask me to produce a forecast of fuel duty receipts, I might assume that the Government's record would suggest that this would go on being frozen ad infinitum. We produce the forecast on the basis of the Government's excellently stated policy that it will go up by inflation next year, although in the last seven it has not. We are given a different task to do and you have been very conscientious in what you have said in recent days of drawing that distinction, which has been very helpful.

Q107 **Mr Jacob Rees-Mogg:** I want to ask about two brief assumptions that are being made, if the Chairman will indulge me, in relation to Brexit. One is on the assumption in relation to future trade agreements. Are you assuming that from 2019, which is when you think we will have left, the trade barriers to the rest of the world will also apply to the European Union? If I understand correctly, you assume they will apply as if we were still in the customs union, but are you assuming that they will be applied to other EU member states?

Robert Chote: It is not as explicitly a policy-related assumption. We are looking at a range of three of the major outside studies of what could happen to the levels of trade barriers in and out under a variety of different potential trade regimes and we are making an adjustment to our flows of imports and exports on the basis of that rather than making a specific assumption about which trade regime is there. The underlying spirit of your question, which is clearly what this does not assume, is a unilateral dropping of import barriers. That would be inconsistent with that.

Q108 **Mr Jacob Rees-Mogg:** It could even include putting up trade barriers against Ireland and Portugal, if that is within the assumptions of the other people.

Robert Chote: You would have to look at the three individual studies to see what they were assuming. The assumption would be overall that those studies assume that trade barriers would be higher in aggregate over this sort of time horizon. Remember that we are dealing here, certainly over the five-year period that we are looking at, as a period primarily of negotiation, not the steady states to which these things are settled out. Even if one was an optimist about getting to a very liberal trade regime at the end of this, you might not expect that to have been cemented into place over the five-year horizon that we are looking at. What we have assumed, therefore, is that, over a 10-year horizon, you have import and export growth weaker than it otherwise would be but then saying that there is no reason to believe that you could not then go back to the sorts of rates of import and export growth beyond that period. You have a period in which the economy ends up being less trade intensive than it otherwise would have been and then that transition passes. Obviously it is built on no more concrete assumptions about the policy than that.

Q109 **Mr Jacob Rees-Mogg:** When the Government gives you policy, you will be able to provide elimination on what might happen.

Robert Chote: The thing to be wary about there is that negotiation is a two-way street and indeed possibly a multiple-way street. The Government may have very clearly set out hopes that it may not achieve. My suspicion is that, in particular, if we are in a negotiation in which nothing very much is agreed until everything is agreed, I could be retired, you could be in the Lords and much will have passed before we know where we are.

Q110 **Mr Jacob Rees-Mogg:** I think you will deserve your peerage first. Finally, I just have one quibble on where you put the saving from no longer paying membership fees to the European Union. Of course we are expecting it to go into the National Health Service but you are statutorily not allowed to think that; however, you are allowed to assume that it would go off the deficit. I do not quite understand why you assume that Government policy would lead to extra spending commitments in the absence of any policy having been set out.

Robert Chote: All we are saying is that we do not know the degree to which, if and when there is a reduction in the net expenditure transfer, that will either be used as the bus intended or whether it will be used to reduce the deficit. We are assuming that it is spent, and that could be on providing support to people who were getting support from the EU such as farmers or whoever it might be, or it could be providing support to the NHS or something else. The key point is that, if there was to be a reduction in net expenditure transfer and if the Government were to choose to spend it on the NHS or something else, it does not make the hole bigger. That is the key point to take away.

Q111 **Mr Jacob Rees-Mogg:** Isn't the neutral assumption, in the absence of a Government statement, that the net contribution will not be spent—that we leave and the money is available?

Robert Chote: Given that the Government have already started making commitments about continuing to spend money on some things—

Mr Jacob Rees-Mogg: That is only out of the gross amount. It has not made commitments to spending out of the net amount.

Robert Chote: The spending will be out of the expenditure transfer.

Graham Parker: The overall net contribution to the EU is made up of the AE bit, which is what we forecast, which is the net expenditure transfers, but there are also receipts that come back from the EU. They score as negative DEL, the ones that come from the public sector. We have not touched there in DEL: there is £6 billion a year or something like that. All we are looking at here is the expenditure transfers.

Q112 **Mr Jacob Rees-Mogg:** The Government have only made commitments to maintain existing expenditure. They have made commitments to spend money that is spent by the EU on universities, farming and so on, up until the end of the multiannual financial framework. You can argue about the figure but that leaves around £10 billion a year that is in excess that we pay and that we do not get back. The Government have made no commitments on that expenditure, so I do not understand why you have assumed it will be spent.

Robert Chote: The corner solutions here would be to assume it is nothing or all of it. We have obviously explained to the Government that this is the assumption that we were going to make and, if they would like to be clearer about something that they would like us to assume, we would be glad to hear it, but they did not.

Q113 **Mr Jacob Rees-Mogg:** If they did, it would be said that they were unfairly trying to influence you.

Robert Chote: They would be explaining current Government policy. There are domestic elements of spending but clearly some countries that are not members of the EU make net expenditure transfers to the EU, for example because they wish to be part of university support arrangements or indeed for payments that correspond to particular privileged trade access. It is about the combination of the fact that those things are not ruled in or out—you are not ruling in or out the possibility of continuing to provide the support that the Government has guaranteed over a period—and, of course, the talk that the whole point of this was to spend the money on the NHS, which is obviously not Government policy in that sense.

Mr Jacob Rees-Mogg: No.

Robert Chote: The alternative would have been to come up with some sort of arbitrary judgment of "Let's assume that a third of this is taken off the deficit and the rest is spent". We thought it was clearer to do that. The key point that arises in particular for those people who have said, "This is an opportunity to spend money on X or Y," is that we have assumed that it is spent on something and therefore, if you do spend it, you are not digging yourself deeper into a hole than you otherwise would.

Q114 **Chair:** I have indulged Jacob but I am now going to indulge myself by pursuing one of the questions that he asked, which was one that I was intending to come to anyway, in a bit more detail. Your forecast for export growth, as I understand, across the period when the Government have told us that we are going to be leaving the EU, in spring 2019, is 0.3% of GDP; that is the same in the quarters before as it is afterwards. Does that not have a clear implication that there will be no tariffs introduced on imports at the point of Brexit?

Robert Chote: I am not sure that follows. In terms of the forecasts that we have made for the trade flows generally, you have got three things that are going on. In the near-term you have the impacts of the exchange rate movement.

Q115 **Chair:** I heard what you said in the answer that you gave a moment ago. Are you saying that it just so happens that they all arrive at the point where there is no change at all in the forecast for exports?

Robert Chote: Import and export growth are both weaker for, we assume, a 10-year period and are therefore covering the forecast, and then implicitly you could assume that it goes back to that beforehand. One key point is that they are in parallel. The impact of the assumptions that we make on trade on the path of the economy is a near-term boost as a result of the fall in the exchange rate and weaker domestic demand for imports but, by levelling down growth in both imports and exports further out, we are not increasing the medium-term drag on GDP for the trade assumptions.

