HOUSE OF COMMONS

Treasury Committee

Oral evidence: HM Treasury Annual Report and Accounts 2016-17, HC 712

Wednesday 24 January 2018

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Watch the meeting

Members present: Nicky Morgan (Chair); Rushanara Ali; Charlie Elphicke; Stephen Hammond; Mr Alister Jack; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 1 - 140

Witnesses

I: Sir Tom Scholar, Permanent Secretary, HM Treasury; Sophie Dean, Finance Director, HM Treasury; Charles Roxburgh, Second Permanent Secretary, HM Treasury.

Written evidence from witnesses:

– [Add names of witnesses and hyperlink to submissions]

Examination of witnesses

Witnesses: Sir Tom Scholar, Sophie Dean and Charles Roxburgh.

Q1 **Chair:** Good afternoon. Thank you very much for being here today. For the benefit of the tape and those who are watching online, as well as in the room, perhaps you could briefly introduce yourselves.

Sir Tom Scholar: Good afternoon. I am Tom Scholar, Permanent Secretary to the Treasury.

Charles Roxburgh: I am Charles Roxburgh. I am Second Permanent Secretary to the Treasury.

Sophie Dean: I am Sophie Dean, the finance director.

Q2 **Chair:** Lovely. Thank you very much indeed for coming to the Select Committee this afternoon. We are going to start with the issues surrounding Carillion. Tom, it would be helpful if we could understand how involved the Treasury has been in the Carillion issues so far. I know the Chancellor attended one of the COBRA meetings last week, but have Treasury officials also been involved in further meetings across government on this?

Sir Tom Scholar: Yes, we have. Let me give a first answer to your question, and then I will hand over to Charles, who has been leading the work for the Treasury on this, along with James Bowler, the director-general of public spending. The Treasury has been fully involved in this, through supporting COBRA and through wider official discussions, both in support of the Cabinet Office work to ensure that the collapse of the company did not affect vital public services, and looking at the impact of that across the departments that are responsible for those services. We have also made sure the finance was there to keep those services provided while the official receiver goes through all the statutory work that the official receiver is obliged to carry out. We have been fully involved and, as you say, so has the Chancellor through ministerial discussions.

Charles Roxburgh: As Tom says, we were involved and particularly got involved after the Christmas break, when the seriousness of the situation became intensely clear. We were working in the contingency planning up to the announcement and following on. As Tom says, that covered both making sure that departments had contingency plans in place and we had the funding for those, and that we had funding for the central costs as well. We were very involved in the contingency planning, but the Cabinet Office and the team there were firmly in the lead, providing the co-ordination and leadership through John Manzoni, the chief executive, and Gareth Rhys Williams, who is head of the Crown Commercial Service.

Q3 **Chair:** As far as the Treasury is concerned, when did it become clear that Carillion was sliding towards receivership? There were profit warnings in July last year, but it was particularly clear after the Christmas break. Are we talking late December to early January?

Charles Roxburgh: Before the Christmas break, we received an update from the Cabinet Office about the situation and that it was monitoring it very closely. As the company's situation became clear, the level of preparation intensified over that break. When people came back, and when I was back on the first day of work in this new year, it was immediately clear that the company was facing a very serious situation. That is when the more intense discussions within government started.

Q4 **Chair:** I would like to broaden it out a bit. There will be lots of examination of exactly what happened in that particular case with that company. More broadly, in terms of value for money and those sorts of outsourcing contracts, how involved is the Treasury in those discussions and supporting other departments in those negotiations?

Charles Roxburgh: I would separate two types of contracts. Outsourcing of services would depend on the scale. If it is a relatively small and uncontroversial contracting service, that would be for the department to do. It would have its own processes of scrutiny if it was within its departmental limits. The Crown Commercial Service in the Cabinet Office would provide a very expert level of expertise to support that. If it is a small and uncontroversial contract, it may not come to the Treasury, but above a certain level—the departmental limits, which will vary by department—Treasury might get involved in reviewing those.

For something like a PF2 contract, the IPA, which is part of the Cabinet Office, but Treasury is heavily involved, would conduct an intense process of risk assessment on those new contracts. It goes through very rigorous assessments to understand the risks and the value for money, using the full green book methodology to assess whether this is a good investment or not compared to alternatives. We were very intensely involved in that type of arrangement.

Q5 **Chair:** The government guidance on procurement sets out the requirement to "assess the risk to public sector business and/or public money which would result if a potential provider bidding for a contract were to go out of business during the life of the contract, or have inadequate financial resources to perform the contract; and when justified, eliminate from a procurement any potential provider whose current financial capacity would pose an unacceptable risk to business and/or public money". Do you think that the Carillion case is an example of where government has failed to follow that procurement guidance?

Charles Roxburgh: It would be inappropriate to comment on specific procurement processes, which are governed by very strict law and have to follow very rigorous processes and evaluate exactly those things. It is inappropriate to comment after the fact, given that I was not involved in them and they were led by the department, with the Crown Commercial Service's support. As to whether each individual contract was or was not, we have no evidence they were not done completely professionally and completely properly.

Q6 **Chair:** Was there overall Treasury involvement in this?

Sir Tom Scholar: I will add a couple of things to that. As I am sure the Committee knows, the official receiver is required by law to carry out an investigation and will do so. We need to see the conclusions of that first. Of course, there is an overall framework. The Treasury, with the Cabinet Office, is closely involved, in drawing up the kind of guidance that you have quoted and it has a policy responsibility for looking at the overall framework. We will certainly look at it and consider what lessons we should learn from the episode.

Q7 **Chair:** There is a suspicion that government was aware, as was the market, of the difficulties Carillion was facing some months ago. The concern was that contracts continued to be awarded, in the hope that that might help Carillion to manage or to get itself out of its financial difficulties. At what point were there discussions that such contracts should not be awarded or that the risk factors attached to Carillion were now too great for contracts to continue being awarded?

Sir Tom Scholar: As Charles said earlier, there is a very clear legal framework that applies to procurement and the awarding of contracts. Departments obviously have to respect that legal framework. The profit warnings last summer clearly were a public event, so everybody would have known about them. My understanding of the framework is that it would not be admissible to use that as a reason not to. That is not permitted under the legal framework. I do not know precisely what conversations different departments had with whom following those in the autumn of last year. As Charles said, as soon as it became apparent in recent weeks that the problems were really quite serious, a full system, mobilised by the Cabinet Office, was put into action.

Q8 **Chair:** Do you think that the framework is something that should be looked at? Would you agree that, had Carillion not been awarded new contracts in the course of the autumn since the profit warning, it might have gone under and that might have been better overall, in terms of the amount of money the taxpayer will now have to spend bailing contracts out? Had it gone under earlier, that might have saved the taxpayer money.

Sir Tom Scholar: It is too early to speculate on that. We need to wait for the report of the official receiver and until we have completed the process of untangling the whole thing and re-awarding the contracts. That has been going on across a lot of the departments last week, this week and will continue. We cannot say at this point what the ultimate cost will be. We need to get to the end of that process. Having done that, we should certainly look at the whole episode. It is a failure of a major corporate and one with a big involvement in the provision of government services. We will have to look at that.

Q9 **Chair:** Has that prompted government to look at other very big contractors that government is dealing with, to make sure there is not going to be a repeat of this any time in the near future?

Sir Tom Scholar: For all departments, the first priority of the last couple of weeks has been ensuring the continued provision of public services. That has been a very well-run exercise, but I am sure that each department with similar relationships to other suppliers will have been examining those as well.

Q10 **Chair:** There is a view in the market—I do not know if it is a view held in government—that there is not sufficient competition. There are not enough companies able to bid for these contracts. We are creating a situation where you have companies that are too big to fail, as we saw with the banks 10 years ago, and a total lack of competition in this marketplace.

Sir Tom Scholar: Carillion was a large company with quite widespread activities. It provided important services to government, but did plenty of other things as well. In fact, it primarily started as a construction company. Its activities went much wider than government services. I do not want to speculate on the causes of its failure in advance of getting the report of the official receiver, but there has certainly been quite a lot of commentary to suggest that some of those other activities, including the construction activities, were material causes in its failure. It is not simply a question of the government service contracts it was under.

Q11 **Chair:** Do you think there is a need for more training within government in terms of negotiating these contracts and agreeing realistic prices? Again, there is a suspicion out there that Carillion had for a long time been consistently underbidding for contracts on which it could not possibly make an adequate commercial return to support everything else.

Sir Tom Scholar: I would agree. We need stronger commercial expertise. That was identified several years ago. The Government Commercial Service was created in that time as a result and is now bringing in a great deal of expertise, centred in the Cabinet Office, but available to support departments in their negotiation for commercial suppliers. That is good progress, but we need to keep on with it.

Q12 **Stephen Hammond:** Leaving aside issues of the Government's relationship with Carillion, but looking at Carillion as a company that was audited less than a year ago, are you happy with the quality of the auditing function across the United Kingdom? Do you not think the Treasury ought to be asking the regulatory authorities to look at the quality of accountancy?

Sir Tom Scholar: I am sure this is one of the things that the official receiver will look at. It has been the case when there have been other major corporate failures: you mention the banking failures of 10 years ago, but also other large corporate failures. There are always searching questions asked about the quality of audit, the reliability of the information it provides to investors, and I am quite sure those questions will be asked. We, the Treasury, will have a close interest in that. The policy lead is actually with the Department for Business, but we will take a close interest and work with it on that.

Q13 **Stephen Hammond:** There is an increasing concern that the audit profession appears to be signing off anything that is presented to it, without doing the proper work behind it in a number of cases. Carillion may or may not be an example there.

Sir Tom Scholar: I should not comment before the official report is ready but we will have to look at these things.

Q14 **Charlie Elphicke:** It has been said in some quarters that action should have been taken as soon as profit warnings were given by Carillion and the contract should have been terminated. If the policy was to terminate a contract whenever there was a profit warning, what would the impact on the public finances be?

Sir Tom Scholar: I cannot answer that specific question, but I would say two things. First of all, immediately terminating contracts would very likely bring about the very eventuality that people did not want to happen: in other words, the collapse of the company. Secondly, as I said earlier, there is a very clear legal framework that governs not just the performance of contracts but also the award of new contracts. I am not a legal expert in this, but it seems to me that that action would not be possible within the state of the existing law.

Charles Roxburgh: There is a very big difference between a profit warning and a company entering into financial distress. A profit warning means that you are not going to achieve the level of profit the market is expecting. Some are bigger than others. Relying on profit warnings as a proxy for financial distress is very unreliable.

Q15 **Rushanara Ali:** Can I start with some of the costs related to this? Does the Treasury have an early estimate of the order of magnitude for the cost to the taxpayer of Carillion's collapse? There have been references to £600 million. I wondered if you could say a bit more. I know there will need to be more interrogation of actual costs. Have you any thoughts about that?

Sir Tom Scholar: We are at a very early stage. I think the reference to the £600 million, if it is the same £600 million that I saw, is a reference to potential pension liabilities. That was the call on the pension protection fund, rather than on the public finances. As to the cost to government, we do not know. The process that is being worked through now is to re-award the contracts to other contractors, to continue to provide the services. Departments have a choice as to whether they do that or whether they take them over themselves for some period. We will know only at the end of all that at what price it has been possible to do that, and whether there is ultimately a cost to the public.

Q16 **Rushanara Ali:** Do you have a sense of what that might cost, from the outset? When would you be able to establish the cost of those transfers?

Sir Tom Scholar: We do not know now. I am not sure. Charles, do you have a sense?

Charles Roxburgh: The Government have underwritten the transitional cost, which is a gross figure. We do not know what the net figure will be yet. That will depend on, as Tom says, how the rebidding, recoveries and insolvency go. That is a matter for the Cabinet Office. It is finalising that gross number. That will be published, through its normal process at the time, through the supplementaries.

Q17 **Rushanara Ali:** In terms of timing, do you have a sense of when that might be?

Charles Roxburgh: Within the next few weeks.

