

Treasury Committee

Oral evidence: Budget 2018, HC 1606

Thursday 1 November 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Colin Clark; Mr Simon Clarke; Charlie Elphicke; Stephen Hammond; Stewart Hosie; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 80-178

Witnesses

I: Professor Diane Elson, University of Essex, Paul Johnson, Director, Institute for Fiscal Studies, and Rain Newton-Smith, Chief Economist, Confederation of British Industry.

Examination of witnesses

Witnesses: Professor Elson, Paul Johnson and Rain Newton-Smith.

Q80 **Chair:** Thank you very much to our witnesses for being here today for our second session in our post-Budget inquiry. We are very grateful. I know everybody has had a very busy week trying to digest everything that was announced on Monday. I am going to ask you to introduce yourselves. This session is actually being broadcast, so should you suffer from insomnia and watch BBC Parliament into the night, you may find yourselves being broadcast. I am going to ask you to introduce yourselves, and then we have got a whole series of questions on measures announced in the Budget.

Rain Newton-Smith: I am Rain Newton-Smith, and I am chief economist at the CBI.

Paul Johnson: I am Paul Johnson, director of the Institute for Fiscal Studies.

Professor Elson: I am Diane Elson, emeritus professor at the University of Essex, and I work with the Women's Budget Group.

Q81 **Chair:** Thank you very much indeed to you all for being here. I am going to start with the issue of business rates. The IFS's Budget analysis stated that, in the long run, lower business rates help landlords, rather than tenants. Could you expand on that, Paul?

Paul Johnson: Yes, so if you made a permanent change to business rates, you would expect that eventually to be capitalised into the rents that people are paying, because it is the land that is in fixed supply, and therefore, if you change the tax, you would expect the total amount that the tenant pays to remain the same, in the long run. The fact is that this is, at least in principle, a temporary change, brought in quickly, so for the most part the large majority of it will benefit tenants. It is something that, in the short run, will benefit tenants. If it became a permanent change, in the long run—it might be the really quite long run—the effect would be on the rent that they pay as well.

Q82 **Chair:** Would it be like for like? Would you see the shift from rates—

Paul Johnson: You would expect it to be a 100% shift in the long run, but as I say it might be the very long run, and it might be a smaller shift in the shorter run.

Q83 **Chair:** This Committee will return to the issue of business rates separately at some point. I have got a couple of questions, and it would be helpful to get your thoughts on them. If the CBI and Professor Elson have thoughts on this, please respond. Why does the incidence of tax on commercial property fall on the tenant, rather than the landlord? Is that the right way



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to go for a business rates system? Mr Johnson, do you want to start? Then I might ask Ms Newton-Smith.

Paul Johnson: The formal incidence is on the tenant. Our point is that the actual incidence is, in the end, almost certainly on the owner. I guess your question is, should you be trying to charge the owner, rather than the tenant? I think there might be quite a lot to be said for that, because it would make much more transparent where the effect eventually is. What I don't know is how much more difficult it might be to identify. It is easy to identify who is occupying something. It ought to be possible, you would think, to identify who owns it.

In terms of pure transparency, there will be a case for thinking quite hard about whether you could change the formal incidence to the person on whom you imagine the final incidence actually sits. What it would not allow you to do would be what the short-term change has done, which is to provide an immediate boost to the tenants by giving a short-term change, because, as I said, the incidence of that will be on the tenant. Whereas, if you were to do that and the incidence was directly on the landlord, you would not be able to support in the short run through that, but I think that would be a small price to pay.

Q84 **Chair:** Ms Newton-Smith, what is the CBI's view on the changes announced and the longer-term issues?

Rain Newton-Smith: Look, I think the measures for supporting smaller businesses and the high street more generally were very welcome. We were disappointed that there was no more fundamental reform of the system, and, importantly, that it did not do anything for large employers.

One of the things that businesses certainly talk to us a lot about is how business rates are a real barrier to investment. That is true for retailers, manufacturing and logistics. One of the points that I would make is that business rates are on much more than retail premises.

One of the challenges, of course, is that retail and hospitality are huge employers; one in four private sector jobs depends on them. If you focus only on some of the smaller premises, you are excluding some of the very big employment opportunities. We would have wanted to see more action. There are certainly things that can be done quite easily in terms of having annual revaluations.