Q116 **Chair:** Have you considered making any assumption about transitional arrangements after the point of Brexit?

Robert Chote: No, we have not. As I say, at this stage, not knowing what the endpoint would be, let alone the transitional stage, we did not feel that we had a basis for doing that, so we have made, as you can see, relatively simple overarching judgments and we will come back to that if and when this becomes clearer.

Q117 **Chair:** Have you tried internally to give any estimate on what falling back on WTO rules might do to trade?

Robert Chote: No. As I say, we have looked at the average; we have looked at a series of studies looking at a variety of possible trade regimes and taken a simple average. Neither internally or externally have we done what the Treasury did in the sense of coming up with, "Here is what would happen under WTO and here is what would happen under Norway plus or minus." Your advice to us at previous hearings about not wanting to place too much emphasis on a particular point forecast and to have four precisely calibrated forecasts for different trade regimes would possibly not be going in the direction that you have urged us to.

Q118 **Chair:** It is always refreshing when witnesses listen to the advice from the Committee. We are very grateful. I just want to go back to the questions that Jacob asked on uncertainty. It seems to me that there are two crucial points on uncertainty. One is the leaving date, which we are now told is March next year. The other is the place of arrival. I have been asking questions about that just now. I know that you have given a partial explanation in that you have spread these effects over a 10-year period without giving detailed explanations as to why—

Robert Chote: We do not have an Article 50 moment and a precise moment of departure and transitional elements.

Q119 **Chair:** However, would you not agree that the crucial moment of most uncertainty is likely to be the consequences of any new arrangements put in place after we arrive in the arrival hall?

Robert Chote: What is your date for the arrival hall?

Chair: 2019.

Robert Chote: As I say, it comes back in part to the degree to which this ends up being a negotiation in which nothing is agreed until everything is agreed. Are things going to be that much clearer in 2019? I fear possibly not.

Q120 **Chair:** Imagine yourself in an airplane and you are about to take off and there is a discussion taking place about where to go. Would your feeling of uncertainty be increased, decreased or unchanged if, while you were having that conversation, you took off?

Robert Chote: The fact that I have got on an aircraft and people are still discussing where they wanted to go would be a source of sufficient alarm before we even started.

Chair: You are very good at not answering the question. At that point we will move on and I may come back to those exchanges later on this afternoon.

Q121 **Helen Goodman:** I am afraid to say that I am going to go over the same ground about uncertainty and trade a little bit more. I was a bit surprised when I compared the fan chart for the November forecast with the fan chart for the March forecast because I was imagining that all this extra uncertainty would mean that the fan chart was broader now than it had been six months ago, but it does not look to me as if that is the case. Is it? I have got a piece of paper out and it did not as if it was.

Robert Chote: That is very conscientious of you and indeed it should be roughly the same width. The way we do fan charts is different from the way in which the Bank of England does fan charts. The Bank of England does a subjective probability distribution. We use the fan chart simply to demonstrate what confidence you would have in the central forecast on the basis of the pattern of past forecast errors both in terms of size and distribution.

Q122 **Helen Goodman:** Okay, so you are not saying that the stuff that is shaded dark grey is 98% probable.

Robert Chote: No, there is a paragraph under the fan chart that says that, under the current circumstances, because we have been banging on even more about uncertainty than we normally would do, you might think that, however uncertain things were back in March, they are more uncertain now. The way in which we use the fan charts is a mechanistic thing of saying, "Imagine you have landed from Mars. You know nothing other than the new forecast we have made and the record of the past ones. What would you conclude?"

Q123 **Helen Goodman:** The uncertainty that is in the real economy, which businesses are facing, is reflected in your forecast by the reduction in the forecast for output and business investment and trade and all those things.

Robert Chote: Yes. An interesting twist on this in terms of going from that to the fiscal forecast is that, ironically, weaker business investment is better to the public finances, not worse, over the time horizon that we look at because there is a negative tax rate on business investment. The more business investment there is, the greater use of capital allowances is made.

Helen Goodman: Every cloud has a silver lining.

Robert Chote: The impact on public finances is being driven much more by what you assume is happening on particular earnings and therefore income tax receipts than the impact of business investment, which is telling you a story about the economy and it is telling you a story about potential GDP and about the long-term path to which the economy will attend but oddly, as I say, the largest element of revision with the business investment is not something that drives the deterioration of public finances.

Q124 **Helen Goodman:** Turning to this question of the trade intensity, everybody can understand that, in the period of uncertainty, there is a reduction in trade intensity, but it is very striking. In fact, this is probably the core of the argument between the Remainers and the Brexiters: that the forecast shows that there will be less trade intensity in the long run. Is that wrong, Mr Parker?

Graham Parker: It depends what you mean by "the long run". Over the forecast period, it does mean less.

Q125 **Helen Goodman:** In the very long run, do we go back to where we are now?

Graham Parker: Yes.

Robert Chote: In level terms with regard to the level of trade intensity, if you have a period of weaker growth in both imports and exports and then beyond that no reason to assume that you do not get back to the sorts of rates of growth that you had, you would have had a downward level shift in trade intensity.

Helen Goodman: So it is less trade intensity.

Robert Chote: In terms of whether that is the defining difference between the views of the forecaster, because that is not driving a great deal of the change in the GDP forecast or the fiscal forecast because it washes out—

Helen Goodman: I understand that.

Robert Chote: That is much more driven by weaker productivity growth leading to weaker earnings growth leading to weaker income tax.

Q126 **Helen Goodman:** I understand that. That is not what I am asking about. I am asking about why all those people on whom you were drawing—the OECD, the National Institute, the IMF—are saying that the situation would be less or no more trade intensive in the new world where we trade with third countries on either WTO terms or on the same terms as we are trading with the Europeans—and the Europeans are not privileged—than where we are now. I wonder whether you have thought about that at all.

Robert Chote: It may differ from study to study. I presume that, for most of them, it is a judgment that the combination of tariff and trade barriers with our trade with the EU means that there will be less trade with the EU than there otherwise would have been. There may be corresponding judgments that they may have made about the opportunities to lower barriers for non-EU countries but, because of the sort of gravity growth models, you would assume that you gain less from the latter than you do from the former. Stephen, is there anything you want to add?

Professor Sir Stephen Nickell: Given the examples that we have had recently, it takes a long time to agree trade deals with countries. In the short run, EU trade is down because that happens quite quickly. Opening up alternatives, i.e. to get different trading arrangements from the ones that the EU has with places like China, India and so on, is going to take an awful long time.

Q127 **Helen Goodman:** That is partly because the negotiations about trade are connected to negotiations about migration, and that is a bit of a sticking point for the British Government.

Professor Sir Stephen Nickell: That has come about recently with the Indian example—I can see where you are coming from—but there are all sorts of other factors. The fact is that our experience with trade negotiations is that they take a long time. Even bilateral ones take a long time to complete and, in the meantime, we are not there yet. That is why we have this period of reduced trade that lasts until 2025 and then it gets back to something more normal.