Q18 **Rushanara Ali:** There have been reports, in the last 24 hours in fact, that Carillion handed £500 million to shareholders in the last seven years before its collapse. Do any of you want to comment on that? Have you any reflections on why it was, while government departments were tendering out contracts to them, there was a profit warning and so on? What do you make of that report?

Sir Tom Scholar: First of all, you have referred to a figure there of dividends over seven years. Obviously, the profit warning was only six months ago. As Charles said earlier, sometimes when you have profit warnings a company then reports lower profits than were expected; sometimes it subsequently reports higher and resumes the payment of dividends. In itself, it does not determine anything. That said, and this goes back to the questions from Mr Hammond and Mr Elphicke earlier, the speed with which its affairs seemed to unravel towards the back end of last year is quite striking. I would not want to comment now, in advance of the report of the official receiver, as to whether there was any relationship or quite what the state of the company's financial affairs was. I am sure that will be a central question people ask when they see that report.

Q19 **Rushanara Ali:** You can understand why the public will be extremely frustrated by the fact that companies are receiving these big contracts from government while they are making profits. The people running the company would have known long before the six-month period that the company was not doing as well as it should be, but that did not stop them from dishing out profits. You can understand the public disquiet over this.

Charles Roxburgh: Because of the level of public interest and the importance of these issues, the Secretary of State for Business, Energy and Industrial Strategy has asked the official receiver to expedite its report. That is what we have to wait for to see what the rigorous assessment of the official receiver is on that.

Sir Tom Scholar: Obviously the receiver will look at the actions of management. It is worth recalling, though, that the shareholders in Carillion will bear a large part of the loss here. It is not simply a question that the private sector has taken money out and the public sector has paid. I do not think that is a fair characterisation. There are certainly losses to shareholders and creditors in Carillion.

Q20 **Rushanara Ali:** Yes, but there is huge disruption and losses to the public. I wanted to get on to the issue around the change when the function of the Office of Government Commerce was moved from the Treasury to the Cabinet Office. Do you still feel that is the right place for it to be in, or should it be brought back into the Treasury?

Sir Tom Scholar: The Government Commercial Service is a new body that has been created in the last few years in the Cabinet Office, and has taken on some functions that the Treasury previously exercised but is a much broader thing. It is also part of a broader agenda in which the Cabinet Office is providing expertise from the centre of government on certain functions that are provided on a cross-government basis. I think that does belong in the Cabinet Office. It is important for the Treasury to remain focused on its core task. This is a different issue, which crosses departments, and having it in a separate place enables them to build up the resourcing and the expertise that is needed. I am very comfortable with that.

Q21 **Rushanara Ali:** What help will the Government and HMRC provide small businesses that may have been relying on Carillion payments to pay their own tax liabilities, which are due at the end of this month?

Sir Tom Scholar: HMRC has a facility where it can give businesses suffering in these kinds of circumstances a bit more time to pay. That is one that it can use at its discretion. It has already indicated that it will be using that in this case as well, within its existing framework.

Q22 **Rushanara Ali:** To what extent will contagion through Carillion's supply chain be an issue? Is the Treasury exposed to firms in the Carillion supply chain through the guarantee scheme?

Charles Roxburgh: The infrastructure guarantee scheme covers nine projects. Carillion was not involved in any of those, so we do not think we have a direct exposure there. This remains under close review from the IPA, which administers that scheme. We are not aware of any further risks there, but we will keep it under close monitoring.

Q23 **Rushanara Ali:** I have one final question, which is a broader question about procurement, public procurement and the use of private companies. Should there be a radical rethink in the way that happens, not just because of this particular case, but also given the NAO report around value for money, public concern about public-private partnership and so on? Will that be part of the job of the Treasury and other departments, in the light of what has just happened?

Sir Tom Scholar: There is a pretty major political debate about this issue with very different views between the Government and the Opposition. It is not for me as an official to get in the middle of that, but I will make a few comments. In the NAO report, a lot of the issues that it is referring to refer to the previous private finance initiative, which has already been substantially overhauled, and we now have PF2, which is a very different policy framework. Our job is now to look, within the policy framework that we have, at what has happened and see what lessons we can draw from that.

Q24 **Rushanara Ali:** Those lessons should also drive thinking around how future policies should be devised, whichever party is in government, in terms of making sure that the public interest is served when there are procurements happening with public contracts being tendered to private companies, do you not think?

Sir Tom Scholar: Absolutely. Every accounting officer has a responsibility to ensure value for money and feasibility. They need to look at each contract to see whether this is a feasible way of providing the service and whether it offers value for money. I am sure they are all doing that in their areas and we will certainly look at it as well.

Q25 **Chair:** We are going to move on to our favourite topic of the EU shortly, as you will not be surprised to hear. On that last question, though, about the different accounting officers, Rushanara has touched on the public concern out there, let alone among those who are pensioners or working at Carillion, who have discovered their pension scheme is in substantially more deficit than they were led to believe. Who in government is accountable for what has happened? Is it the Cabinet Office? Is it John Manzoni? Is it the Treasury, because it owns the guidance on procurement? Is it disparate between the different accounting officers in the departments? It is a question that both the public and MPs are asking, and even one for Committees, in terms of deciding who we are going to call to explain. There seem to be an awful lot of people occupying this space in government.

Sir Tom Scholar: Each individual contract is the responsibility of the department concerned. The overall framework is set by the Cabinet Office, but has particular rules, which the Treasury operates, applying to the necessary financial approvals. In some cases, those are delegated to departments and in other cases, particularly where they are very large, novel or contentious in some way, they come to the Treasury.

Q26 **Chair:** It sounds as if there is not one person who is accountable for this. I know that some Ministers are tasked with having relationships with particularly large companies. I remember from my time being a PPS in the BIS Department that, when something happened at a company, it was one Minister who got on the phone to talk to the chief executive. Who had the relationship, among officials, with Carillion at the top, regardless of individual contracts and everything else?

Sir Tom Scholar: That has primarily been led by the Government Commercial Service, which is part of the Cabinet Office.

Q27 **Chair:** It is John Manzoni.

Sir Tom Scholar: Yes, and his team there.

Q28 **Alison McGovern:** To change subject for the moment, I want to ask about the Treasury's modelling capacity on Brexit scenarios. We have had the sectoral analyses that were published by the Department for Exiting the EU. A large number of those would have affected matters connecting to Treasury responsibilities. I wanted to ask how you inputted into those sectoral analyses.

Sir Tom Scholar: The papers that were published by the Department for Exiting the EU were drawn from a wide range of departments. Each department, in the sector it was responsible for, would have provided that. Of the papers that were published, the ones that originated in the Treasury were the ones covering financial services. At the same time, in our internal work, we have done a great deal of analysis, right across the economy, looking at different sectors. We do not have the same detailed expertise on those that other departments do, so it does not go into the same level of detail as the work that they have done, but we have attempted to get a cross-economy view of the various issues.

Q29 **Alison McGovern:** Did DExEU come to Treasury for any advice on making sure that those analyses were robust?

Sir Tom Scholar: Yes. There has been really close co-operation between us and DExEU. There has also been a lot of work across the Government Economic Service, because you have economists in each different department trying to make the best estimate they can.

Q30 **Alison McGovern:** Who led for GES on those analyses?

Sir Tom Scholar: In the Treasury, it was the current chief economic adviser, Richard Hughes, but in each department it would be the lead economist. To be clear, there is not a single cross-government product coming out of that. Rather, it has been a process of discussion as each department is doing its own work. It is good practice to test work, assumptions and conclusions with others.

Q31 **Alison McGovern:** In terms of the economic robustness, the Government Economic Service is responsible, and the person at the top of that would be the chief economic adviser.

Sir Tom Scholar: There is no single Government Economic Service paper on this. Different economists in different departments work on it within their own departmental structures. The sector-by-sector papers that were published were produced in each case by the Department for Transport, Department of Health, Department for Business, Energy and Industrial Strategy, or whoever. That is the responsibility of each department. Within the Treasury, our own chief economic adviser has been overseeing the internal work that we have done on that.

Q32 **Alison McGovern:** To turn to that internal work that the Treasury has done, the Chancellor told this Committee in December that the Treasury had "modelled and analysed a wide range of potential alternative structures between the European Union and the United Kingdom, potential alternative arrangements and agreements that might be made". It has been made clear to us as parliamentarians that the results of that modelling are deemed to be sensitive and therefore will not be released to us. However, I want to ask a few questions about the structure of the model. Before I do, has that model been shared with other departments?

Sir Tom Scholar: I am not sure of the answer to that. I am not sure even whether you could describe it as a single model. As I said earlier, each department would have a much more detailed way of looking at the issues in its sector. We have an overall macroeconomic model where, if you put different contributions in together, it generates different results. I think I am right in saying it is not the case of a single model that would be shared across.

Q33 **Alison McGovern:** Let me put the question in a different way. From what you have just said, I imagine it produces different scenarios and then provides information about dependent variables, for example GDP, employment or whatever, in different situations. Have the results of that analysis been shared with other departments?

Sir Tom Scholar: As I said earlier, we have had discussions across departments of the possible impacts of different scenarios. We do not have a single agreed view on that, but when we are doing our top-down work, which we do, we like to test the emerging results of that by talking to the experts in particular sectors.

Q34 **Alison McGovern:** Let me make it more specific and see if that gets a bit closer to the description of the work I am looking for. One situation that is discussed in Parliament regularly is the possibility that we might not have a deal with the European Union, and that we might trade on WTO terms. Is that a scenario that you have modelled?

Sir Tom Scholar: We have looked at that within the Treasury. It is quite a difficult thing to model because it is not clear precisely what no deal means. It could mean a range of different things.

Alison McGovern: Hard no deal or soft no deal.

Sir Tom Scholar: There is a spectrum. It is also a situation in which it is very difficult to anticipate the impact of that on consumer confidence, investor intentions, markets and so on. It is a very, very difficult thing to model. To try to understand it better, we have talked to all departments about what they think it means within their areas, because it is a very technical area that we would not possibly have the expertise to look at alone.

Q35 **Alison McGovern:** Just to be clear, presumably you are working from a base case of our continued membership of the European Union and comparing that with the alternative.

Sir Tom Scholar: No, we are not doing that, because we clearly are leaving the European Union. That is the decision of the referendum and of the Government. It is not a question of comparing it against a base case; it is a question of comparing different possibilities and different types of economic relationship.

Q36 **Alison McGovern:** What are you comparing it to?

Sir Tom Scholar: There is a spectrum of options out there. The Government have been quite clear that they are not looking at a bespoke, off the shelf—

Q37 **Alison McGovern:** I am very sorry to interrupt you, but you are saying we are comparing a range of no-deal options with a range of other options. Can you describe some of those other options so that we know what you are analysing?

Sir Tom Scholar: The base case for looking at all economic developments is what the OBR forecasts, because it provides the official forecasts. It would be better placed than I am to explain to you how it has put its forecasts together, but my understanding is that it is forecasting on the basis of government policy. That is what it is required by law to do. Government policy is to achieve agreement on a deep and special partnership with the European Union. Of course, we do not yet know precisely what that means. My understanding of what the OBR has done—although it set this out in its report, and I am sure you have asked Robert Chote about it—is that it has taken a midpoint between the different possible estimates, based on different outcomes. There is no complete science to it, because it does not know any better.

Alison McGovern: It has raised its economist's finger to the air.

Sir Tom Scholar: It does not know any better than the rest of us what is going to happen. The OBR forecast provides the base case for the economy. When we look at alternatives around it, that is what we take.

Q38 **Alison McGovern:** You cannot say what the specific alternatives are.

Sir Tom Scholar: We are looking at different types of relationship, which could include a higher or lower degree of alignment. That is all part of the discussion that we need to have.

Q39 **Alison McGovern:** From what you said, it sounds like this is a macro look. Do you have regional breakdowns? Have you attempted to forecast the impact on different regions or smaller parts of the country?

Sir Tom Scholar: Yes, we have.

Q40 **Alison McGovern:** To what level? What is the smallest unit?

Sir Tom Scholar: I do not know the answer to that, but we certainly have looked. I think it is by region—in other words, north-east, north-west, south-east and south-west.

Q41 **Alison McGovern:** Could you write and confirm?