Another area we were keen for the Chancellor to look at was around downward transition. One of the challenges with downward transition is that it means, particularly in areas where commercial property prices have fallen, where you are likely to have seen slower regional growth, businesses across a range of sectors are having to wait for quite a while until they have relief from those lower valuations. We felt that that was one area where the Chancellor could have taken more action.

We also have a longer paper that does some analysis around business rates and gives some specific examples of types of business that have been affected. We would be very happy to share that with the Committee.

Q85 **Chair:** Thank you. That would be terrific. The IFS has also proposed replacing business rates with a land value tax. What is the thinking behind that? Does the CBI have a view on that?

Paul Johnson: The thinking behind it is essentially that business rates, as they are, disincentivise improving or building business property, because they are a tax on the value of the property. In central London, most of that value is in the land. In many other parts of the country, most of the value would be in the building. That therefore creates a clear disincentive on improving the building. A more neutral tax would be one that was taxing the land.

You might also want to extend business rates. There are significant groups of businesses that are wholly exempt, in particular farm land and farm buildings, which are fully exempt from that. You could, if you wanted, extend the land value tax to cover that as well and treat them more neutrally.

The question is, how difficult would it be to value the land separately from the buildings? That is done in a number of other cities and countries around the world, so it is certainly not impossible, but clearly there would be a significant transition to go through. In an ideal system, you would have something that was taxing the value of the land.

Q86 **Chair:** Does the CBI have a view on taxing land as opposed to taxing buildings?

Rain Newton-Smith: I do not think we would have a particular view. The work of the IFS sets out very helpfully where the ultimate incidence of the tax would fall. What we can say is that, when you look at international comparisons, we have the highest proportion of property taxation—over 3.1% of GDP—of the G7. If you look at the business rates multiplier at 50%, and we have to remember that business rates come out of businesses' operating expenses before they have even made a profit, you can see that the system we have at the moment is broken and does not work.

Picking up on what Paul was saying, there are certainly elements that you could look at in terms of what is included within business rates. One of the challenges that businesses talk to us about is that if they have a factory, and they make it more energy efficient, they will ultimately just increase the rateable value of that property and therefore their business rates bills, so they are disincentivised from making energy investments.

Q87 **Chair:** Professor Elson, do you have anything in particular that you would like to add to that?

Professor Elson: In the longer term—the interaction between the system for business rates and local government funding. One of the big problems still is that austerity isn't over for local government. If the plan for the future is to have local government funded by business taxes, there are clearly some tensions there. Maybe the land tax is worth exploring more in that context.

Chair: Thank you. It won't surprise you to know that we will come back to ask questions about austerity at some point.

- Q88 **Rushanara Ali:** My questions are focused on the gender dimension to the Budget and the Government's equality analysis. Professor Elson, you have written and contributed to these debates around gender budgeting. What does it entail, and how could the Government provide a more detailed analysis of how their tax measures affect men and women and of the consequence of specific measures?

Professor Elson: This is something that has been adopted by a number of Governments around the world, although they do it differently according to the particular circumstances of the countries and the gender equality questions that they want to address. In general, it entails looking at the gender impact of spending and taxation—both individual measures and the cumulative impact—in considering whether the Budget will decrease, leave the same or increase different dimensions of gender inequality, such as the wage gap, the incomes gap, the employment gap, the pensions gap and the unpaid care-giving gap.

What this doesn't mean is taking table 2.1 in the Red Book, which lists all the spending measures and tax measures, and then trying to divide up the spend or the tax for all these measures into what goes to women and what goes to men. That is a sensible thing to do only for certain items, like income tax, but it would not be the approach that many would adopt. There are many other ways of doing gender analysis of the Budget, which the Treasury could adopt. We are disappointed that the Treasury has still not produced a comprehensive equalities impact analysis of the Budget, although it has produced an annexe that looks at the impact on households by decile. We feel that that's not really fulfilling the public sector equality duty in the way it should be fulfilled.

- Q89 **Rushanara Ali:** On the measures in the current Budget, can each of you say something about which measures benefit men versus women? Where are the areas where women particularly benefit, and where are they losing out?