Robert Chote: Another point worth making is that one of the differences between the studies is not necessarily what matrix of tariff or non-tariff barriers you have but how responsive trade flows are to that. For example, if you look at the work that Patrick Minford did, he assumes that there is much more of a response, i.e. that trade takes advantage of those low-cost opportunities and that the differences in trade are much more driven by the differences in trade regime than they are by what the gravity model would suggest whereby a lot of this depends on the relative size of the economies that are trading and how geographically distant they are. I do not think the differences just reflect what you think the trade regime outcome is but how people would respond to that as and when it happens.

Q128 **Helen Goodman:** That is absolutely the next question that I was going to ask you: about the extent to which you think that we could trade more with the current regime and that there would be various policy levers that we could pull, short of having new trade deals—say, trebling spend on UKTI or something—that could impact on this. There seems to be a bit of a confusion between levels of trade in exports and doing trade deals or having new trade treaties. The extent to which the one impacts on the other is not clear.

Robert Chote: It is not for us to go into detail about what trade promoting policies you could adopt but, in terms of "taking advantage" of the opportunities, it is worth noting that, labouring under the yoke of the EU as it does, Germany manages to export three times as much in terms of manufacturing and services to China as we do. There are different areas of industrial specialisation so there could be all sorts of explanations for that. I would be surprised if it is down to the quality of trade promotion policies.

Helen Goodman: People's foreign language skills perhaps.

Robert Chote: There will be an element of whether we are taking advantage of the existing opportunities, in which case do you end up with a new set of opportunities or a different set of opportunities?

Q129 **Helen Goodman:** Your assumption is that this decline in trade openness does not feed through into a decline in productivity. Your decline in productivity is for other reasons.

Robert Chote: That is right. The Treasury's pre-referendum analysis made an explicit additional downward revision to the path of productivity growth on the basis of studies suggesting that essentially there is a link between economic openness and innovation.

Q130 **Helen Goodman:** Indeed that is the assumption of the current Secretary of State for International Trade as well. He thinks that, by having more trade, we will increase our productivity.

Robert Chote: We have not made an explicit adjustment of that sort. The link is not well understood. There are a variety of studies of the patterns of trade. There is, famously, the natural experiment of the closure of the Suez Canal that people have drawn upon in order to estimate this. In common with other national institutes, we did the same thing regarding the referendum where they said that, "This is not well enough understood for us to make a concrete adjustment," and we have not made a concrete adjustment at this stage.

Q131 **Helen Goodman:** Since this is a commonly held view, one might think that there was a benign bias in what you have done. Is this something that you will keep under review?

Robert Chote: We will keep it under review. I am not sure what new evidence would be likely to emerge but clearly, if we had taken that view, then we would have had another step down in productivity and another step down in the state of the public finances from that which we have in the report.

Q132 **Rachel Reeves:** Thank you for coming in today. In your EFO, the economic and fiscal outlook, you estimate that the cumulative increase in borrowing as a result of the referendum between 2016-17 and 2020-21 is £58.7 billion. Is it fair to interpret that figure as the cost of Brexit?

Robert Chote: We have made a series of judgments, as you can see, and the overall path of the finances is shown there. I am wary of adding up nominal numbers because, the more years you add up, the larger the number you get and that is not necessarily terribly helpful. If you look at the overall level of the change in the budget deficit before any policy measures, it is about 1.1% of GDP worse on average. The Brexit element of that is about 0.5% of GDP on average, so that would be one way of thinking of it because obviously, the more years you add up, the bigger the number that you will come up with.

If you look at the adjustment we have made and compare it to the adjustments that we have made on productivity in past forecasts, it is the third largest of the ones that we have made over the past 14 forecasts. It is not insignificant but it is not the biggest.

Q133 **Rachel Reeves:** Do you think that a better way of looking at it would be to say that it is costing 0.5% of GDP?

Robert Chote: In the public finances over this period, that would be a reasonable way of looking at it, yes.

Q134 **Rachel Reeves:** What would that be in pounds per year?

Robert Chote: If you have got roughly £60 billion over roughly five years, it is roughly £12 billion per year. Whether the billions mean much to people is another matter, but 0.5% of the size of the economy would be another way of looking at it.

Graham Parker: Is it 0.4% or 0.5%?

Robert Chote: It is in that order of magnitude.

Q135 **Rachel Reeves:** Would £12 billion a year be a good interpretation of what you are saying in terms of the costs of Brexit to the economy?

Robert Chote: The way that we have tried to split it out here, as I say, is that we have made a new forecast and it seemed perfectly reasonable that people would say, "How much of this is down to Brexit?" We have given a rough answer to this. It cannot be a completely clear calculation. For example, you do not know how much of the weakening in business investment over the course of this year would have happened anyway. You do not know how much of the fall in the pound that has happened after the referendum would have happened anyway. It is a rough judgment but we thought it was the most transparent way to set it down.

Q136 **Rachel Reeves:** It could be more, it could be less, but £12 billion would be your central estimate.

Robert Chote: Yes, 0.5% of GDP.

Q137 **Rachel Reeves:** In table 1.4 of the document, you break down those costs. In the early years of the forecast period, it is the cyclical slowdown. I am just looking at the November counterfactual and then changes related to the referendum result. In the early years, it is cyclical slowdown that is causing the additional borrowing and, in the latter years, it is the lower trend productivity growth. Can you explain, Mr Chote, how both of those channels work?

Robert Chote: Yes. It is not as though one thing is happening at the beginning and another thing is happening at the end. There is one thing that is happening progressively through the forecasts, which is that we assume that productivity growth is weaker than it otherwise would be and we have put that down to less business investment, less capital deepening, workers having less capital to work with and producing less and so forth. Other people may say, "I would like to put that down more to trade intensity," and you can do that. You have that effect, which basically lowers the path of potential output to which the economy would eventually tend if the Bank of England is doing its job and getting inflation to target and keeping it there.

In addition, you are opening up more spare capacity relative to that lower trend path in the near term. Our assumption is that we started off with very little spare capacity in the economy—0.1% to 0.2%—and that rises to 0.7%, and that is because you are having demand weakened in the short-term partly by the direct effect of the weakness of business investment but also because you have consumer spending being squeezed and because inflation means that a pound in the consumer's pocket does not go as far. Offsetting is the net trade effect. Roughly speaking, half of the impact of investment and the inflation squeeze on the consumer is offset by the net trade effect. That is giving you a short-term opening up of spare capacity and an opening up of the output gap. That then reverses itself and you move back to this lower path of GDP. That is the reason why we do not have downward revisions to the annual rate of GDP growth towards the end of the forecast: because that is the period in which the output gap is closing.

Q138 **Rachel Reeves:** Yes. There are two other things in this table that are of interest. Higher inflation, even by the last year of the forecast period, is adding £2.2 billion to borrowing. Is that just a base effect of inflation in the early years, or is it that you are expecting higher inflation in those future years? I am happy for Mr Parker to answer.