Sir Tom Scholar: Yes.

Q42 **Alison McGovern:** Does it consider the impact of trade intensity on productivity?

Sir Tom Scholar: Perhaps I can cover that in the same letter. I think the answer to that is yes, because trade intensity is one of the important building blocks of the model we have been using.

Q43 **Chair:** We might come back to this later on. This is my understanding, but I want to get the exact wording. The OBR has basically said it cannot model because government policy is not clear and not settled. The question for you at this stage, Sir Tom, is: if the Government had a clear end state in mind, and were working back from a position of free and frictionless trade and saying, "This means the agreement is going to have this, this and this, but not this, in it", would that help in terms of the modelling that the Treasury is doing? Presumably it would help to make the model more certain, if you knew what the end state was going to be. I appreciate there are negotiations.

Sir Tom Scholar: There are negotiations. That is very important. The end state will depend on what position the UK takes, what position the EU 27 takes and what is concluded. Of course, you are right: the more information we have, the easier it is to model around it. My understanding is that, as the OBR prepares each forecast, one of the things it does at the start is to ask us questions about areas of policy where it is not precisely sure what the Government's intention is. That might be some issue to do with public spending or whatever, and it asks us about it. This is all a matter of public record; it puts it all in its report. In each case, we have directed it to the most recent comprehensive statement of government policy. In the run-up to the budget in November, it was the speech the Prime Minister gave in Florence.

The OBR has taken that. It is clearly assuming in its forecasts that the UK leaves the EU. It is not that it has said, "We cannot model. We do not know, so we are not even going to try". Instead, it has looked at a range of other studies that people have done on the possible impact of different future relationships, and then tried to take some kind of—I am not completely sure how it would best describe it—average, weighted average or blend of the different possibilities.

Q44 **Chair:** The OBR said that it asked the Government if they wished to provide any additional information. You are absolutely right. This is for the forecast outlook it produced in November. It set out that the Government directed it to the Prime Minister's Florence speech in September and a White Paper on trade policy published in February. It goes on to say, "Given the uncertainty regarding how the Government will respond to the choices and trade-offs it faces during the negotiations, we still have no meaningful basis on which to form a judgment as to the final outcome and upon which we can the condition our forecast". It then talks about the various uncertainties, as you have said, about what is going to happen in terms of the economy. It has maintained the same broad-brush assumptions regarding Brexit.

What I am trying to get to, and what Alison was trying to get to, is that having the OBR as a counterfactual or a basis is also predicated on mass uncertainty. The OBR is saying that it does not have enough information to come up with an updated or meaningful judgment. Is it not very satisfactory, is it, that the Government are not providing officials with enough tools or enough end-state certainty of at least where they want to go, regardless of negotiations, in order for you to advise Ministers on what the potential alternative scenarios are?

Sir Tom Scholar: We are in a position where we can advise Ministers of the pros, cons and trade-offs. It is obviously extremely difficult to be precise. In fact, it is not possible to be precise in a quantitative way. It never is in terms of economic forecasting, so you are always looking in terms of ranges, degrees of magnitude and directions. I have obviously followed your exchanges with the Chancellor on this. As he said to you, when we have an agreement and Parliament is voting on it, it will clearly be very much in the public interest for the Government to set out in detail the terms of that agreement and Parliament will obviously want to consider the impact against a range of different alternatives. I know you have also put this to the OBR. We are not in a position where we can do that today because we are just starting this negotiation, but we very much recognise the public interest in providing the information when we can.

Q45 **Chair:** You will be aware of the Committee's report from December on the Budget, saying that we think the OBR should produce an updated outlook before Parliament has a vote. I want to move on to something else, which is the financial services sector. You will be aware that I and those in the City are looking for a position paper or some kind of more detailed statement than we currently have from the Government about where they want to get to.

I am sure you have been a subject of the intense lobbying that we have all been subject to from financial services firms saying, in a way, "We can cope with what is thrown at us, but what we cannot cope with is uncertainty, in terms of knowing where the regulatory outcome is going to be". You are being lobbied by contacts in the City of London and elsewhere. Would you agree that they want to know what the Government's plans are about convergence or divergence from existing financial services regulations?

Sir Tom Scholar: We have a very close and continuous dialogue with the financial services industry and totally recognise the desire for greater information and certainty that you set out. The first thing we are doing to respond to that is working very hard to secure an early agreement on an implementation period, which then removes the risk of a cliff-edge effect at the end of March 2019. That is, in our discussion with the industry, its main immediate concern. Of course, it wants more detail on the future direction. That is not just about the financial services industry; that needs to be considered within the context of the overall negotiation.

We discuss that with the industry. We cannot tell it what the answer is. We do not yet know the answer. It is something we work a great deal on internally. We are providing a lot of internal advice on that. As you know, the Chancellor has said that he does not think it is in the public interest at this early stage of the negotiation to provide a lot of detail on that. He has given a number of speeches indicating the direction of travel. We will be advising him as we go along, because this clearly would be our departmental responsibility, on the point at which it is helpful for both the negotiation and the needs of industry to provide further detail.

Q46 **Chair:** I am keen to move on to other things, but this is such an important issue. What does the Treasury think of the proposal by the International Regulatory Strategy Group for having agreement on mutual recognition?

Sir Tom Scholar: I do not think we would be ready to make a detailed comment on that at this stage, but what it has identified is something we do very much recognise, which is that the UK financial services industry is a great resource, not just for the UK but for the Europol economy. If you are a business or consumer across Europe hedging against currency movements, fixing a fixed-term mortgage interest rate or fixing your energy prices, you are probably drawing on the services of the UK industry. We are keen to get into a detailed discussion of that as soon as we can, because that will help to move it forward.

We start from a position of not just regulatory alignment and mutual recognition, but of identical rules and regulation. The question then is how we can preserve as much of that as possible, including looking at supervisory co-operation. Once we leave the EU, we will still be under the same global rules and standards that are agreed. This is a very unique circumstance and quite different from the circumstance you face when you are starting a normal discussion on trade agreements. We need to look at how we can use that situation in the mutual interests of the UK and the EU 27.

Charles Roxburgh: As you remember, there was a very important set of announcements just before Christmas, co-ordinated between the Bank, the FCA and the Treasury, about indicating the approach to inward branch authorisations, which was a very important signal to inward branches. That showed that, subject to regulatory co-operation, the Bank and the FCA would be willing to authorise on a branch basis. The Government also indicated their willingness to create the powers to grant temporary permissions. That allows extensions if needed for those operating in the UK, but also allows firms to pay claims on insurance contracts. These were actions that the Government and regulators could take unilaterally to signal a willingness to work collaboratively with Europe. As the Chancellor said, he hopes that the Europeans will respond and this is a mutual interest, particularly on issues around financial stability.

Q47 **Chair:** One would assume that any position paper on financial services could build on that. The Government could throw down the gauntlet to the EU in a similar way on other issues, to show the intention of continuing to work together. Let me ask one final question. You will be aware of the amount of secondary legislation that will be needed, particularly in the area of financial services. Although there will not be the period of normal consultation among stakeholders that one would expect in secondary legislation, do you have a plan for how you are going to listen to the industry—it could be insurance, financial services or professional services firms—and get their input on that secondary legislation, as it is going through a necessarily truncated parliamentary process?

Sir Tom Scholar: As you say, the time period will necessarily be shorter. It is also fair to say that what the legislation would be achieving is less ambitious in scope than what you normally do when you are doing secondary legislation. At this stage, the purpose of the work is to transfer what is currently on the statute book by virtue of our membership of the EU on to the statute book without the European Communities Act. It is in effect an exercise in translation. There are definitely some areas where it is not completely obvious what the answer is because, for example, a piece of legislation might refer to an EU body that we would no longer be a member of. We would have to explain which body would in future be performing the function that that body currently performs. It is not going to be a question of major regulatory change. It should be possible to do this in the time available.

Q48 **Chair:** And to listen to input from outside?

Sir Tom Scholar: Yes. We are currently at the stage of discussing this intensively with the Bank of England and the FCA. One of the things we think about in that discussion is the need for time, to make sure not just that the legislation has time to come in by the deadline, but also that we are able to consult and get views from the outside. What I cannot tell you now is precisely when we will be able to do that or precisely how much time there will be. Some of it is out of our control because it is down to the parliamentary timetable, which we have to accept is what it is. That is certainly our intention.

Q49 **Charlie Elphicke:** Sir Tom, you were saying that it is very hard to forecast what the effect of Brexit will be, but that did not stop the Treasury in the middle of the referendum campaign producing a dossier warning of immediate recession, did it? Do you regret that?

Sir Tom Scholar: As to what the Treasury did, before the campaign, actually, because we were not able to take any part in the campaign, the Government asked us to set out a paper illustrating the long-term consequences of three different stylised scenarios. That is what we did, because were asked by the Government to do that.

Q50 **Charlie Elphicke:** How do you think it has turned out in retrospect?

Sir Tom Scholar: That work, first of all, made a number of assumptions because you have to make assumptions. A number of assumptions were made: for example, that the Government would trigger Article 50 immediately after the referendum. The then Prime Minister said that was what would happen, so naturally we incorporated that into the work. We also assumed that there would be no response from monetary or fiscal policy. In practice, there was a major supportive response, both of monetary policy from the Bank of England in August 2016, and then from the Treasury in the Autumn Statement and again in the Budget last year. That is another thing that has turned out differently. The third is that the global economy has recovered much more strongly in that time than we expected at the time.

Secondly, that paper was not an exercise in forecasting precisely what would happen in the next two years; it was a comparative statics exercise, looking over a long, 15 or 20-year timeframe at what you could expect to be the long-term consequences of three different models. We are at an early stage there. The final thing I would say is that government policy is to aim not for any of those off-the-peg models but for something different. I do not think the pre-referendum analysis is useful in the current debate about our attempts to secure a deep and special partnership, because that is a different thing from any of the three scenarios illustrated in that paper.

Q51 **Alison McGovern:** I am presuming that you think the monetary response you just mentioned, which altered the situation that came about, is not well understood by the public either.

Sir Tom Scholar: We do not comment on monetary policy. We leave that to the Bank of England.

Q52 **Alison McGovern:** In terms of the assessment of the Treasury's modelling work pre-referendum, do you think that the fact that it has turned out differently to the model because things were different is well understood by the public?

Sir Tom Scholar: I have given my explanation. I have to say, when I read the newspapers, it is not often an explanation I see.

Q53 **Alison McGovern:** Indeed. Can I check one final thing in relation to the SIs that you are working with the Bank of England on? At what point does ministerial approval come for those pieces of secondary legislation to be laid before Parliament?

Sir Tom Scholar: In the usual way: when they are ready. Any statutory instrument has to be approved by a Minister, of course. We are still working through the policy. I am not sure we have even started the drafting yet.

Q54 **Alison McGovern:** Will it cross Ministers' desks?

Sir Tom Scholar: Absolutely.

Q55 **Catherine McKinnell:** In your understanding, is the Brexit financial settlement, estimated to be between £35 billion and £39 billion, contingent on the agreement of a trade deal or on any particular outcomes of the Article 50 negotiations?

Sir Tom Scholar: The government position, as you know, is clear that nothing is agreed until everything is agreed. That I understand to be the Article 50 agreement, which under the terms of Article 50 covers not just the separation, but also the framework for the future relationship, which would include the implementation period.

Q56 **Catherine McKinnell:** In what particular circumstances can you envisage the UK not paying the financial settlement?

Sir Tom Scholar: I would not want to speculate on that. The Prime Minister and Chancellor have both said the UK will honour the commitments made during the period of our membership of the EU. The Prime Minister said that in her speech in Florence in September. The financial settlement that you have referred to, which we spent all autumn discussing and was agreed in December, is a conclusion of the work to turn that statement in the Florence speech into a detailed agreement on the numbers. That was an agreement, which now needs to be turned into a legal instrument. The legal instrument is the withdrawal treaty. The withdrawal treaty is under Article 50 and will cover the three things I have said.