Professor Elson: Women will particularly benefit—men will benefit, too—from increased funding for the national health service, because women, more than men, use the health service. They staff the health service, and they are also the ones who pick up the pieces in the family and community when there is a lack of healthcare provision. Men will definitely benefit more than women from the income tax giveaway. I was able to do some calculations using data from the House of Commons Library that was shared with me by Yvette Cooper's office, which show that 63% of the gains from the change to the raising of the threshold in income tax go to men, and 37% to women, in the period 2017-18 to 2021-22. That is not really surprising, because we know that men have higher incomes than women, and a lot of women are already below the tax threshold and won't benefit at all.

- Q90 **Rushanara Ali:** That is an obvious thing that the Chancellor would have



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known. Does that suggest a lack of commitment to gender equality? It's a straightforward analysis, isn't it?

Professor Elson: It is a kind of analysis that could easily be done. Maybe the Treasury has done it, because sometimes they say, "We did this somewhere on the back of an envelope, but we didn't publish it." What they did publish, in a rather obscure, long document that contains an impact analysis of all tax measures, is a statement that 30.6 million people will benefit, 58% of them men and 42% of them women. So, they have done a little bit of analysis, but they didn't publicise that and it didn't make them rethink the measure. They didn't build upon it to go into more detail about how much of the giveaway goes to men and how much to women.

The other question is, "What could have been done with that money instead?" That is always a question when we are looking at the Budget from a gender equality point of view: what could have been done with that money instead, in terms of investment in public services, for instance, or unfreezing welfare benefits? The same goes for fuel duty and the alcohol duties that have been frozen. That question of, "What could have been done with the money instead?" is always an important one to ask.

- Q91 **Rushanara Ali:** The freezing of the beer duty is supposed to benefit men significantly more, because they are consumers of beer rather than wine. The Chancellor is obviously keen to make sure that men have a beer or two without spending as much as women do drinking wine.

Professor Elson: What the Treasury said was, "Due to differences in alcohol consumption, any changes to alcohol duties will have an equalities impact that reflects consumption trends across the adult population." I think that is a bit of a B-minus answer.

- Q92 **Rushanara Ali:** Mr Johnson, did you want to say a bit about the benefits? Where are the benefits for women versus men in the distribution by gender?

Paul Johnson: I agree with everything Professor Elson said, in terms of where the benefits are likely to lie. I might add a couple of things. One is that how you see this obviously depends on your view of how income is shared within a household. If you have a household where the man is earning and the woman is not, for example, the benefit looks like it goes to the man. It might do, but it might be shared between the two, so one needs to take a view about how the sharing occurs.

Another change in the Budget was the increase in the work allowances for universal credit, and that will go partly to lone parents, who are largely women. That is clearly going to benefit them, but it will also particularly benefit single-earner couples, where it is often the man who is in work. Again, the family as a whole ought to benefit, but the individual benefiting will be the man.

The third thing it might be worth saying is that possibly the biggest gender equality impact of Budgets over the past two or three years has been the



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very big increases in the national living wage, which were referred to in this Budget. Those have gone overwhelmingly to women, and that has a very big and substantive effect.

- Q93 **Rushanara Ali:** But overall, on balance, looking across the Budget, who does better? Is it men or women, and by how much?

Paul Johnson: I don't have a number for that. If you are just looking at the tax and benefit changes, it is probably men, on the grounds that they tend to be higher earners and they are benefiting from the tax changes. However, as Professor Elson said, the public service change—£20 billion-plus going to the NHS—will, one way or another, probably go more towards women. I would not want to balance those off.

- Q94 **Rushanara Ali:** Dr Newton-Smith, did you want to add anything to those points?

Rain Newton-Smith: I agree with both what Professor Diane Elson has said and what Paul has said. I would highlight a couple of areas. Coming back to this issue about creating jobs, particularly in the retail sector, a lot of women are employed in that sector, so we have to look at where jobs are being created. It is also important to think about the regional implications, because you need to make sure that jobs are being created across all regions within England. Some helpful elements were announced in the Budget, such as the high street funding: the idea is that local authorities can bid for some capital investment to regenerate high streets where that can create more jobs in areas where growth has been weaker. That should provide more opportunities for women as well.