Graham Parker: There is a lot more detail on this in Annex B of the EFO on page 248. This is the effect on borrowing: things like the effect on debt interest.

Q139 **Rachel Reeves:** I understand that but is it because of inflation in the early years that then lasts through the whole forecast? It is not that you are expecting inflation to be higher every year because there is basically a depreciation effect.

Robert Chote: The level of consumer prices is about 2% higher than it otherwise would have been.

Q140 **Rachel Reeves:** My final question on this is just about the lower migration numbers. In the final year of the forecast period, that is adding another £5.9 billion to borrowing. This will be because your assumptions are that migrant workers contribute more into the public finances than they draw down on benefits. However, presumably, in terms of GDP per head, GDP per head would not be higher through net migration.

Robert Chote: Not as higher. You are right. In one sense, that shows up because you are increasing the size of the population but, generally speaking, net inward migrants are more likely to be of working age than the rest of the population so it tends to boost the employment rate as well as just the size of the economy.

Q141 **Rachel Reeves:** It only boosts the employment rate because people coming here are working, not because they are creating more jobs, in your forecast. Is that right?

Robert Chote: Employment rises over the course of the forecast and you can attribute three-quarters of that to the impact of net migration. In terms of the employment rate, that is the age effect rather than the size of the population effect.

Q142 **Rachel Reeves:** My point is that, if you have got an employment rate of 75% and then 2 million come in who are all working, that will increase the employment rate but it does not increase the employment rate amongst the people who were here in the first place.

Robert Chote: No.

Q143 **Rachel Reeves:** With the migration numbers, although it has a negative effect on borrowing, it does not necessarily have a negative effect on GDP per capita, does it?

Robert Chote: If you are increasing the size of the population and the size of the economy, that will make the economy grow more rapidly.

GDP per head would be improved to a much lesser degree because these people are more likely to be of working age. There is still some positive effect but it is not anywhere near as big.

Q144 **Rachel Reeves:** Parallel to what I was saying previously is that having higher levels of net migration would not improve the GDP per head of the people who are here previously.

Graham Parker: No.

Robert Chote: No.

Q145 **Rachel Reeves:** Sir Stephen, can you foresee any situation in which Brexit has a positive impact on the public finances in the coming years?

Professor Sir Stephen Nickell: Do you mean that you want me to create a scenario?

Rachel Reeves: Can you foresee one? Is there any possibility that leaving the European Union might have a positive impact on the public finances?

Professor Sir Stephen Nickell: I can think of elements of something that might happen that might be positive for the public finances. For example, supposing after we left the EU that we went back to the system of agriculture support that existed before 1973, which, as far as I recollect, went something along the lines of we traded at world market prices in agricultural products, which are incidentally cheaper than the prices we trade at now, and then we compensated British farmers so that they did not all go bankrupt when they tried to sell at world market prices, that might lead to a situation where we needed to give less money to farmers than under the current arrangements, which would improve the public finances, and also people would like it better because food would be cheaper. That is one part of one possibility.

Q146 **Helen Goodman:** I just want to interject here that the NFU have done three scenarios, and they do not think that.

Professor Sir Stephen Nickell: They do not think what?

Helen Goodman: That the public finances would be better off.

Professor Sir Stephen Nickell: Of course they do not. They have a vested interest in not thinking that.

Helen Goodman: You are making Mr Rees-Mogg happy, anyway.

Professor Sir Stephen Nickell: This is a tiny part of a big story.

Robert Chote: Particularly how much of our EU membership you end up replicating through the back door.

Q147 **Rachel Reeves:** So one way that the public finances might not be as badly affected as you set out is that we may replicate a situation that looks very much like our membership of the European Union, which would make Mr Rees-Mogg much less happy.

Robert Chote: We could have a world in which you end up with a much more liberal trade regime, which promotes greater productivity, greater growth, and great income.

Chair: Forecasting is such fun. We could carry on.

Q148 **Rachel Reeves:** We could carry on, but I will not carry on for much longer, Chairman; do not worry. You write in the Economic and Fiscal Outlook that the deal the Government reaches with the EU may or may not include agreeing to contribute to the EU budget in order to retain some of the benefits that it has enjoyed from membership. The Secretary of State for Exiting the European Union has said that his job involves regaining control of laws, borders and money. Does that not suggest that a deal in which the UK makes continued contributions to the EU budget has been ruled out?

Robert Chote: I suspect he mean that by retaking control you get to choose which of those things, at a greater level of granularity, you continue to contribute to than you otherwise would do, does he not? We could decide to contribute to something that pays for university, allows us to participate in cross–national university research projects, but does not end up spending money on something else we do not want to spend it on.

Q149 **Rachel Reeves:** In terms of how you came to your conclusions, you say on page 37, paragraph 3.3, that you had asked the Government to give you some information. You say, "The Government's response leaves us little the wiser as regards the choices and trade-offs the Government might make during the negotiations." That is your view: that you have not had the information to be able to provide a forecast.

Robert Chote: We have not had any more information that was already in the public domain. I think if the Government had decided that this was the moment to say more about what they expected or where they wanted to get to, the world I would not have liked to be in would be for the Government to say, "Here are some things we are aiming for, or that we think we can achieve, which we would like you to take account of, but you cannot tell the Committee or anybody else about it." That would be a very bad position.

In effect, we felt it was important to formally say to them, "Look, is there anything you want to tell us?" but in practice, that would be a choice about whether they wanted to tell us, Parliament and everybody else.

Chair: The moment they tell anybody, they will be telling everybody anyway, because everything will leak.

Rachel Reeves: As Mr Chote said in his introductory remarks, I think it may be some time before we have any information about where we are going.

Robert Chote: Yes.

Q150 **Chair:** We are lingering on this forecast because this is the most important one you have produced since 2010, and there is so much colour and fun in it anyway.

Robert Chote: That was very much the objective we had in mind, Chairman. Colour and fun is what it was all about.

Chair: I am told that the vote might be at 4.30, rather than 4.00, by the party that has most control over this, so we have a bit more time.

Q151 **Stephen Hammond:** In the spirit of colour and fun, you will recognise from the Treasury's Autumn Statement, obviously, the statement "Raising productivity is the central long-term economic challenge facing the UK." The Chancellor then, in his speech, told us that we lagged the US and Germany by 30% and France by 20%; we were even behind the Italians. Is it not the reality, however, that we know that Britain needs to be better in productivity, but those international comparisons are pretty spurious?

Robert Chote: They are hard to do. The key point to bear in mind, which puts Brexit and the uncertainties around it in context, is that the defining uncertainty around this forecast, and every previous forecast that we have done over the last few years, is the outlook for productivity growth. There is the level issue, yes, but we have been in a period where productivity growth has been a lot weaker since the financial crisis than it was beforehand. The UK is not unique in this, although it is more noticeable here than it is in many other countries.