Q57 **Catherine McKinnell:** The Chancellor has said to the Committee that it is inconceivable that the UK would not pay its financial settlement, regardless of the outcome of the Brexit negotiations, and that that was just not a credible scenario. Therefore, has the position changed or are there still circumstances in which that financial settlement is not agreed, given everything is not agreed until it is agreed?

Sir Tom Scholar: That is not for me to comment on. Government policy is that the UK will honour its financial commitments. Within that policy, we have negotiated a settlement, which has been endorsed by the Cabinet. It has been agreed at the European Council. It now needs to be turned into a legal agreement.

Q58 **Catherine McKinnell:** It is agreed, although the Prime Minister has also said to the House that, if we do not agree a future partnership with the EU, the agreement is off the table, which seems to be a bit of a contradictory message. Is there a difference between where No. 10 is and where the Treasury is on this? How do you square that circle?

Sir Tom Scholar: I do not think there is any difference at all. The Chancellor has also said many times, including I think to this Committee—in fact, I am sure he said it to this Committee because I remember reading it—that nothing is agreed until everything is agreed. That is a reference to the withdrawal treaty, which will include all these things. Ultimately, of course, this is a decision for Parliament because there will be a vote on this withdrawal treaty. It is not ultimately a decision for the Government.

Q59 **Catherine McKinnell:** The difficulty is that it has also been made clear that no future partnership agreement can be reached until after we have left the EU. This is agreed, although it is not contingent upon any future trading relationship; is that correct? It is not agreed until it has gone through Parliament, gone through its process and been signed off but, in terms of it being contingent upon any future trading relationship, that is not the case.

Sir Tom Scholar: The intention of the Government is to start immediately negotiating that future agreement, with a view to concluding those negotiations on the future framework later this year, so that it can be agreed with the EU 27 and then put to Parliament for a vote. That is, on this issue, the main task of the year.

Q60 **Catherine McKinnell:** It may be that the financial settlement is not agreed if the agreements about the future trading relationship are not agreed satisfactorily. Is that your understanding?

Sir Tom Scholar: All these things happen in parallel. I should say that phase two of the discussions, as I am sure you will know, has not started yet. On the EU side, they are working out their position and then the British government will also have to make proposals. I do not know precisely when that is going to be. My anticipation, when it starts, is that we will be working on all these things in parallel: the financial settlement, turning it into a legal agreement. By the way, there are still some separation issues that have not been completely agreed. They also need to be worked through to a high standard of detail so that they can be incorporated into a formal treaty.

There are: first, all the separation issues; secondly, all the implementation period issues, where there is an obvious question and discussion to be had; thirdly, the framework for the future agreement. All those things would happen together. The intention on both sides is to conclude those three and bring them together in a withdrawal treaty later in the year, which would be agreed, ready for the process of ratification on each side, which on the UK side means a vote in Parliament.

Q61 **Catherine McKinnell:** If all those things are not successfully negotiated to the point of being agreed, ultimately, despite what the Chancellor said about it being inconceivable that the UK would not pay its financial settlement, there is still the possibility of the UK walking away from its financial agreement with no deal, if it does not reach a future trading relationship that it is happy with.

Sir Tom Scholar: I cannot predict the future. I cannot say what the consequences would be if, for some reason, there was no agreement at all on any of this, or if there was an agreement and Parliament rejected it. I do not know the answer to either of those questions any better than anybody else.

Q62 **Catherine McKinnell:** Nobody has plotted or modelled those scenarios of there not being a satisfactory future trading relationship agreed, and therefore what the financial settlement would be.

Sir Tom Scholar: As I said earlier in answer to Ms McGovern, we have analysed the economic impact of no deal, depending on what no deal would mean.

Q63 **Catherine McKinnell:** Can you give some details about what that would mean? Would it mean paying the financial settlement and walking away with no deal, or not paying the financial settlement?

Sir Tom Scholar: When Robert Chote appeared before you at the back end of last year, he said that the ultimate cost or benefit to the UK of leaving would be determined by the future development of the economy, which would be much bigger than the size of the financial settlement. That is the right way to look at this question as well, in that you would want to look at the implications of no deal more broadly, rather than the financial settlement, which probably would be small compared to the overall impact.

Q64 **Catherine McKinnell:** The Comptroller and Auditor General has said that he was in discussions with the Treasury about the National Audit Office examining the EU financial settlement. What work do you anticipate the National Audit Office doing on this? Are there terms of reference? Have they been agreed? How long do you anticipate this work taking?

Sir Tom Scholar: That is right. We have spoken to the NAO. The NAO, of course, is a completely independent body, and it decides its own work programme and terms of reference. It came to us in the autumn, as it saw the negotiation moving forward, and said it would like to talk to us about the financial settlement. We have also spoken to it since the agreement was reached at the December European Council. We have explained to it both the nature of the settlement and how we have gone about it, and it is up to it now to decide exactly how it wants to organise its work.

Q65 **Catherine McKinnell:** Have you considered the implications of whatever outcome might arise from that, if it decided that it was not reasonable, or that your assumptions were not reasonable? Might that mean having to revisit the financial settlement, or indeed revisit the negotiations overall?

Sir Tom Scholar: We are very confident in the settlement that we reached. It was a long negotiation and quite an intense one, and we think we have secured some important elements in the agreement: for example, a number of technical adjustments that reduce the contribution overall, and a recognition that the UK has a claim on a share of assets that it has contributed to, including the European Investment Bank. We are very confident of the agreement, and confident that it will stand up to scrutiny. We have said to the NAO that, as you would expect, we will co-operate fully with it in its investigation, in whatever direction it wants to take it.

Q66 **Catherine McKinnell:** You are confident that that financial settlement will be payable regardless of any other negotiations, in terms of our future trading partnership.

Sir Tom Scholar: I am very confident that it was a successful outcome to the negotiation, which represents value for money, given that we were asked to reach an agreement honouring the UK's commitments, so that is what we have done.

Q67 **Catherine McKinnell:** Is that value for money in terms of the cost of exiting from the European Union?

Sir Tom Scholar: We were asked to reach an agreement through which the UK honours the commitments that it has made through the period of its membership. That is what we have done. We think it is a fair outcome to that discussion. We are also confident that, when people look at it, they will think that it has been a professional job. Now, as I said earlier, that then gets turned into a treaty, and the legal obligation to pay only arises once the treaty is agreed and ratified by both parties.

Q68 **Catherine McKinnell:** There is a spending review coming up; they come around remarkably fast. How do you expect Brexit generally, and the financial settlement in particular, to affect the availability of money to spend on public services, particularly given the fact that many people, when they voted in the referendum, understood that it would mean more money available for the NHS: £350 million a week, for example?

Sir Tom Scholar: We do not know the answer to that yet. As I am sure you know, in the forecast and the fiscal numbers that we are working from, the OBR has assumed that the money we currently spend on net contributions to the EU still gets spent on something.

There is money there in the budget, available, first of all, to meet the financial settlement that we have reached. Secondly, to the extent that in any particular year—which will be the case as you move out of the forecast—there will be money available, that can be spent on other public services, maybe, in some cases, to replicate some service or some budget that previously came from the EU, or can be allocated to other public services. That is just in terms of the direct numbers in the budget.

That said, as Robert Chote set out to the Committee, the overall impact on the public finances is likely to be determined much more by the overall impact on the economy, and that in turn depends on whatever we agree in terms of the future economic relationship, which we do not know

now, but we will know by the time we do the spending review next year. That will be after the point of agreeing the withdrawal treaty and all the various other procedures that go with that.

Q69 **Charlie Elphicke:** I had a couple of very quick follow-ups. The first was about why the Government have not published a financial services Brexit paper yet.

Sir Tom Scholar: We have not published a paper yet because Ministers have concluded that it would not be in the public interest, at this early stage in the negotiation, to say too much about what we intend to put forward. The Chancellor has given a number of speeches setting out his ambition and the direction we want to go, but he feels it is too early to start publishing detailed papers. That point may come as we get into the discussion, but we have not even started it yet. Our energy in the immediate future is to ensure that we get the implementation period agreed in March, to take effect from the end of March next year, to give businesses the certainty that they are looking for.

Q70 **Charlie Elphicke:** I will come to that in a minute, but let me just press you on that, Sir Tom. There is obviously a view in parts of the City, particularly in the Treasury, that we might well lose EU trade if we leave the customs union. How much extra trade would we have to have with the rest of the world to make up for that, in the Treasury's view?

Sir Tom Scholar: Leaving the EU means leaving the single market and the customs union. That is clear. The impact of that depends on what the future agreement with the EU is, and that is not clear, so it is not really possible to answer the question at this early stage until we have a clear idea of where we are going.

Q71 **Charlie Elphicke:** Turning to the implementation agreement, do you agree that you need to agree the end state before the implementation period starts? Otherwise, there is a risk that the whole thing will just end up like the Hotel California: you will check out, but never leave, and just be stuck in endless transition.

Sir Tom Scholar: The intention is to agree the framework of the future relationship this year, under Article 50.

Q72 **Charlie Elphicke:** Finally, I have analysed the financial settlement issue, and, legally, the arguable case is that, as a matter of international law, we owe them to the end of the MAFF period, but not beyond. You would only pay a larger amount if you were going to get something in return. That is the only circumstance in which it would be value for money, "in return" being a longer-term trade deal. Has the Treasury taken that into account, and would you agree with that analysis, or do you think that we will just write out a cheque, regardless?

Sir Tom Scholar: The settlement that the Government have reached is in the context of what the Prime Minister said in her speech in Florence, that the UK will honour the commitments made during the terms of its membership of the EU. It is not a payment for the future; it is a settlement of obligations arising from the past.

Q73 **Charlie Elphicke:** If we have no deal, you think that we will still write out a cheque for £40 billion, or whatever it is.

Sir Tom Scholar: It will be Parliament that decides whether there will be a deal or not, and what the consequences will be.

Q74 **Chair:** Yes, but if the payment is for past obligations—obligations that have already been agreed under a treaty—surely, from what you are saying, that will be payable regardless of whether there is a deal or not, because the two are disconnected. I think that is the consequence of what you are saying.

Sir Tom Scholar: The legal obligation to pay arises at the moment at which the formal, legal withdrawal agreement, which has the status of a treaty, is ratified by both parties. That clearly has not happened yet. The process that we have followed has not been a legally-settled agreement; it has been a negotiated agreement, and the negotiating objectives on the UK's side were to honour the commitments that the UK has made during the period of its membership. Within that context, we have been in discussion with the EU 27. We have reached an agreement at the highest political level at the December European Council. That now needs to be turned into a legal agreement, but it only becomes a legal agreement at the moment that it is agreed by both parties, and in the case of the UK that means a vote in Parliament.

Q75 **Chair:** I think the consequence of what you are saying is that, despite the fact that there are things that we have agreed to pay, if we were not leaving the European Union, we would carry on paying, in this multi-annual financial framework period up to 2021, so many billion pounds. That is an obligation that the UK is under to pay, regardless of Brexit and everything else. The logical point of what you are saying is that, if there is no agreement ratified by Parliament, or eventually signed by both parties, we would not pay that amount, even though we have an international obligation to pay it at the moment as members of the European Union.

Sir Tom Scholar: A failure to reach an agreement prior to the date of exit would put us into a completely different world. I cannot give any commentary now on what might happen in those circumstances. It is so different from the position that we are in today. The position that we are in today is that we have a negotiated agreement that is just one part of a much bigger negotiation, which is the overall negotiation to withdraw from the EU and then agree a future partnership. It is within that context that we have done all the work on it today.

Q76 **Chair:** I think what you are saying is that walking away is inconceivable, so—going back to the question that was asked earlier on about preparations for that inconceivable situation—those preparations are not really happening.

Sir Tom Scholar: No, they are happening. Government departments absolutely are ensuring that they are ready to deal with the consequences of no deal. That is something that is co-ordinated by the Department for Exiting the EU. The Treasury is very closely involved in that work, not least because in some cases it means spending money, so departments are preparing for both the consequences of a deal, without knowing exactly what the deal would be, and the consequences of no deal. Now, in many cases, quite a lot of that preparation for the two outcomes would involve doing some of the same things, so that work certainly is happening.