There is probably a more important topic around skills and retraining over the long term, and it was welcome to see in the Budget more flexibility about how the apprenticeship levy is used. One of the challenges is that high-quality apprenticeships, certainly, have not always appealed to women. If encouraging retraining is one of the main Government policies, there is a big challenge in making moving into high-quality apprenticeships something that appeals to women. I think having more flexibility in how apprenticeships are used is really important in that regard. One of the big challenges for the comprehensive spending review next year is to think very much about the training provided for post-16 education and to make sure that that has high-quality routes for women into a range of occupations.

- Q95 **Rushanara Ali:** I just have one broader question: if you were Chancellor and each of you had to develop a Budget that had gender equality and improving the life chances of children and lifting them out of poverty at its heart—that was its objective—what would that Budget look like? This is your opportunity to try being Chancellor.

Professor Elson: I think it would not have had these tax giveaways in it, and it would have tried to make a start on investing in the social infrastructure that we need in pre-school childcare services and in the education system. In health, it has made a start but there is still a long way to go, and in the social care system it really has not made a start at



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all. I would have thought that to address issues like child poverty, investing in the future capacities of our people, making sure that people have a dignified end to their lives, and having a better balance between men and women in respect of who has the capacity to earn good income with a good job and who has to do all the unpaid care work, more investment in the social infrastructure should have been the No. 1 priority.

Paul Johnson: There are two parts to your question; one is about supporting women and the other about supporting social mobility. We know that the point at which the gender pay gap really opens up is the point after childbirth. Part-time work is a terrible outcome in the labour market for men and women, but women make up most of those working part time. We should focus on anything that improves retraining and the equal pay legislation that supports women working part time and increases their opportunities, which might mean investing in childcare. One of the things that drives this is that women working part time after childbirth tend to travel incredibly short distances to work for obvious reasons—they tend to be the ones responsible for the childcare. That is an important part of the gender pay gap and I think we should focus on that.

The second part reflects what Rain was saying about priorities for encouraging mobility and post-16 education for those who are not doing so well in the formal or academic education system. That will probably help boys more than girls, because girls do far better at school and are far more likely to get to university than boys, so that would not necessarily help on the gender front, but it is probably the most important thing we can do to support improvement.

- Q96 **Rushanara Ali:** What would have been left out of the Budget by Chancellor Johnson? What would you have done or not done if you were focused on improving the gender balance? Would you have had a freeze on beer duty, which is supposed to cost about £7 billion or something like that?

Paul Johnson: The freeze on beer duty is really not terribly expensive.

Rushanara Ali: It is a lot of money.

Paul Johnson: I think I would have done all of the things that I have said—

- Q97 **Rushanara Ali:** What would you not have done?

Paul Johnson: In terms of not doing, you could have put a little bit less into the NHS and done a little bit less on increasing the tax allowances. There were really only two significant giveaways in the Budget: one was well in excess of £20 billion for the NHS, and the other was £1 billion for increasing tax allowances. They were essentially the only measurable giveaways to take money from.

Rain Newton-Smith: There is probably not much to add. I think there is certainly something in focusing on education both at pre-school and at primary level if we are interested in increasing social mobility. I would also



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highlight the pressure on working parents; in the UK we have among the highest childcare costs in Europe. Making it easier for parents to take shared paternity and maternity leave, as well as shared parental leave, will help to support that, but I think childcare costs should be supported.

There is another bucket, which has already been mentioned, in respect of adult retraining and providing more routes for people as they re-enter the workforce. There is an onus on the Chancellor, but there is also an important onus on business, to make it easier for working parents and to provide more flexibility for people in terms of working hours. It is also important to provide better routes for progression for women in particular in the workforce.

Chair: Fascinating, thank you very much.

Q98 **Stewart Hosie:** Paul, which income deciles have been the winners and which have been the losers from this Budget?

Paul Johnson: There are three groups of winners. The first is those who benefited from the universal credit increase and the work allowances—they will be in the bottom third of the distribution. The significant winners from the increases in the tax allowances will be in the top half of distribution. In terms of proportion, I do not have the chart in front of me that we published, but I do not think it is a huge difference across the deciles.