The successive downward revisions that we have had to make to the outlook for the public finances, and the outlook for the economy, have been primarily driven by the fact that that period of weak performance has gone on for longer, and therefore we have had to place more weight on that, relative to the many decades of stronger performance that preceded it, as the basis for the forecast. It is very important to recognise that we have Brexit affecting the outlook for the economy, via an investments-to-productivity channel, but Brexit is not supplanting that source of uncertainty. It is adding to it and augmenting it.

Another implication of this is that when we gather together in 20 years' time, nostalgically, and look at the exciting work that the young PhD economists have been doing on untangling what has happened to productivity growth over the next, i.e. then past, 20 years, disentangling the effect of Brexit from how the underlying productivity puzzle ended up resolving itself will be a virtually impossible distinction to make. If productivity growth remains really weak, which is not good for the public finances, as we outlined in chapter 5 of our scenario, some people will say, "Well, that was Brexit that done that."

It may not have been; it may simply have been the fact that the underlying weakness in productivity growth persisted. On the contrary, if productivity growth starts shooting up, it is not because "Aha! Everybody was wrong about the impact of Brexit," necessarily; it is the fact that the productivity puzzle resolved itself, and we went back to something more like past performance. You highlight a key issue that underpins not only this forecast, but every one that we have done to date. It has been a very unusual period, not just for the UK but for the global economy, and nobody knows quite why it is happening.

Q152 **Stephen Hammond:** You mentioned the financial crisis and the lack of pick-up of productivity since. Presumably in your forecasting, the fact that Britain has a greater element of output coming from the financial services sector, or services sector, as opposed to more easily measurable Germany heavy manufacturing, could be a potential reason for that lack of productivity growth.

Robert Chote: There is a sectoral story to be told here, but it is a broader story than that, and it is not just about the UK. The Federal Reserve is having exactly the same discussion, on somewhat smaller magnitudes, on how we interpret the weakness of productivity growth. Is it down to the fact that there are no things worthwhile to invest in anymore, as there used to be? That is the supply-side version of the secular stagnation story. Is it more a demand-side story as well?

In terms of the specifics of the financial sector, on the output side of the national accounts we do not do a sector-by-sector, bottom-up approach. One area where we have taken some explicit judgments on the financial sector is on things like financial sector profits and wage growth, where we have assumed that Brexit is likely to hit that harder than the rest of the economy. Therefore, we have made some adjustments on tax receipts for that reason.

Q153 **Stephen Hammond:** But no assessment of productivity as separate.

Robert Chote: No.

Professor Sir Stephen Nickell: Can I say one thing? It is true to say that productivity is hard to measure in the service sector and so on, but, by and large, if you are comparing one country with another, the level of productivity there is generally reflected in the level of real wages. If you look at what people can buy, or what the average person can buy, in different countries, by and large, that reflects what the measured productivity numbers tell us, in a broad-brush way.

The fact is that if you go to Germany the average worker in Germany can buy more than the average worker in the UK, and that is because they have higher productivity. It is not all a myth; it does have real consequences.

Stephen Hammond: I am not suggesting it is, but for the average worker there could be some quite big real wage pressures simply from currency movements, for instance, imported inflation.

Professor Sir Stephen Nickell: Yes.

Q154 **Stephen Hammond:** Can I just come back to Mr Chote's remark that what you are reflecting may not be worthwhile things to invest in? Obviously, the Chancellor thinks there are some worthwhile things to invest in, because he set up the National Productivity Investment Fund. Can you say whether the OBR has done any modelling to determine what impact you think that will have on future productivity growth?

Robert Chote: The first point, on things not to invest in, is I was talking about the private sector rather than the public sector. We have not made any explicit adjustments to the trend productivity—that is the underlying path of productivity growth—as a result of the measures that the Government have announced. They would be small in comparison to the judgments that we have made related to business investment, but that is not to say that we are saying it is not a good idea to be spending the money in the areas that he is talking about: transport, research or whatever.

Q155 **Stephen Hammond:** But broadly speaking, some of those matters on transport and research are obviously back-end-loaded. If they were front-end loaded, would they have a bigger impact on investment, and therefore a bigger impact on potential productivity growth?

Professor Sir Stephen Nickell: It is just not big enough. The fact is that in our forecast, the level of business investment will be about £27 billion per year lower by the end of the forecast. The impact of the public spending on similar goods is of the order, by the end of the forecast, of £3 billion per year. Basically the £27 billion beats the £3 billion by a street, and that is why productivity growth is going lower in our forecast.

Q156 **Stephen Hammond:** So you would not have much confidence in the assertion in the Autumn Statement that the new investment will fund projects that show a clear and strong contribution to economic growth?

Professor Sir Stephen Nickell: It is clear and strong, but—

Stephen Hammond: Tiny.

Professor Sir Stephen Nickell: Very small.

Stephen Hammond: That is the one word they missed out, from what you are suggesting.

Robert Chote: They may also be talking about the direct demand effect of these things, as well as the longer term supply improvement. There, again, it is a small number. The additional public expenditure is not the near–term fiscal stimulus package that some people either expected, feared or wanted, in discussions in recent months. It is a relatively small, gradually phased increase in spending on a variety of areas of public investment. It makes 0.1% difference, up or down, to the annual GDP growth rate, at most, in the years of the forecast.

Q157 **John Mann:** If I could just pick up an answer you gave, Sir Stephen, to Mr Hammond, does the average German or French worker leave significantly more, when they die, to their children, or whoever inherits, than the average Briton?

Professor Sir Stephen Nickell: I have no idea, sorry.

Q158 **John Mann:** When you talked about what people can buy, of course my disposable income, and obviously that of most Britons, incorporates rather a lot of money on mortgages, whereas the average German, for example, is paying significantly less because they are tending to rent. In terms of those definitions of productivity and the one you gave, it seems to me that the fixed take from where you are living, and how you accumulate wealth, is quite considerable.

Professor Sir Stephen Nickell: First of all, of course quite a lot of Germans have mortgages, but, I agree, fewer than Britons. The rent, of course, enables them to live in the house but not to accumulate assets. In the UK, as you rightly point out, we accumulate assets by using the mortgage system to buy houses. What I would come back to, however, is this broad-brush issue. I have no idea how much Germans leave in their inheritances, but most people in the UK do not leave very large inheritances.

Q159 **John Mann:** The only reason is that you made rather a broad-brush productivity comparator; that was my point. If I can move on, Mr Chote, is this forecast roughly 100% likely to be wrong?

Robert Chote: Yes, as they always are. It is a median forecast: there is a 50% probability, in our view, that things are better and a 50% probability that they are worse. We are at the more optimistic end of the spectrum, so if you were to base this on outsiders' views, you would say there was a net downside risk.

Q160 **John Mann:** How well do you think you have done this time in explaining to the general public what a forecast really is, and what the limits of the forecast are?

Robert Chote: It is always a challenge to explain that to everybody. As I say, we try to do that in part by talking about the uncertainties that are around it, in part by looking, as you know we do each year, at past performance, and also being clear with people what the assumptions are. I suspect that the average member of the population is not fully seized of the fact that we are producing a forecast conditional on a particular set of stated Government policies and others are not. We try to explain that as best we can, but I am not naïve in believing that that is completely understood.