I was trying to explain that, on the precise question of what the legal and political ramifications of a failure to reach an agreement would be, I cannot say. At the moment, this discussion on the financial settlement has not been conducted. It has not been a legal process; it has been a negotiated process, although, of course, it is informed by legal advice on both sides, but the situation is unprecedented. There is a treaty that sets out legal agreements. As you know very well, there is the annual budget negotiation, which you have taken part in the past.

Chair: I have—a joyous occasion.

Sir Tom Scholar: There is no case law as to what precisely is an obligation and what is not. Although we have our legal advisers, they have theirs, and we have debated the issues, the settlement we have reached is a negotiated settlement within the overall context that we are trying to negotiate a co-operative withdrawal and a close future relationship.

Chair: I think you are saying that a no-deal situation—walking away with nothing agreed—is conceivable, because thought is going into it, but it is unprecedented and potentially, many of us would say, undesirable for that to happen, given all the difficulties it would cause.

Q77 **Catherine McKinnell:** You went on to talk about the money that has been set aside to prepare for Brexit, and the Treasury agreeing allocations for 2018-19 in early 2018. We are there now, so has it been done yet? If this is not published yet, is it something you can provide to the Committee once these allocations have been agreed?

Sir Tom Scholar: The first thing to say is that already, in the last 18 months, we have allocated £700 million. Some of that was in 2016-17; some of it was in 2017-18, and the allocations for this year will be included in the spring supplementary estimates that will be published in, I think, two weeks' time. That is for 2017-18, and the sum involved—because I think I am right in saying it was about £400 million in 2016-17—must be about £300 million in 2017-18.

We are at the stage now, with departments, of working through their requirements for 2018-19. That is not complete yet, and it would not necessarily be the full £1.5 billion that would be allocated right at the beginning. We are in a process of looking at what departments need, scrutinising it and so on, but I think our Ministers have indicated that they want to make clear, once decisions have been made, where the money is being allocated.

Q78 **Catherine McKinnell:** Are you still confident that the £3 billion that has been allocated is going to be enough, even in the conceivable/inconceivable no-deal scenario?

Sir Tom Scholar: It is our best estimate, but as the Chancellor has said, if more is needed, we will provide it.

Q79 **Stephen Hammond:** Good afternoon. Thank you for giving evidence this afternoon. It is part of your role, obviously, to ensure that we have an effective and efficient customs system. You set out two options—the highly streamlined customs arrangement and the customs partnership—last year. At that stage, you indicated that both of those would entail greater administrative costs than we have currently. Can you say something about the work that the Treasury has done on trying to establish the scale of those costs, and whether you have done any work on the wider costs and benefits of either of those arrangements that would inform you as to which route the Government are likely to prefer?

Sir Tom Scholar: We work extremely closely with HMRC on this, and the chief executive, Jon Thompson, and his colleagues gave evidence to you last autumn. Obviously, they run the customs system; they have the operational expertise and huge policy expertise, too, so we work very closely with them on this.

I think we are at the stage of saying that we have identified these two possible routes. There is not a decision yet between either, not least because, in part, it will depend on the negotiation. Once we get into stage two, which we are just about to do, that will be one of the very early things we need to start to discuss. There will be a mutual interest on both sides, given the very, very important issue of the negotiations for Ireland, France, the Netherlands and others. We are at the stage now of making sure that we are ready to engage in the negotiation, and then pursue whichever is chosen.

Q80 **Stephen Hammond:** I am going to go on to the negotiations in a moment, but do I take it from that answer that, although work is being done, it is not ready to be presented, as to the wider costs of both schemes?

Sir Tom Scholar: Do you mean costs in terms of the administrative costs?

Stephen Hammond: Well, the administrative costs and the potential benefits and costs to the economy of operation, as against the status quo.

Sir Tom Scholar: The administrative costs would be set out through the process I was describing just now to Ms McKinnell, through spring supplementary estimates and then HMRC budget allocation. The cost to the economy, of course, depends on what comes out of the negotiation, and the government objective is very clear: we should have an agreement that allows for trade to continue, as frictionless as possible.

Q81 **Stephen Hammond:** In one of your earlier answers, you talked about the importance of agreeing the transition or implementation period—call it what you like. Jon Thompson, in his evidence to us, said, "In relation to the new customs partnership, our assessment is that that is more like a five-year implementation. There are some around us who think that it might take longer than that". In the context of the negotiation, if we are aiming for a two-year transition/implementation period, and it is going to take five years to implement if we go down the line of the customs partnership, what does the Treasury anticipate would be the arrangements for the interim period?

Sir Tom Scholar: That is something that needs to be addressed very early on in the discussion that we will be having this year.

Q82 **Stephen Hammond:** Are you saying to the Committee that you are going to discuss it at that time, or are you saying that there is scenario planning; it is just that you cannot make that public?

Sir Tom Scholar: I am saying that the implementation period that we are arguing for will be, as the Prime Minister said, about two years. Not just on the question of customs, but on a whole host of other ones, the whole Government will be doing everything possible to make sure that, at the end of those two years, the new arrangements are in place.

Q83 **Stephen Hammond:** Jon Thompson, who you said runs the system, has given evidence that it is not physically possible to implement one of those options, in his opinion, before five years. There is a big gap between the end of an implementation period and when it is physically possible to implement the new arrangements.

Sir Tom Scholar: If that is the option that is chosen, there will be a question for both sides of the discussion about what to do about that gap. It may be that that is not the option that is chosen, and another option is chosen that does not give rise to the same problem. As I said earlier, this is something where the EU 27 has every bit as big an interest as we do in avoiding obstacles, so we would expect to address that co-operatively within the discussion and find answers.

Q84 **Stephen Hammond:** I am not disputing that point. It is just that it is clearly of major concern to us, as well as to the EU. I note that Jon Thompson also gave evidence that, if you went down the other route, he was expecting it to take about three years to implement, so whichever way you look at it there is likely to be some sort of gap. There needs to be an explanation from the Government as to how we are going to solve that customs problem.

Sir Tom Scholar: He was talking to you in September last year. A huge amount of work is going on to make sure that, first of all, in the event that we have to deal with this just over a year from now, we are ready to do that. In the event that we get an implementation period of about two years, we will be ready for that too.

Q85 **Stephen Hammond:** In the first-phase agreement between the UK and the EU, the UK commits to avoid a hard border between Northern Ireland and Ireland in all circumstances. Is the Treasury's understanding that that is a statement of intent, or legally binding?

Sir Tom Scholar: The agreement reached in December was not a legal agreement, but I think all three parties—the UK, the EU 27, and in particular the Irish Government—are absolutely committed to this.

Q86 **Stephen Hammond:** On that basis, it said that there is an attempt to avoid a hard border. In the event that there is an absence of a negotiated solution, or a negotiated solution that says, "The United Kingdom will maintain full alignment with those rules of the internal market and the customs union which, now or in the future, support north-south co-operation", what is the Treasury's view on what sectors there needs to be full alignment on to meet that commitment?

Sir Tom Scholar: I cannot give you a detailed answer to that. As you quote there, it is clearly qualified. It is not talking about the whole of the single market; it is about things that refer in particular to the Belfast agreement and the common travel area, and the specifics of the Northern Irish and the Republic of Ireland's economy.

Q87 **Stephen Hammond:** The Chancellor gave us two examples: the electricity market and animals. Beyond that, are we talking about financial services? There is quite a big industry that works between Belfast and Dublin, and Dublin and the rest of the United Kingdom.

Sir Tom Scholar: As you said, the Chancellor gave a couple of examples. This is something that needs to be worked through. The December agreement was not only not a legal agreement; it does not go into any of this detail. It is a headline agreement, and it leaves a lot to be worked through to the satisfaction of both parties for the next stage. It clearly does not apply to the entirety of the single market.

Q88 **Stephen Hammond:** I accept that it is not a legal agreement but, as you said, it is something that both sides have committed to.

Sir Tom Scholar: Absolutely.

Q89 **Stephen Hammond:** In the event that there was no negotiated settlement, and we are talking about maintaining alignment with the rules of the internal market and the customs union, given that the Prime Minister has said that the UK is indivisible on this, presumably that would mean that the rules of the internal market and the customs union would apply to the whole of the United Kingdom.

Sir Tom Scholar: The word "alignment" is carefully chosen. It is not the same as harmonisation. It refers, as I understand it, to outcome, and it is possible to achieve the same outcome in some circumstances through slightly different rules.

Q90 **Stephen Hammond:** If I take your distinction between "harmonisation" and "alignment", do you think the EU 27 interprets it in the same way as you just have?

Sir Tom Scholar: I cannot comment on its interpretation.

Q91 **Stephen Hammond:** The Government have said that there should be no physical infrastructure at the Irish border. I am just keen to understand how you as the Treasury are going to work with HMRC, or what advice has been given to you as the Treasury, about how that will actually work. What does that mean, for instance, if there is an inspection point 100 metres inside the border? How are you going to distinguish between small businesses and large businesses in assessing what is going across the border, if there is no physical infrastructure at the border?

Sir Tom Scholar: HMRC, in common with customs authorities across the world, has a whole range of different techniques and methods of assessing what goes across a border and what is payable on it, and that, in some cases, involves physical infrastructure. I do not have the figures, but I would suspect that quite a lot more is done away from the border than at the border. There is a whole set of different ways in which you can do this.

Q92 **Stephen Hammond:** So we are going to interpret the border as a fairly loose arrangement. Somewhere between a quarter of a mile and half a mile away from the border would still count as "the border", in terms of the need for physical infrastructure.

Sir Tom Scholar: You would need to ask these questions to HMRC, but there are lots of recognised processes without infrastructure anywhere, including goods coming from a very long way away, where the paperwork is all prepared in advance.

Q93 **Stephen Hammond:** That presupposes that we negotiate staying inside the CCT and other things.

Sir Tom Scholar: I do not think it necessarily does. We are at a very early stage in this, and all I can say is that the commitment is absolutely firm on the UK's side, and I understand on the EU's side, as well.

Q94 **Stephen Hammond:** Given that that commitment is firm, and it is not yet legally binding, has the Treasury been asked to give any advice on how the wording might be put together so that it is legally binding?

Sir Tom Scholar: That would not be our responsibility.

Q95 **Stephen Hammond:** If you are being asked to advise on how to avoid a hard border in all circumstances, does the Treasury not have any input into how that might be conceived?

Sir Tom Scholar: The issue of the hard border is not a Treasury responsibility. Inasmuch as it touches on the negotiations on customs, we become involved, but the whole process of turning that agreement into a legal agreement has not started yet. That is not the stage that we are in.

Q96 **Chair:** My understanding is that you have just recruited a director of customs. Would they be assisting in this process?

Sir Tom Scholar: Yes. We previously had a customs team within the business and international tax group. We have found over the last 18 months that the work on business and international tax has not gone down at all, and the work on customs has increased enormously, so to create the extra capacity we have a new director, and she leads all of our work on customs, in close co-operation with HMRC.

Q97 **Chair:** She might be involved in turning the negotiated agreement into a legal agreement, in relation to the relevant bits for customs.

Sir Tom Scholar: Yes. I think the actual process of negotiating the legal agreement will be led by government lawyers, and there is a central process to co-ordinate that. I do not think that that would be either a Treasury or an HMRC responsibility.

Q98 **Chair:** I have to say, I personally find this question of what is a responsibility and what is not quite concerning. At the end of the day, the Treasury—and HMRC, which the Treasury oversees—will be responsible for making this work on the ground, in terms of making sure that there are not lots of goods coming across borders that should be paying duties. We hope, obviously, that no hard border is necessary. Presumably, there is, if not a responsibility, at least a huge interest from the Treasury in making sure that—as would be the case for any other client instructing lawyers—what the lawyers put in the agreement works in practice for the client.

Sir Tom Scholar: I was perhaps interpreting the question too literally. What I think Mr Hammond asked was whether we had been asked to give any legal advice about how to do this.

Stephen Hammond: I should have said, "Have you been asked to give any input into the thoughts behind the legal advice?"