Q99 **Stewart Hosie:** You are saying it is not a huge difference in terms of proportion; I want to delve into that a little more, even though you do not have the tables with you. The higher income deciles have benefited more in cash terms. Is your argument that in terms of proportion of income, it is broadly similar across the piece, or have some deciles benefited more in proportion of income terms than others?

Paul Johnson: The first important thing about this Budget is there is not much in there. There is £1 billion or so on tax allowances; there is £1.5 billion on universal credit and there is knocking on for £1 billion on reductions in duties. The universal credit changes give about £600 a year to about 2.5 million families. The tax changes give an average of something like £40 a year to 30 million people. You can see that there is a small group of concentrated winners from the universal credit changes, and a large group of relatively small gainers from the income tax changes.

Q100 **Stewart Hosie:** Are those policies you outlined—tax and universal credit and the chunk of duty changes—the ones that pretty much have had all the impact on household incomes?

Paul Johnson: In terms of what is in this Budget, which is a pretty small Budget in that sense, those are the key ones, yes.

Q101 **Stewart Hosie:** The IFS's long-run distribution analysis looks different to the Government's long-run analysis. What is the difference between your distribution analysis and the Government's?



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Paul Johnson: We have looked at the impact of changes announced since 2015, but I think the Government started in 2016. Therefore, they miss the big changes to the benefits systems. There was a set of benefit cuts announced in 2015 that in current-day terms were about £15 billion. Most of those are missing from the Government's analysis. Clearly, because those are cuts to the generosity of the welfare system, they have a big effect on people on lower incomes.

Q102 **Stewart Hosie:** Please correct me if I am wrong: as I understand it, for the poorest decile that would amount to something in the order of 10% of household income—that is a negative—and that is effectively missing from the Government's distribution analysis.

Paul Johnson: Yes; it is worth saying that within that 10% there is a surprisingly large chunk that comes from the way in which universal credit affects the self-employed. There is a little uncertainty about 2% or 2.5% of that 10%. But yes, it is a big cut for the lowest decile. If you take £15 billion out of the means-tested benefits system, that will take a lot of money from the poorest households.

Q103 **Stewart Hosie:** I appreciate that. Professor Elson—both of you, in fact—I am sorry to focus on the IFS and the comparison with their numbers, but what would you ask the Government to do to improve its distributional analysis so that there was far more clarity—one might say honesty—in terms of who was and was not impacted by changes in a given Budget?

Professor Elson: The kind of analysis that is in this report about intersecting inequalities, which tries to do just that by looking at the cumulative impact of all the measures that have been introduced since 2010 on different kinds of households and different groups of people. It looks not only at gender but also race, ethnicity and social class as measured by—

Chair: Disability?

Professor Elson: We've got one just out on disability. This one did not have disability in it, but we have got one just out on disability.

It is easier to do it for taxes and benefits because you can attribute them to individuals. Paul mentioned households to some extent sharing, and they do, but we can't assume they all share equally. We know that the amount of money that the person brings into the household, whether it is from benefits, earnings or a pension, influences bargaining and spending decisions within the household.

It is more difficult when you bring in the impact of cuts or expansions of spending on the public services because we don't have data that allows us to measure the uptake of those services on an individual basis, but we can do it for different types of households. For instance, we can look at single mother households compared with other kinds of household. I am afraid that the overwhelming evidence suggests that there has been a much harsher impact on single mother households from the measures from 2010 onwards than on other groups. This Budget will not reverse all of that.



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The Resolution Foundation has done some analysis on the impact on different groups and finds that the single parent is still hardest hit and the Budget will not make good all the losses that have been suffered. The changes in universal credit are important and will help single parents, but they will not cancel out all of the losses that have been suffered so far. The benefit freeze still continues, so there are still a lot of cuts to come.

Q104 Stewart Hosie: Professor, on the substantive point about an inability to measure certain things, does that mean we shouldn't pay too much attention to the Government's analysis because it does include benefits in kind changes, or is that a useful addition to the distributional analysis?