Q161 **John Mann:** It would be interesting, as well, if we took those newspapers whose commentators are the most enthusiastically pro-EU, they seem to have given significant front page headlines to your forecasts, without ever defining that they are forecasts. You said this was a top priority in 2015, in answering the Chair, to explain what a forecast is and the limits to it. My point is, there is danger that if you do not do so, that it could be taken as a new truth by people.

Robert Chote: I do not think that there is a great weight of people outside there who have an enormous amount of faith in economic forecasts. I may be underestimating it. I would not say that the headlines have been entirely dominated by people who regard our forecasts as truth and bound to come out, either, but maybe we read different newspapers.

Q162 **John Mann:** On one particular aspect, what has been the trend since the end of June, in this country in net migration?

Professor Sir Stephen Nickell: We do not know. It has not been counted yet.

Graham Parker: The figures come out tomorrow, but even they will only go up to about June.

Q163 **John Mann:** In 2011, in the first proper exchange on migration figures since you came into existence, you said that you based your figures taking into account net migration change. When questioned about how many migrant workers were in your labour market statistics, you said, Mr Chote, that that kind of detail was not something that fell within your remit. This time, you have a whole section in which you predict "stricter controls and/or a reduction in the attractiveness of the UK as a destination could reduce net inward migration". Where is the policy basis for determining that there will be stricter controls?

Robert Chote: On the basis of what the Government have said about wishing to have more control over migration policy, plus—

John Mann: They said that in 2010 and every year since.

Robert Chote: Yes, and we have adjusted our migration assumptions on the basis of the lack of success in achieving that, in some degree.

Q164 **John Mann:** What has changed? You are predicting a huge change before what the Government say is the end of the Brexit negotiations. Before the end of the Brexit negotiations, what are these stricter controls that will change net migration?

Robert Chote: The point we have made is that you have the controls, and you also have the pull factors. One of the reasons we had understated or used ONS population projections that had a lower net in migration number than actually happened, was because we did not put sufficient weight on the degree to which people would be attracted by the performance of the economy. If you have a weaker outlook for the economy, that would, you would assume, mean that there would be less of a pull factor.

You are not relying precisely on the change in the control element there. Basically, the judgment we made was that, on the basis of the most recent set of data, which I think were 330,000 or thereabouts net inward migrants over the previous year, the ONS assumption would have been too low, and that in the absence of the referendum, we would have got moved to the ONS's high net inward migration variant.

The judgment we have made here, as we said explicitly, is to assume that, because of at least the direction of policy, and the possibility that, whatever the outcome of the EU negotiations, there may be greater policy leverage than has been exertable to date, plus the pull factor, we would stick with the migration assumption that we had back in March. That makes, in practice, about 80,000 per year difference. We also said that we did not feel that we knew enough at all about where the migration regime would end up, or about the strength of those pull factors, to move even further to the low migration scenario, which would obviously have had a greater effect in the same direction.

Q165 **John Mann:** For the last six years, every single year, you have underestimated both inward migration and net migration, and suddenly you are shifting to this huge change, which is not validated by any policy change or any data. You are getting into the realms of guesswork here, are you not, as opposed to economic prediction?

Robert Chote: It is a transparent assumption upon which we base the forecast. We have made assumptions and moved them on the basis of what the Government's stated policy is and what the data suggests about the success to date in achieving that. We have explained here why we would have moved it again.

John Mann: You have specifically said "stricter controls". It looks as if you have done a total transformation of your position. You were not even prepared in 2011 to identify the number of migrant workers coming in, and now you are creating a headline. I will come back to my first or second question, about how you are explaining what a forecast is. You have created a very big headline that says that the economy will be badly hit, because far fewer people will come here because of Brexit.

Robert Chote: Each time we do a forecast, we have to make an assumption about what population projection to use, and part of that is deciding which variant of migration flow we have used. Every time that we have either set it, or moved it, we have explained the basis on which we have done that, and, as transparently as we can, what the impact of that would be. That is what we continue to do. You are perfectly—

Q166 **John Mann:** You have built in a policy that does not exist, of which you do not have any notification it will exist, as part of the basis. "Stricter controls"—there is no policy change that has created stricter controls, yet you have put that in as an explanation of a prediction you have made.

Robert Chote: As I say, we do not know what the Government's policy is as to what it wants its import tariffs to be, either. To be as helpful as we can at this stage, we have made as transparent and clear a set of assumptions as we can, and stated very clearly that these are broad-brush and on the basis of no more information than anybody else has about where things will end up. Where we end up on our ability to do more or less control of migration may be related to the deal that ends up being done on access to the single market, for example.

At this stage we do not know precisely what the Government's objectives or expectations are on that, but we need to set out as clearly as we can for people what we have assumed, and produce the forecast on that basis.

Q167 **Chair:** John's point is that the Government has been saying that we will have stricter controls for a long time, and you did not put a step shift into the forecast, but you have now, and John is seeking an explanation for that.

Robert Chote: We did. The point is that we did put a step shift up, on the basis of migration numbers coming in higher, and we have said in this report that we would have put another step shift up in as well.

Q168 **John Mann:** Considering the importance of this issue, is this an area where you intend to do more work before your next forecast, compared to before?

Robert Chote: Did you read the last report? As you saw, what we did there was to have a special section looking at it, where we set out what we thought the economic and public finance implications would be of moving either to the higher or lower levels. You were our target audience for that one, I think, so I am glad you did read it; I would have been distraught to think not. We have explicitly, in this report, said, "Given the choices we have had, we have set out previously what we thought the effect would be," and we also pointed out back then that it is fairly linear, so if people want to make different judgments, you can scale the likely effect fairly straightforwardly for yourself.

Chair: We are moving on, distraught Chote or not.

Q169 **Kit Malthouse:** I just wanted to rattle through some questions that might dodge around a bit; they are things to clear up a little. Referencing your earlier conversation with Jacob Rees-Mogg about uncertainty, am I right in construing that what you said is that there is no methodology to your evaluation of uncertainty? There is no science behind it? The Bank of England made a stab at some kind of science; they Googled how many times it said "uncertainty" in the *Guardian*, that kind of thing. You, however, said it was a purely a judgment thing.

Robert Chote: It is a broad judgment, but obviously we can look at the work that they and others have done, which they have cited. The Nick Bloom Stanford methodology of trying to come up with a policy uncertainty index is one measure, and that would obviously have shown it being higher. I do not think we would go so far as to calibrate the adjustments that we have made precisely to movements in that, or anybody else's, quantitative model.

Q170 **Kit Malthouse:** If it is just about feel, and you are looking at what else is out there, if what else is out there is trumpeting uncertainty, does that not become self-reinforcing?

Professor Sir Stephen Nickell: There are surveys. Businessmen say, "Uncertainty is making us reduce our investment spend." The Bank of England's agents have been around talking to people, and they also say the same sort of thing. These are not just numbers plucked randomly from the heavens; we do try to take account of what people are actually saying.