Sir Tom Scholar: As the government work proceeds on discussing and negotiating the draft legal agreement that will give effect to this, yes, absolutely. The implications of whatever is written down there for the customs regime, including the deliverability of it and what it would mean, would absolutely be something that we would be fully involved in. I should have answered the broader question, rather than the narrower one—my apologies.

Q99 **Charlie Elphicke:** Looking at the National Infrastructure Commission, the chairman seems to have stood down recently. Our understanding is that he was appointed in April, and there was not any kind of confirmatory process with this Committee, which normally there is with such appointments. Do you regret that?

Sir Tom Scholar: He was indeed appointed in April. He was, I think, the first person appointed to this role. There is obviously an agreement between the Government and the Committee on a whole range of different appointments, and the role that the Committee takes in relation to them. I know, Chair, that you have written to the Chancellor about this, pointing out that, because this is a new appointment, it is not covered by the existing agreement.

As you will know, he has written back to say that he feels it is important that Ministers are clearly accountable for appointments made to government bodies, delivering functions on behalf of the Government, so he would not expect this figure to go through a pre-appointment hearing, but instead through a confirmation hearing.

Q100 **Charlie Elphicke:** Who was responsible for appointing Lord Adonis? Would that be the Chancellor?

Sir Tom Scholar: Yes, it was the Chancellor.

Q101 **Charlie Elphicke:** It was the Chancellor's idea to appoint Lord Adonis.

Charles Roxburgh: Yes, after a competition. We had a competition for that post. He was appointed initially as the interim chair, subject to open competition once the body came into permanent being. We had a wide evaluation process. Lord Adonis was chosen at the end of that process, on the recommendation of a panel to the Chancellor. The Chancellor made that appointment.

Q102 **Charlie Elphicke:** I think many people would think that the appointment of Lord Adonis was controversial. The controversy has been added to, because now you are not going to have a process at all; you are just going to appoint the deputy chairman. Do you not think that there ought to be a proper process and an open competition again?

Charles Roxburgh: Sir John Armitt was a candidate in that earlier process, and was judged by the panel to be appointable under the rules established for those public appointments. If a vacancy arises within 12 months of an open and competitive selection process, the Chancellor does not need to rerun a process, but can pick a candidate who was judged appointable in the earlier process. The Chancellor was making that appointment entirely within the rules that have been established for these appointments. Given that Sir John Armitt is an outstanding candidate, extremely well qualified for the role, and given the chance to bring stability and continuity to the commission, the Chancellor felt it was both appropriate and desirable to move quickly to that appointment. In his letter back to you, I think he has made that clear.

Q103 **Charlie Elphicke:** I understand what you are saying. "It is all within the rules" is a term that we are all very familiar with, and it is what people say when, frankly, they could have taken a different path. I would put to you that the better path would have been—nearly a year on, things having dramatically changed in the country in that last year—to have an open competition and see who else is out there, to see if anyone from maybe a non-traditional background, who is not a career quangocrat, might come forward and add a new perspective. Why did you not try something like that?

Charles Roxburgh: It is a critical year for the National Infrastructure Commission. It is producing the final national infrastructure assessment this summer. That will set out a 30-year strategy for this nation's infrastructure. The commission is working hard on that. It would have been extremely disruptive to the commission's very important work to have put it on hold and conduct a selection process, which would have concluded shortly before it was due to do that.

Secondly, as I said, the Chancellor's decision was that Sir John was an outstanding candidate, and would bring the right sort of leadership to this commission at a critical time. Rather than create all the uncertainty of an open competition, having just done one and looked very broadly at a wide range of candidates, which showed that John Armitt was a very strong candidate and clearly appointable, the Chancellor felt it was the right decision to appoint him.

Q104 **Charlie Elphicke:** Let me just understand: you are saying that they are all working feverishly at the National Infrastructure Commission. It has been going on for about two years, has it not?

Charles Roxburgh: In interim form, it came into being after the election in 2015, and then it was made a permanent body.

Q105 **Charlie Elphicke:** It has existed for a bit more than two years now, and in that period it has produced four studies. I had a look: on average, these studies were 84 pages each. It has 35 members of staff, so in aggregate they seem to be producing five pages of study each per year. Do you not think that we could do with some more productivity out of the National Infrastructure Commission?

Charles Roxburgh: No. We think they are doing an outstanding job.

Q106 **Charlie Elphicke:** What about a fresh perspective, a different perspective or different leadership?

Charles Roxburgh: As I say, we are confident that they are doing an outstanding job. The vision statement that they are consulting on to set out the 30-year strategy for the nation's infrastructure has never been done before. It will guide the level of investment in critical infrastructure across a whole range of sectors. That is a very impressive document. If you look at studies like the Oxford to Cambridge corridor, again, that is a hugely exciting economic opportunity for this country. They have done fundamentally important work in shaping that opportunity. I know that the Chancellor feels that they are doing a very good job.

Q107 **Charlie Elphicke:** Brexit is, of course, potentially quite important to the infrastructure of this country. It is one of the bigger projects—perhaps the biggest project—that this country has undertaken since the Second World War, and yet the National Infrastructure Commission said that it did not think it was something that it should look at. Do you think that that is perhaps a misconceived approach, and it ought to change it?

Charles Roxburgh: It is looking at a 30-year time horizon. The aim of the National Infrastructure Commission is to bring to British public policy something that has been lacking, which is this very long-term vision for our nation's infrastructure over 30 years. That is the horizon that it is focusing on. Within that, the Government can ask it to look at certain particularly important issues, like the Oxford to Cambridge corridor. It has also looked at Transport for the North. It has looked at smart energy networks, so we can set it specific questions to look at, but its most important deliverable this year is this 30-year vision.

Now, there are issues around infrastructure that needs to be in place at ports, as Tom was talking about. That is a much shorter-term issue. It is also hugely important, but that is an issue for, in that case, HMRC to be working through what infrastructure we need in the ports, depending on the outcome of the negotiations. We want the NIC focused on the long term, which is a big, new addition to how we are going to shape infrastructure policy in this country.

Q108 **Charlie Elphicke:** You think it is more important for the long term that we get the Oxford to Cambridge corridor right than that we get the infrastructure we need for this country to leave the European Union and successfully trade with the economies that account for 50% of our entire trade.

Charles Roxburgh: The exam question that we have set the National Infrastructure Commission for this year—because the Chancellor can set it a big question this year—is around freight. That is a critically important aspect of our economy: how we get the right infrastructure for our freight, to get it from the factories to the ports, to distribute our food, and how that is going to change over the long term. We have set it that important question to look at, again, with a long-term perspective for this year.

Q109 **Charlie Elphicke:** When can we expect that study to appear?

Charles Roxburgh: That will be on an Autumn Budget timetable.

Q110 **Charlie Elphicke:** It is meant to produce an infrastructure plan every single Parliament, isn't it?

Charles Roxburgh: Yes.

Charlie Elphicke: It did not do that in the last Parliament.

Charles Roxburgh: It was a short Parliament. The national infrastructure assessment is being produced for this summer. It has produced its vision statement, which is a high-level outline of the elements within that. That is a consultative document, and it is taking consultation on it. It is finalising it in the period up to the summer, and that will be the national infrastructure assessment for this Parliament.

Q111 **Charlie Elphicke:** There seems to be a lot of vision, to my mind, but not an awful lot of work. Do you not think that we need to see a step change in productivity, output, proposals and concrete work from the NIC?

Charles Roxburgh: No. We think it is doing a very good job.

Q112 **Chair:** Sir Tom, did you have anything that you wanted to add?

Sir Tom Scholar: Coming out of Brexit, there are some crucial infrastructure questions, but they are being addressed. It is just that it is not the National Infrastructure Commission's responsibility; it is HMRC and the Department for Transport.

Q113 **Charlie Elphicke:** Finally, Sir Tom, this vexes me. Going back to the withdrawal agreement very briefly, you say the sum that should be agreed to be paid is about £40 billion, and that is our commitments. Am I right in saying that you do not think we are getting anything in return? I am not sure what we get in return through the withdrawal agreement. It seems to be that we pay them, and we do not get a lot in return. Do we get anything in return?

Sir Tom Scholar: What we are agreeing this year—and it will all be wrapped up in the same single, indivisible legal instrument—will be the separation agreement, which includes the financial settlement, the implementation period, and the framework for future co-operation and the future relationship. It is all in one legal agreement, which Parliament will vote on.

Q114 **Charlie Elphicke:** Will the policy be not to write out any cheque until everything is agreed, including what our future relationship will be?

Sir Tom Scholar: As I said, the position of the Government is that nothing is agreed until everything is agreed, and this is all part of one single legal instrument.

Q115 **Wes Streeting:** Sticking with Brexit, this afternoon, Robert Chote's name has come up quite a lot, and lots of balls have been kicked over to the OBR. The good news is that we do not have to wait until the OBR next comes in front of the Treasury Committee, because Robert Chote has given an interview to the *New Statesman.* Some of those comments have been published this afternoon, just in time for our Committee, which is really useful. One of the things that Robert Chote says is that, in terms of what has happened as a consequence of the leave vote, in terms of the net effect on GDP—this is a direct quote—"the hits to demand have outweighed the boosts". Is that the view of the Treasury?

Sir Tom Scholar: First of all, you are better briefed than I am. Congratulations.

Wes Streeting: We do try, and occasionally succeed.

Sir Tom Scholar: I have not seen his interview, but we have an independent forecaster, the OBR. The Government do not produce their own forecasts. We take the forecasts that the OBR gives us, so we would not comment on what he says. We just take it as the basis for our work.

Q116 **Wes Streeting:** Following on from Alison's questions earlier about the scenario planning that the Treasury is doing, Robert Chote, citing most of the work that trade economists have done, which shows that the costs of leaving the single market and the customs union are greater than the benefits, says that the reduction in openness with the EU is likely to outweigh any increases elsewhere. Is that what your scenario planning shows?

Sir Tom Scholar: He is referring to external studies there. Some of the external studies that I have seen assume that the UK leaves the customs union and leaves the single market, but does not put anything in their place. That is not the objective of the Government. The objective of the Government is to negotiate a deep and special partnership, meaning a very close economic relationship. That would include a new customs arrangement, which would aim to secure trade as frictionless as possible, and a close relationship with the single market. I do not know which studies he is quoting, but some of them certainly would not apply to this situation.

Q117 **Wes Streeting:** Which of the scenarios that the Treasury has modelled show that we would get greater benefits through this new deep and special relationship, compared with the one we currently have with the single market and the customs union?

Sir Tom Scholar: I just cannot answer that, because we do not know what the outcome of the negotiation is going to be yet.

Q118 **Wes Streeting:** No, but I put to you the question of which scenarios that the Treasury has modelled show a greater net benefit than being members of the single market and the customs union.

Sir Tom Scholar: We have done a lot of internal advice for Ministers, but that is what it is. It is internal advice for Ministers, and the Chancellor has been clear that he does not think that this is the moment to publish it, at this early stage.

Q119 **Wes Streeting:** When you do scenario planning for Ministers, what is the purpose of that advice?

Sir Tom Scholar: It is advice to Ministers.

Q120 **Wes Streeting:** To what end?

Sir Tom Scholar: The Chancellor, first of all, discusses these issues with his colleagues at Cabinet and in Cabinet committees. He also regularly meets with his counterparts: he was at ECOFIN yesterday in Brussels. He meets a range of economic agents of all different sorts.

Q121 **Wes Streeting:** Your advice helps him to prepare for those discussions, and make informed choices.

Sir Tom Scholar: He needs to think through what, for the interests of the economy, we should be aiming to achieve through this negotiation. That is what our advice is there to illustrate.

Q122 **Wes Streeting:** Of course. Given that you have acknowledged this afternoon that, ultimately, it will be Parliament that decides on the future relationship, why should this advice be the preserve of Ministers, rather than the preserve of Parliament? We are ultimately going to be the decision-makers.