Professor Elson: I think it is a useful addition, although it is also useful to do them separately: do the tax and benefit one and then do the public services one. It is very useful to do the two things. We may pay for public services by having higher taxes, so we need to bring the two things into the equation. We can't do exactly the same kind of analysis from the point of view of different individuals for the public services as you can for tax and benefit, but you can do useful analysis, and it is good that the Government has started to do that analysis. There is always an issue in these kinds of analyses. You always have to make lots of assumptions, but on the issues about what starting date you use, as Paul has pointed out, there is always a temptation for any Government to choose a starting date—

Chair: That is more favourable.

Professor Elson: That will show its measures in the most favourable light, yes, so the period that is being covered by the analysis is always a thing to look at. But it is useful analysis.

Q105 Stewart Hosie: Ms Newton-Smith, in terms of how you would want the distributional analysis to be changed, is there anything the Government or others could do that would make it more useful, more readable and more real to those of us who have to look at this stuff?

Rain Newton-Smith: I think I would just point to the work that Diane Elson and her colleagues are doing. There is a lot to be learned from some of the analysis they have done, and the more we see proper distributional analysis done by the Treasury and the OBR, I think that is really important. To my mind, there are different ways you want to look at it. One is looking at the regional impact. One is looking at gender, but also other groups in society—so disability and ethnic diversity as well. I think the more we have some of that information in the public domain, it helps to improve the overall public debate.

Q106 Stewart Hosie: Do you think we are too fixated on the big picture analysis, rather than a more granular look at who is really affected—rather than a broad-brush approach?

Rain Newton-Smith: I think sometimes in the immediate response we can focus a bit too much on the macro picture. Again, I would just reiterate that ultimately what improves our standard of living over the



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long term is increasing our productivity growth. Often we focus only on the macro-productivity growth, but actually our standard of living is determined at a very local level. We did a big report two years ago looking at regional growth, and to do that you really need to improve outcomes for education, better regional connections from infrastructure, and better innovation at a local level. That is how you really help to improve standard of living around the regions in the UK. We know that in the UK we have among the highest levels of regional inequality in Europe, so that in some sense is the UK's big productivity challenge.

Paul Johnson: Can I add two things about the context of these distributional effects? One is that you need to think about the distributional effects in the context of all the other effects that those policies are going to have. You can look at the distributional effect of universal credit. As we pointed out, actually it creates a large number of very big winners and a large number of very big losers. It is really important to look at why it is doing that, what the impact is on work incentives and what the long-run impact on living standards is likely to be. One thing is to think about the purpose of these changes beyond just changing who has got what money.

The second thing is, again, to look at the long-run changes. So think of the two tax changes in this Budget. An increase in the personal allowance was just adding to the same thing that has happened Budget after Budget for the last eight years, so essentially the same people were winning, but the increase in the higher rate threshold was actually slightly undoing very big reductions in the higher rate threshold over the last eight years. In the end, if we put all of that together, higher rate taxpayers have lost quite a lot and basic rate taxpayers have gained quite a lot. Looking at these things in a longer-term context, as well as just what was in this particular Budget, really matters for understanding what the impacts are.

Professor Elson: I would agree with that. The distribution analysis is really important, in that it gives you a snapshot at that moment in time. The behavioural incentives and disincentives and what is going to happen over time really matter—so things like what is the work allowance, what is the taper rate in universal credit, and what does that do for incentives and disincentives for secondary earners in families, who are mainly women, really matter, as well as the snapshot. We need both.

Q107 **Colin Clark:** I want to take us on to housing, and specifically regional Help to Buy caps. The Government's stated aim is "Building more homes in the right places is critical to unlocking productivity growth and making houses more affordable." So with that in mind, the Budget announced a series of regional price caps on which properties would be eligible for Help to Buy in the future, set at 1.5 times the average price of a first-time-buyer home. Do you think regional price caps make sense?

Paul Johnson: Probably. To have a £600,000 cap for first-time buyers in the north-west, for example—clearly only the very highest-income first-time buyers are going to be making use of that full cap, so if the purpose of this is to support first-time buyers into the market it is not obvious why



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you would have such a big cap in some parts of the country, whereas in London, which is the only region where the £600,000 cap is being maintained, that, astonishingly, is much closer to a normal level for a first-time buyer. So I think there is reason for thinking that it makes sense to have different levels, because the costs are so different in different parts of the country, just as we have, in the benefits system, very different allowances—

Q108 Colin Clark: I suppose the worry is that it entrenches the regional house price differences?