Q171 **Kit Malthouse:** Essentially what you are saying is that it is polling, like opinion polling. That is the system that is used.

Professor Sir Stephen Nickell: No; it is people telling you what their decisions are, not people telling you what their opinions are.

Kit Malthouse: Is it retrospective or prospective?

Professor Sir Stephen Nickell: Prospective.

Kit Malthouse: So it is about opinions. It is "I feel uncertain."

Professor Sir Stephen Nickell: No; it is about what they intend to do. It is about their decisions, not about their opinions.

Kit Malthouse: Which is the same as an opinion poll; people tell you what they intend to do in an opinion poll.

Professor Sir Stephen Nickell: It may depend; if you ask them their opinion on whether blue is a nice colour, they give you their opinion on that. That is not a decision.

Q172 **Kit Malthouse:** I am not trying to be difficult. I am just saying that we ask people if they are going to vote Conservative or Labour, and they say yes, they are, and the lesson of the last few years is they did or did not.

Robert Chote: You do sometimes have to interpret. When you ask businesspeople whether uncertainty is a factor, whether they actually mean uncertainty around a central projection or whether they mean "I am gloomier," is not always entirely clear.

The other point, in addition to the prospectiveness of the things like the Bank of England agents' business surveys, which do at least have the virtue, unlike some opinion polls, of a long track record, for what that is worth, is the data that we have to date. You have seen business investment weaker over the earlier quarters of this year, relative to previously. Again, I would be very cautious about how much weight you place on quarter-by-quarter movements, although we have to produce a forecast on that basis, because this is not the firmest foundation within the national accounts. These numbers are highly revised and volatile.

Q173 **Kit Malthouse:** On that point, you did mention the weakening of business investment earlier in the year. I could not find that. Where would I find that in the book? We were trying to find where the data for that was?

Robert Chote: The data has moved on a bit, as well, because we had new numbers out last week.

Q174 **Kit Malthouse:** Was it weak in the earlier part of the year?

Robert Chote: Yes, it rose in the latest quarter. Over the three quarters of the year to date, it was weaker on a comparable basis than we had forecast in March and than it was last year.

Q175 **Kit Malthouse:** I found it confusing, because I was looking at some ONS figures last night that showed, for instance, that hard asset finance growth was significantly up on last year. I think the quarter to September was something like 12% up on the previous year, and that was following 36 straight quarters of asset finance growth.

Professor Sir Stephen Nickell: This is business investment we are talking about.

Kit Malthouse: Yes, of which this would be part.

Professor Sir Stephen Nickell: But this is the totality of business investment, as defined in the national accounts, and for the ONS numbers for real business investment last year and then this year, the first three quarters' average this year is over 1.5% lower than the first three quarters of last year, on average. Those are just raw numbers.

Q176 **Kit Malthouse:** Are those numbers that have come out recently an improvement that you had in here, or a decline?

Robert Chote: They are about two-and-a-bit per cent weaker, I think.

Kit Malthouse: Weaker than the numbers you were working from?

Robert Chote: Not in here, sorry. No, I meant in March.

Q177 **Kit Malthouse:** So the numbers that you have used in here, where are they relative to the ones that have just come out?

Robert Chote: Business investment in the latest quarter is stronger; consumer spending is fractionally weaker; net trade is weaker.

Q178 **Kit Malthouse:** On the business investment, you are saying the actual figures are stronger than what is in the book.

Robert Chote: In the last quarter.

Professor Sir Stephen Nickell: The growth in the last quarter, yes.

Robert Chote: However, the fact is that we are always a bit sceptical. Business investment bobs around quarter by quarter, so I like to think of longer averages.

Q179 **Kit Malthouse:** I think I understand. We have got another Budget in four months' time and what you seem to be indicating earlier, Sir Stephen or Robert, is that this was not the particularly strong fiscal stimulus that I think you said some people dreaded or were looking for. The reason for having forecasts, presumably, is so you can do something about it in advance. If you wanted to avoid this dip, if you were Chancellor, you might think about some kind of fiscal stimulus that could mean you could outperform these figures in the future.

Robert Chote: The thing to be wary of there is how quickly you could do it. If there had been a steeper downturn in prospect, then the part of the judgment we do to that is, "Could you do something about it quickly enough to make it worthwhile doing it?" In particular, if your focus is on investment, the ability to get additional public sector fixed investment out of the door quickly enough to use it as a near-term stimulus tool—

Q180 **Kit Malthouse:** This is the point I am trying to get to.

Robert Chote: The point is that the Bank has moved relatively swiftly, back in August. Obviously, some of the people who had produced pre-referendum analyses suggesting a very weak position after a "Leave" vote explicitly assumed that the Bank would not do anything in response to that, whereas in fact it has. For them, you would have to disentangle that effect. You may differ on whether what they did was a good idea or not.

Q181 **Kit Malthouse:** I think it is most of our experience that Government are quite slow at getting capital out of the door, and the key thing therefore is stimulating private sector investment in some way. That can be done quite quickly, can it not?

Robert Chote: This would be one of the arguments for the package of measures that the Bank announced back in August, where by providing support for bank lending through the Term Lending Scheme, through purchases of corporate bonds, and much more indirectly through vanilla QE with purchases of gilts, that was one of the things they were trying to achieve, presumably.

Q182 **Kit Malthouse:** If they have been doing that over the past few years, and you say private sector investment has been a bit weak, does that indicate that it is not working, or that they need to crank it up?

Robert Chote: It depends what you think would happen to it in the absence—

Kit Malthouse: There must be some implication here.

Professor Sir Stephen Nickell: Cranking up business investment by Chancellor's action is not easy to do. It is true that if you really wanted to spend some money you could say, "You get a really generous capital allowance, fixed term, for a year, if you spend it this year, and after that it goes away." That may well encourage people to bring investment forward, and that probably would work, but it would perhaps be quite expensive in terms of losing out on—

Q183 **Chair:** It would not do much for the following year, either.

Professor Sir Stephen Nickell: No, it would not. If you are trying to fit in a whole—

Q184 **Kit Malthouse:** It depends if the capital investment yielded a profit in the future. There was one other thing you said; you said that German services' were three times UK services' sales to China in terms of exports.

Professor Sir Stephen Nickell: No; manufacturing plus services. The total.

Kit Malthouse: The total. They are not both three times.

Professor Sir Stephen Nickell: No, they are not both three times.

Q185 **Kit Malthouse:** That was just a clarification. On inflation you seem to be putting the entirety of the inflation that is coming through down to the drop in the pound, although I might be misreading you. We had the Governor of the Bank of England here a couple of weeks ago, and he said that Milton Friedman was wrong, and that the increase in the money supply had nothing whatsoever to do with inflation. Do you think he was right or wrong?

Robert Chote: Those are two slightly different questions. In terms of the inflation it is not just a sterling story. It is predominantly a sterling story, but of course you also have oil prices 30% higher than they were on the assumptions that we made in March. You have to draw that sort of distinction. As for whether inflation is a monetary phenomenon, I will leave that for you, Steve.