Sir Tom Scholar: Again, I will refer back to what the Chancellor said to you when he was here in December. At the point at which Parliament is voting, and there will be an extremely important decision to be made, the Government will absolutely want to set out in detail what has been agreed, and Parliament will want a clear sense of the consequences. We are not at that point yet. We have not even started; we are just about to start the negotiation on the future relationship. The strong view of the Chancellor—and it is not just the Chancellor; it is the position of the Government—is that this is not the moment at which to be setting out too much detail of our negotiating objectives.

Q123 **Wes Streeting:** Presumably, in terms of process, officials in the Treasury and across government must be working to a kind of timeline. We know, in broad terms, what the decision-making timeline looks like, because we know what the exit day is. When, according to your timeline, will that information be put before Parliament?

Sir Tom Scholar: I do not know any better than any of you what the timetable will be. Working back, the day of exit is at the end of March next year. There has to be some period of time for the ratification process for both parties to the agreement. That, in the UK, involves a vote in Parliament, so I do not know how long these things will take. It also depends on how quickly the negotiation proceeds. I do not know that either, but it will be at some point later this year.

Q124 **Wes Streeting:** Going back to the substance of the negotiations and what we hope to achieve, I am struggling to conceptualise the basic possibility of any future deal with the European Union being better for our economy than continued membership of the single market and the customs union. Am I being pessimistic? Do you think there is a possibility that we could get a better deal than being in the single market and the customs union, based on the work that you have done in the Treasury?

Sir Tom Scholar: I am not going to comment on internal advice. The question needs to be framed around the UK's relationship not just with Europe, but with other countries around the world. The Government's objective is to agree a deep and special partnership with the EU that will preserve a very close economic relationship with the EU, while at the same time giving the UK flexibility to adjust regulation for the needs of the economy. This includes, for example, new areas of the economy that are developing, new technologies that are developing very rapidly, where a country on its own—rather than as a bloc of 28—should be able to move more quickly. There is also the issue of trade agreements with other, rapidly growing parts of the world, so it is not a question that you can look at just in terms of the EU. You need to look at the overall context.

Q125 **Wes Streeting:** Sure, but the EU is our single biggest trading partner, which is presumably why David Davis said that the objective is to achieve the exact same benefits that we currently enjoy. Is it possible to achieve the exact same benefits, based on the position that the EU 27 has set out?

Sir Tom Scholar: The EU is our single biggest trading partner, that is true, but others are growing much more rapidly.

Q126 **Wes Streeting:** Is it possible to get the exact same benefits?

Sir Tom Scholar: I cannot predict what the outcome of the negotiation will be.

Q127 **Wes Streeting:** It is unlikely, though, is it not?

Sir Tom Scholar: I cannot predict what the outcome of the negotiation will be, but the objective of the Government is to achieve a deep and special partnership that will preserve a very close economic relationship with the EU, while giving the UK flexibility to pursue trade deals elsewhere.

Q128 **Wes Streeting:** Given that, through the single market and the customs union, we already have trade agreements with 65 other countries around the world, how much scope is there for better trading relationships with more countries to offset any negative impact from leaving the single market and the customs union?

Sir Tom Scholar: Well, there are quite a few countries, including some important countries, that we do not have trading agreements with. It may well be the case that acting as a single country gives us greater flexibility in negotiations, and it becomes more possible to reach those agreements.

Q129 **Wes Streeting:** Does greater flexibility offset the lack of collective muscle? In order to secure a trade deal, you have to give something over, and we are a market with a far smaller number of customers than being part of a collective of half a billion customers. For example, a bilateral trade relationship with the United States of America may lead to demands on the Americans' side that are unpalatable politically for Parliament, or are unpopular with the public. I wonder how much scope really exists.

I do not really think, at this stage, that these are unreasonable questions to ask officials, because these are live negotiating points. The public are following this, and have to make a judgment about whether the leave vote was correct, because this is not an irreversible process. Most importantly, parliamentarians have to make judgments, on legislation that is before Parliament now, about the parameters that we are setting for government and/or the deal we eventually sign up to. Why is it so difficult to get answers to quite fundamental but basic questions, for which the Treasury will have the work already done?

Sir Tom Scholar: These are quite reasonable questions, but the answers are not very easy to give. On the broad question of trade agreements, first of all, all trade negotiations are difficult, in my experience. Relative size may well come into it, but there are other issues too. For example, when the EU 28 is negotiating a trade agreement, its negotiating mandate is determined by a process involving all 28 countries. It may well often be that that includes elements that do not benefit the UK in any way, which get prominence, and other issues that would be bigger for us do not get the attention that they would deserve.

Where we are acting as one country, we can pursue tailor-made agreements that are closely connected to our economy. It may well be the case that, by doing that, we are able to open up avenues that would not otherwise be available. That is a rather abstract answer. I cannot give you a detailed answer, because we need, first of all, to work through the process with the EU, and then see where that takes us in terms of trade agreements more broadly.

Q130 **Wes Streeting:** I totally accept that, as officials, you work to the Government of the day. The points you made about the Government's unwillingness to share internal advice clearly direct us to ask these questions of the Chancellor and the Prime Minister, so it is not fair to beat you up for coming along and working to the mandate that you have been given.

The reason that these are really reasonable questions is not simply that, ultimately, we need to make decisions about the deal we sign up to, and need to be well informed. It is also that, when we questioned your predecessor and the Chancellor's predecessor ahead of the referendum, they were remarkably candid, and terrifyingly so, when they said that there had been no contingency planning for the event of a leave vote. I think that the country suffered as a result of that lack of planning and preparation. We were told by the Government that there was a whole range of very thorough, very deep work, covering every sector of our economy, and when that was eventually dragged out of the Department for Exiting the European Union, we found it pretty thin and threadbare.

We are told that the Government will not even produce a position paper on financial services as was previously promised.

It is not just that we want to see advice because it helps us to make better decisions. It is also because many of us lack confidence that the work is being done to a sufficient degree and sufficient quality to help protect our country when making some pretty big decisions. Do you think that sort of criticism, of lack of preparedness and lack of thoroughness of the Civil Service, is fair?

Sir Tom Scholar: On the question of preparation before the referendum, the position of the Government of the time was that no contingency planning was done, but the way that I look at it is that, in fact, a great deal of preparation for a no vote was done and, indeed, was published. The Cabinet Office published a paper on how you would leave the EU, if that were the decision in the referendum. The Foreign Office published a paper on alternatives to membership. As I was discussing earlier with Mr Elphicke, the Treasury published a paper on the potential implications of those alternatives to membership.

At that stage, I am not sure what further contingency planning could have been done, because how to implement the referendum vote in the event of the eventual decision to leave could not be known before the referendum. It involved answers to the questions that were set out in the various papers. The Civil Service, at that time, did what it could to set out the issues for people to consider, and of course, since the referendum, there has been a continuous debate about precisely what future relationship to seek. We are moving forward with that.

As for the papers published by the Department for Exiting the EU in December, as it said at the time, this was not the totality of the work that had been prepared. It was the material that it judged was sensible to release at that time, consistent with the national interest in supporting the negotiation. As I have tried to explain this afternoon, the Treasury is doing a great deal of work to inform our Ministers and the decisions that they need to make, and I know that the same is true in other departments.

It is in the nature of government, particularly when you are embarking on a negotiation like this, that there are some things that, quite understandably, the Government decide not to publish. It certainly does not mean that the work is not happening, or that the Civil Service is not prepared. Our job as civil servants, supporting our Ministers, is to make sure that, however the negotiation develops, whatever the questions that get asked, we are ready there with advice to enable them to make choices and defend choices. I am very confident that we are in that position, and we will be able to support them in that way.

Q131 **Wes Streeting:** Perhaps on a final, optimistic note, I wonder if you are able to even say to the Committee and to Parliament that there is a possibility that we will get a better trading and economic relationship with the European Union outside of our current relationship with the single market and the customs union. Based on what you know, and the work you have done, is it even a possibility?

Sir Tom Scholar: I will just refer to two things I said earlier. First of all, this needs to be considered not just in terms of the UK's relationship with the EU.

Wes Streeting: No, but I am speaking solely about our relationship with our biggest trading partner.

Sir Tom Scholar: I do not think that is the correct question for the national interest, because what happens to the economy is determined by lots of things: not just the relationship with the EU, but the relationship with the whole world. Secondly, I cannot predict the outcome of the negotiation, and a deep and special partnership with the EU that preserves many of the benefits that we enjoy there, but gives greater flexibility elsewhere, could be very valuable.

Wes Streeting: I am not sure that I am any more optimistic, but thank you very much.

Q132 **Stephen Hammond:** Could you give your thoughts on our report on Solvency II?

Charles Roxburgh: You made a number of recommendations, most of which fall to the PRA. Mr Woods has given you his response. In a number of respects, he has indicated that the PRA is looking at how it can change some of the aspects and respond to some of the points about the risk margin. You made a couple of points specifically to the Treasury: one on the competition objective, which I thought I would address, and one about whether insurance is or is not a priority in the Brexit negotiations.

On giving the PRA a competition objective as a primary objective, as you know, we have not accepted that recommendation. We did, in the banking reform Bill, add to the PRA's mandate—because it was not in its original mandate—a competition objective as a secondary objective. Ministers concluded that one of the major lessons from the financial crisis for our regulatory structure was that it was really important for the regulators to have clear objectives, and not to have a multiplicity of overlapping objectives.

As you will remember, the then-chair of the FSA, Lord Turner, concluded that one of the weaknesses of that structure had been a multiplicity of objectives and "with regard tos" that they had to meet, and he felt that it would be better, as was the new structure, to have more clear objectives. The PRA has a clear objective around prudential regulation to ensure the safety and soundness of the system and, with insurance, the particular issue around policyholder protection. We think that gives the PRA a very clear objective.

Ministers and Parliament, who made the final decision, decided to give it the secondary objective on competition. Subject to meeting that first objective, it should take actions to facilitate competition. We have also required it to make an annual report about what it has done in the context of that. We think that is the right balance: it has to think about competition, and it has to report on how its approach to regulation has facilitated it, but it is clearly secondary to its primary role, which is to preserve the safety and soundness of the financial system.

In the context of insurance, as you will remember, in the early 2000s—2003 and 2004—the stock market was very weak. Insurance companies can get into financial difficulties if they are not properly regulated, so it is important that we have a PRA focused on safety and soundness. We did not accept that recommendation, but clearly Ministers gave it very substantial thought.

On making insurance a priority in the Brexit negotiations, the Chancellor and the Prime Minister have made clear that this is a really important industry for us; that the new relationship—the deep and special partnership—absolutely has to cover goods and services; and that, within that, financial services is a critically important sector. Yes, the insurance sector is a priority, along with the rest of the financial services industry. It is a very important objective in the new relationship.

Q133 **Stephen Hammond:** I absolutely take the point about the primary and secondary objective. We will look very carefully to make sure that that balance is there, and that it takes that into account, because there is real concern that that may just be pushed to one side entirely, particularly given some of the responses we received last week.

Turning to the insurance industry, there is always tension between a regulator and those they regulate. We all accept that, but there was a wider than usual disconnect between the industry and the PRA on a number of particularly important things that are hugely costly to the industry, which the PRA was not able to give convincing answers for. Do you think that the PRA understands the regulatory cost of the maintenance of unnecessary modelling?

Charles Roxburgh: The PRA is charged with fulfilling its statutory obligations as a regulator. It has to regulate in a way that takes into account a number of factors, and proportionality is one of them. It needs to be a proportionate regulator.

The Chancellor now writes a remit letter to the Prudential Regulatory Committee that sets out the broader context within which it is regulating, in terms of the Government's economic strategy, but also draws to its attention some of the factors that are important to that context. It takes that into account, but it is very important, in a structure of independent regulators, that the regulators exercise their judgment about how to fulfil their statutory obligations. You call them, and you can challenge them, and they are accountable to this Committee.

Stephen Hammond: We did.

Charles Roxburgh: That is your opportunity to challenge them on those judgments. It is very important that neither officials nor Ministers should second-guess their independent regulatory judgments.

Q134 **Stephen Hammond:** Could I just ask one last question, to Sir Tom, maybe? You will have obviously seen the comments from one of your predecessors about hypothecation. I wonder if you could just say whether that might reflect a future strand of thinking inside the Treasury, or whether the Treasury retains its traditional view.