Paul Johnson: It could do, but this is explicitly only supposed to go for two years, and given everything else that is going on in the country, my guess is it will have an extremely limited effect on entrenchment.

Rain Newton-Smith: I would just add a few points. One of the biggest challenges with Help to Buy more generally is that in some sense you are treating the symptom and not the cause of the issue. We know that fundamentally we need to build more high-quality homes throughout the UK, not just for ownership, but for rent. That is one of the challenges I would have with Help to Buy more generally. The challenge with having regional caps is that it could mean it might entrench some of the market values in different regions. Of course, one of the biggest challenges is what happens in the border between those regions. I live in rural Oxfordshire; often that falls in the border between the south-east and the west midlands, and there is some big variation in the regional price cap in there. You can imagine, if you have a home on one side of the border, that is the challenge. To Paul's point, I think you can see what having a regional price cap is aiming at, but you always end up with that sort of cliff-edge challenge.

Q109 Colin Clark: The example we have is the east of England region with a cap of £407,000 and the east midlands with £261,000. As we said, does it risk entrenching the differences? Does it cause a cliff-edge effect? As you said, it is about supply rather than simply stimulating demand.

Rain Newton-Smith: Exactly. Fundamentally, you want to be focusing on supply and routes to building more homes across regions. There were some helpful measures on that in the Budget. Lifting the borrowing cap for housing associations was quite an important measure, and making it easier to convert shops into homes was also useful, but fundamentally we need to be focusing all our efforts on building 300,000 homes a year.

Professor Elson: Building more social housing is particularly important from the point of view of low-income women, who are disproportionately among the tenants of social housing, and of the unmet need for social housing. In terms of where the money gets spent, it is more important to spend it in supporting building more social housing than in helping to buy.

Q110 Colin Clark: I suppose the question is also whether, by being less generous in certain regions, we are being unfair to certain regions with this disparity. Or is this just a technical issue, trying to balance up the difference in house prices in different parts of the country?



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Paul Johnson: My take on this would be twofold. First, why provide a first-time buyer with a subsidy on a property that is three times the average cost in the region? Secondly, to the extent that this has an impact on where people are building, there is a reason why house prices are high in London and the south-east and so on; that is where the demand is. To the extent that it is shaping house builders' incentives to build in those areas, that is probably a good thing rather than the reverse.

Q111 **Colin Clark:** To bring this on to the other aspect of housing in the Budget, stamp duty land tax for shared ownership properties, the policy was applied retrospectively to properties since 22 November 2017. Why do you think the Government applied that policy retrospectively?

Paul Johnson: I don't know, but my guess is it was because they just felt they had made a mistake in the first place. As I understand it, you had a choice about when you paid stamp duty on these shared ownership properties. You could pay it all up front, in which case you got the relief, or you could pay bits as you go along, in which case you did not. They are doing this such that you get the relief if you are just paying a little bit to start with.

Q112 **Colin Clark:** So it is probably a correction rather than a policy change?

Paul Johnson: My guess is that it is a correction, and one where they wanted not to disadvantage those who had made a particular choice. The numbers of people affected are tiny and the amount of money is tiny.

Q113 **Colin Clark:** I suppose at the Dispatch Box you do not really want to declare, "This is a correction."

Paul Johnson: That would be my guess.

Q114 **Colin Clark:** How many others are just corrections? Does it make sense to give money retrospectively to householders? From what you are saying, Mr Johnson, it affects very few people and it is a correction rather than—

Paul Johnson: That is my understanding of it. It is a fairly complex bit of the tax system, but my guess is that if you had asked the Chancellor, he would say that this was to make up for an unintended inequity in what happened before.

Q115 **Colin Clark:** Yes, he probably would say that. Does anybody else want to comment on that? Is it just a correction? How common is it for the Government to voluntarily make retrospective payments to specific groups of people when they are not legally obliged to do so? Do they do these corrections often?

Paul Johnson: I cannot immediately bring any other example to mind, I have to say.