Professor Sir Stephen Nickell: Me?

Kit Malthouse: He flat denied it.

Professor Sir Stephen Nickell: Yes, I can understand why. The problem is that central banks have been trying to pin down the relationship between money supply and inflation over many, many years, and have failed to do so. They eventually ended up being quite sceptical about that.

Q186 **George Kerevan:** This is not a stimulus package, then, in any shape or form.

Robert Chote: It has a very small upward effect on GDP in a year or two's time, but it is neither large enough, nor front-loaded enough, to make a significant impact through the sort of multiplier analysis that people normally do.

Q187 **George Kerevan:** Is it a reasonable assumption, then, that the Chancellor, having looked at all the forecasts that were made, which show a sharp downturn, is just ignoring them?

Robert Chote: The economic news has been better than some people anticipated after the referendum, and the Bank of England has acted in some measure in August, so I presume he took both of those things into account in deciding whether there was a need to do anything much more abrupt on the fiscal front now.

Q188 **George Kerevan:** Tell me if I picked you up correctly. Earlier on in the session, you seemed to suggest that in making your assessments of Government outcome spend, and therefore the impact on the economy, that for instance the fuel duty, you were assuming, would rise even though past history tells us that it does not? Is that correct?

Robert Chote: Yes. You have instructed us to base our forecasts on current stated Government policy, even if the average person does not—

Q189 **George Kerevan:** Let me tell you why I am confused on that. You also say that based on past Government experience, capital spending allocated to a year does not actually take place. You have taken 20% of each year's stated Treasury expenditure and moved it into the next year. That is a) contradicting what you have said earlier, and b) on a pretty big scale. It is not that I disagree, because I think history shows that allocated capital expenditure does not happen in that year, but why did you make that decision and where did the 20% come from?

Robert Chote: It is partly—and the clue is on the tin— that these are departmental expenditure limits. That is how it is set out. Historically there is almost always an underspend against them. In every forecast we produce, given the limits Government have set and our knowledge that the combination of the incentives for spending Departments and for the Treasury that things come in below that, we make a transparent assumption about how much lower or higher it will be.

There is a difference there from the Government saying, "Until we tell you otherwise, it is our intention to raise fuel duty in line with inflation next year." That would be a decision that lies in their hands, whereas "We will actually get that spending done," is an aspiration as much as a direct lever.

Q190 **George Kerevan:** Is the 20% moving back just on historical experience? Is it a rule of thumb?

Robert Chote: As Mr Malthouse has made the point, for the history of the ability to get these things out of the door quickly, you only have to look at the most marked example in the first Labour term. There was a desire to move public sector investment up quite sharply, and it actually fell, on average, over the first term and then picked up later. It is not unique to parties or Governments; it is a fairly constant phenomenon.

Q191 **George Kerevan:** The increase in capital spend works out at what proportion—9% real increase over the forecast period, if memory serves me correctly?

Robert Chote: I do not have that precisely on me.

Q192 **George Kerevan:** That is offset by quite a substantial real fall in current expenditure and resource expenditure.

Robert Chote: Exactly. If you look at a change in the structural budget position over the course of the forecast you have day-to-day current departmental spending and welfare spending falling as a share of GDP, offsetting a small increase in capital. Capital, of course, is much smaller to start with, so a big proportionate change can easily be outweighed by a much smaller proportionate change in—

Q193 **George Kerevan:** So if the resource spending is 90% of the total number.

Robert Chote: Sorry, no, it is a percentage of GDP.

Q194 **George Kerevan:** I think you have said it is a real-terms reduction in resource spend of 5% over the forecast period. Essentially it is still austerity.

Robert Chote: On that definition, yes. You have a structural improvement in the public finances, which is being driven two-thirds by lower spending and about one-third by higher receipts.

Q195 **George Kerevan:** Where I am going is how this relates to the change in fiscal targets. The fiscal rule of balancing the Budget has notionally been removed, but the borrowing and spending envelope are still very much the same. In what sense, therefore, do the new fiscal rules change anything?

Robert Chote: One way of looking at it is to say that in 2021, the new rule says that the Government could run a structural budget deficit, excluding short–term borrowing that is driven by the weakness in the economy, of 2% of GDP. In the March Budget, George Osborne's policy was consistent with a surplus of 0.5% in that year. What you have effectively got is an additional 2.5% of GDP of structural borrowing room for manoeuvre, relative to the plans in the last forecast.

Of that, we have used up or absorbed a chunk of that in terms of a weaker forecast, and the Government have spent some of that, in terms of higher spending on public investment. That together takes up about half of that additional room for manoeuvre, so what they still have the scope to do is to have structural borrowing about 1.2% of GDP higher in 2020-21 than this forecast suggests, taking into account—

George Kerevan: If he need it.

Robert Chote: If he needs it. He might need it because the structural outlook for the public finances could be worse than we think, or he might want to be spending more money. The fiscal rules have clearly been designed for the possibility that things are worse than we say, not in the confident expectation that things will be better.

Q196 **George Kerevan:** I was intrigued looking at this 9% real-terms increase in capital spend from the new investment fund, but that obviously does not take into account the rundown in capital that is also ongoing. What would public sector have to spend in capital, just to maintain the level of the capital stock each year?

Robert Chote: One way you can look at this is to look at public sector net investment, rather than at the particular capital figures, and that is on page 189. Obviously, with a net figure you are taking into account some of what you are talking about there, and we are pushing that up from, at the end of the forecast, about 2.1 to 2.3% of GDP, which is higher than it was in the pre-crisis period. It then spiked, obviously, when nominal GDP fell in the crisis. Whether you think that is high or low is—

Q197 **George Kerevan:** Where I am going is that one welcomes the increase in the capital spend, but it comes after a long period of capital reductions. What I am trying to get is: what, in a steady state, would we have to spend, leaving aside the ups and downs of the economy? What would we have to spend to maintain the capital stock, so that we could use that as a benchmark? Maybe no-one has ever done it.

Graham Parker: I am sure people have thought about it, but it is getting into the depth of the depreciation.

Robert Chote: It is probably something that the whole of Government Accounts would have a stab at. Whether you believe the answer—

Chair: You are saved by the bell. Thank you very much for coming in and giving evidence to us today. What I take from this is that despite all this extraordinary criticism, your forecast seemed no better nor worse than anybody else's, which is not to say very much for forecasts.

Professor Sir Stephen Nickell: Faint praise.

Chair: It is to say that this assault, if it is an assault, is an assault on the whole forecasting community and not on the OBR in particular. I would also just like to put in a particular thanks to Sir Stephen. This is your last session in front of us, is it not?

Professor Sir Stephen Nickell: It is.

Chair: You have always given us frank and forthright evidence, pithy and sometimes you have picked up headlines that were perhaps not always the ones you quite intended. We are all particularly grateful to you for those as well. Thank you very much for coming to give evidence.

Professor Sir Stephen Nickell: Thank you for your kind words.

Chair: Thank you for the hard work that you have put in for these past years on the OBR.