Sir Tom Scholar: I think my predecessor was commenting on the debate on the possibility of some hypothecated tax to fund the NHS. The first thing I should say is that hypothecation has been central to NHS finances since, I think, 1946, in that some portion of national insurance income is used to fund the National Health Service, and that is all set out in legislation. In one sense, it is not a new thought.

Secondly, it is not just the Treasury. Finance ministries and finance professionals around the world tend not to support detailed hypothecation arrangements in the tax system, for the simple reason that it is quite unusual for the amount that you raise from a particular tax to be the right amount that you need to fund a particular service, particularly as things change over time. I think that remains the case.

Thirdly, to refer back to what the Chancellor said yesterday when asked about NHS funding, the Government made £6.3 billion of new money available in the Budget in November. When we get to the next spending review we will be looking at the position again.

Q135 **Chair:** I have just a few final questions. I am very conscious of the fact that we have been sitting here for the better part of two hours, and we have not really asked you about any internal Treasury matters. Before I get to that, I want to ask one question about the National Infrastructure Commission that we did not touch on before. It was originally set up with the intention to be independent in statute, but, instead, it was established as an executive agency of the Treasury. Will you consider that status at the next five-yearly review?

Sir Tom Scholar: Ministers have no intention to review that, because we think it is working very well as an executive agency. It has been set up, as I think you heard from the chief executive and the then-chair, to be impartial. We set it up to make independent recommendations, which enabled it to get set up quickly and effectively. The NIC has been very clear to you that it feels that it is absolutely able to operate independently and make the recommendations that it sees fit.

We have given it a lot of latitude, as you heard, over setting its work programme. Ministers do, and the Chancellor should, set the fiscal remit within which it should operate. It does not do fiscal policy, so he sets the fiscal remit within which it should plan. The Chancellor can also set, as I said, this question for it to look at, but other than that it determines its work programme and can make independent recommendations within its areas of expertise. We think that model works well, and there are no plans at the moment to reconsider it.

Q136 **Chair:** From the evidence, I seem to remember Lord Adonis saying that the independence was because he was a very independently minded person, so we shall watch with interest to see whether Sir John Armitt is as independently minded as I think it has become evident to everyone that Lord Adonis absolutely is.

I want to talk about diversity in appointments, and that NIC appointment moves neatly into this. For the original appointment that led to Lord Adonis, there were 21 male applications and two female applications. For the chair of the FCA—for which Charles Randell, obviously, has been appointed, and we are going to see him shortly—there were 11 male applications and three female applications. You know that we have asked the Chancellor about this issue, about diversity. You have written to us, very kindly, Sir Tom, about the gender pay gap and everything else.

I want to ask a broad wrap-up question, if I might, about how exactly the Treasury is going to move the dial. What is the Treasury doing, both internally within the Treasury—Ms Dean, as a senior woman in the Treasury, might have a view on this—and externally, in terms of appointments? We have heard evidence in this Committee that it is not enough to say that there just are not enough applicants around. There are applicants out there, but they have to be sought. What are you doing in terms of the wording used in advertisements, unconscious bias in interviewing, and people being allowed to take risks in appointments, to appoint somebody different from the people who have gone before?

Sir Tom Scholar: Let me first talk about within the Treasury, and then outside. The Treasury has, over the years, certainly seen women underrepresented at senior levels. I have worked there on and off for 25 years, and over that time, although I have not done the sums, it is probably single figures, in terms of women in very senior positions.

We have made huge efforts to change that in recent years, and they are now really beginning to pay off. We have, I think for the first time ever, an even, 50/50 split of men to women, looking at our group of directors and directors-general. We are not quite there yet in terms of the overall senior Civil Service, but we are up, as I said to you in my letter, from 40% a couple of years ago to 43% last year. The next time we report the figure, it will have risen further.

We are doing this through all the possible routes you might imagine: through recruitment, including external recruitment; through training and development; through talent programmes; and through trying to create a much more inclusive culture within the department. All managers do unconscious bias training, and all senior civil servants last year did a special training on inclusive leadership. I think that really is beginning to make quite an impressive difference. I should say, before I move on, that there are definitely other diversity challenges that we need to overcome. I would highlight in particular ethnicity and disability where, again, we have historically had quite poor representation. On those, we are further behind than we are on gender.

The work that goes into making the department more diverse and more inclusive, and the progress we have made on gender, has much broader impacts on the culture of the department and our ability to recruit and retain people from all different walks of life, with all different characteristics. For the management team, it is probably the single biggest thing in terms of our internal work that we are addressing and focused on. I think we are making decent progress, and we have further to go. We have an ambitious action plan to 2020, but we are on the way.

Externally, we have a direct responsibility for the appointments either that we make or, in the case of the top Bank of England appointments, that are Crown appointments, but where the Chancellor is making the recommendation. We have the FCA, and a number that you are very familiar with. Let us just take the Bank of England. If you look at the top of the Bank of England over the years, again, it has been a very male place. That, I think, partly reflects the make-up of the economics and finance professions, and people who work in markets. If you look at the figures for men and women studying economics at university, for example, it is something like 70/30 still.

We recognise that there is a lot more to do there. I would say, looking at Bank of England appointments—senior executive appointments, the MPC and the FPC—over the last 18 months, we have made six appointments, of which three have been men and three have been women. That is definitely where we need to be. If you look at the committees, there is still a great imbalance, but as we approach these appointments we absolutely require the head-hunters that we use to give us properly balanced, 50/50 longlists. In some cases, we have sent equal numbers of cold-calling, unsolicited emails to prospective candidates—people with the right kind of background—and done that on a completely equal male-female basis.

We are really working hard on appointments, against a backdrop where it is not always easy to find enough women with the right experience. If you look at, for example, the Financial Policy Committee, since people who work on that committee are not able to do any other work in the financial sector, and you want somebody with experience, you are probably looking at somebody with 30 years of experience in the industry, and looking at the people who would have joined the industry 30 years ago. It is an issue that goes beyond just the simple issue of appointments, but we are doing what we can there.

The last thing I will say before I stop, which I think is really important, is about the Women in Finance Charter. We have 162 firms employing over

600,000 people signed up to that. That is more than half of the financial services industry, looking at employment. It is a voluntary scheme. The companies that sign up to it make important commitments around diversity in senior management positions. They have to have a senior board member responsible for it. They have to publish regular updates on progress, and they have to satisfy us and the world that that is taken into account in looking at pay decisions.

We are going to publish an annual report. It reports publicly; it reports to us, and we will bring all that together in an annual report. That is not going to change the industry overnight, but it is a real sign of the energy behind this. Transparency, public pressure and spotlight are the things that, over time, will start to make a big difference.

Q137 **Chair:** The Committee is wholly supportive of the Women in Finance Charter. As you know, we are conducting an inquiry. I hope we will be able to produce some useful recommendations that will be of assistance and help to move things forward and support Ministers' ambitions.

Moving to the Civil Service survey, in the 2017 survey, the Treasury performed significantly above Civil Service benchmarks in all categories except for pay satisfaction. What is the Treasury doing well that others are not? Perhaps you would like to answer that first. Is there something that you have particularly identified that is working well in the Treasury, where others are not yet following the Treasury's lead?

Sir Tom Scholar: We have some natural advantages. It is not a big department: it is 1,200 people or so. It is a department with a pretty clear mission. In my experience, people who work in the Treasury are both very committed to public service and very committed to the mission of the Treasury. That is a natural advantage.

Beyond that, I would say that we have a very talented senior management team. I am not just talking about the top team, but the senior Civil Service, who put a great deal of energy into the issues around inclusive culture that I was talking about earlier, and making it a great place to work. We want people who enjoy working there, because people who are enjoying their work are normally more effective in it.

Q138 **Chair:** The one area where the Treasury did fall behind the benchmarks was in pay. Returning to our conversation about women and diversity, one of the things that came out of an earlier evidence session that we held on the Women in Finance Charter was the issue around bonuses, and particularly women not liking a bonus culture. I think that in your gender pay gap letter to me, as well as setting out the gender pay gap—the mean was 3.4% in the year 2016-17, and the median was 14.6%—there was a large gap between men and women in relation to bonuses. I know that had changed between 2016-17 and 2017-18. What did you do to change that? Can you perhaps talk us through that?

Sir Tom Scholar: First of all, on pay in general, that has consistently been the area in which the Treasury has performed the worst in terms of satisfaction in the staff survey over the years. That is for the obvious reason that people in the Treasury typically have many other opportunities open to them elsewhere, often at much better levels of pay. It is not surprising that some of that comes through in the survey.

It is also, though, an area that we have really worked at. Within the 1% policy—which, of course, we have to follow, just like everybody else—we have worked very hard at the levels where pay is particularly out of sync with what is available elsewhere to try to recycle allowances and target them at those areas. We have actually seen an improvement in our results this year, which is encouraging, not just because of what it means for the results, but because of what it means about satisfaction and people being more likely to stay, because ultimately that is very important.

In terms of bonuses and the 70/30 split for 2016, I was not at the department at the time that that was all agreed. We do this annually; we do an annual assessment of performance of all senior staff, and decisions on pay and bonuses come out of that. When we did this last year, we did two things. First of all, we got the top management team that was making these decisions explicitly trained in inclusive leadership, as I said earlier. We asked the senior psychologist who was helping us on that to attend the meeting where we were making these decisions, explicitly to observe and challenge any examples of unconscious bias. I think that helped us.

We also looked back on the previous year's experience. We were concerned about that. We had it very much in mind that we should be testing our conclusions against the diversity distributions. That is not to say that we tried to fit a template, or retrofitted it. Where it looked like we were getting out of line, we just challenged ourselves and asked ourselves the questions, "Why? Are we treating people fairly here?" Taking all those things together made for a better set of decisions, and a more equal distribution.

Q139 **Chair:** Finally, in terms of resources, we have gone through an awful lot of areas where the Treasury is working very hard and taking on new responsibilities, most obviously in relation to the Brexit negotiations. The 2015 spending review resulted in a 24% planned reduction in HM Treasury's overall resource to 2019-20, which is due to take place in the final two years of the spending review period.

Perhaps you can talk us through whether that is happening, and whether that is possible now, given the Brexit demands. I think you set up a new role of director for EU exit planning, and there is presumably a new team around them. In fact, is some of the £3 billion that Catherine referred to earlier on going to be spent by the Treasury on necessary personnel?

Sir Tom Scholar: Yes, it is a very tight settlement. Obviously, we are not the only department in that position. We, like others, have to live within our means, and it is very tight. We are, each year, living within our means, and we are on course to get to 2019-20 where we need to be. We are, though, one of the departments most affected by Brexit, in terms of the extra work, whether it is the financial settlement, the customs work, financial services or all the analytical work. In a sense, nobody was working on Brexit pre June 2016, but we have had a big increase in the number of people working in the general area of EU and EU financial services.

Q140 **Chair:** Are they new people, or have people had to be taken off other work streams and put on to Brexit?

Sir Tom Scholar: Both. We require other departments to reprioritise; we do the same thing to ourselves. As we go along, we are always looking for people who can be redeployed off one area onto another.

Just to give a few examples of that, people working on EU business as usual are using more of their time to work on Brexit-related issues, and less to work on business as usual. As we make progress through the process of asset sales, which has been a big, big job for the department—we are getting towards the end of that, admittedly with one major exception—and as we are able to take people off that and redeploy them, we are doing that. We had a couple of Bill teams that we no longer needed. The move to a single fiscal event will not just improve policy-making, but free up some people's time to do other things, so we do that as we go along.

We have submitted a rather modest reserve bid, but we have a rather modest budget. We have got some extra resource this year, and that will come through in the spring supplementaries. We will be doing the same next year, because there is a limit to how much reprioritisation we can do, and how much work we can stop on other things. Brexit is a very, very big task for us, and central to our work at the moment.

Chair: Thank you very much indeed. That has been a session that has covered a lot of ground, but we are very grateful to all three of you for your time this afternoon, and thank you for giving us plenty of food for thought.

Sir Tom Scholar: Thank you very much.