Q116 **Colin Clark:** We must all have a lot of constituents who wish they would, because we get endless letters from people saying, "Something is terribly unfair". So we can use this as an example to show that Chancellor can sometimes have largesse.

Paul Johnson: It is a very small bit of largesse. *[Laughter.]*

Chair: Well, that was there for retrospectivity and IR35. Alison.

Q117 **Alison McGovern:** Some of you have mentioned the cuts to come with respect to the welfare state. Would somebody just comment on what that means? Obviously, this Budget really puts money into the health service; if it does anything, it really does that, apart from the tax cuts. So what should we expect in the next Budget that we should be aware of, which is coming down the road?

Paul Johnson: With the cuts in the welfare system, there are essentially three significant cuts coming through. One is the fourth year of the freeze to benefits. Then, the other two big ones are the abolition of third and subsequent children's support within the welfare system, and a reduction in the family allowance. All welfare recipients with children will be worse off as a result of that, and because these are being introduced in a transitional sense, it will take a few years before they are fully effective.

As I said earlier, the key thing in universal credit to understand is that on average it will be about as generous as the system that it is replacing. It is quite difficult to judge whether it will be a little bit more generous or a little bit less, but in a sense that is not the big issue. The big issue is that there will be some very big winners and some very big losers in the long run from that. So, one of the things to look out for is whether any of that changes.

Q118 **Alison McGovern:** On that, just for the record, the winners are?

Paul Johnson: The winners are largely low-income renters, because it is somewhat more generous to that group, and single-earner families with children. But again you find that these are averages; you find winners in all demographic groups.

The big losers are: lone parents, as Professor Elson has said; self-employed people reporting very low levels of earnings in principle get very big losses from this; people out of work who have got some assets, because the asset test is much harder; and on average homeowners who are claiming benefit. But again, within every one of those groups you will find some winners and some losers.

Q119 **Alison McGovern:** Particularly on that, I think it has come up already—it certainly did in the comments after the Budget—that the childless non-disabled see very little gains.

Paul Johnson: It is an interesting formulation of words here. Everyone who had a work allowance had their work allowance increased, but those who had a work allowance of zero were deemed not to have a work allowance, and so that was not increased. It remained at zero and it is essentially the childless non-disabled who have a zero work allowance. In other words, they lose their benefit as soon as they start work.

Q120 **Alison McGovern:** Essentially somebody who does not have kids and is in a low-paid job.



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Paul Johnson: They lose their benefit from pound one, whereas other groups do not lose their benefit until they have earned—generally—something like £500 a month.

Q121 **Alison McGovern:** The idea behind universal credit was that it would deal with that precise problem of people losing their benefit from pound one. Are we saying that there are a significant number of people for whom that is not true?

Paul Johnson: The benefit system has never been terribly generous to those who are childless. They have generally had either a zero amount or a very, very small amount that they can earn before they start losing benefits.

What one tends to see is that this is also a group for whom work incentives are not such a big issue. It is much more with people with children and people with disabilities where you see the significant work incentive issues.

Q122 **Alison McGovern:** Because they are in receipt of greater levels of income support?

Paul Johnson: They have got more benefit and more costs associated with work.

Q123 **Alison McGovern:** And more challenges, as Catherine just said.

Professor Elson: Just to add to that, people who are on universal credit and who would have benefited from the rise in the threshold for income tax will have a large chunk of that clawed back. They will not benefit to the same extent as somebody with the same income who is not on universal credit and will not get it clawed back. They will lose something like 63% of the gain they would get from the rise in the threshold because it will be clawed back through the universal credit system.

Q124 **Alison McGovern:** The proposition that is made is that the rise in the threshold will significantly benefit low earners, but this is yet another reason why that is something of a poor description of the situation.

Professor Elson: Yes.

Q125 **Chair:** Just on that, you made the point earlier, Professor Elson, that a lot of people on low incomes are below the income threshold anyway, so when you raise it, it doesn't really make a difference

Professor Elson: Yes. For those, it doesn't make any difference.

Q126 **Chair:** And are many of those people also in receipt of universal credit or other benefits as well, or do we not know those numbers?

Professor Elson: I don't have the numbers to hand, but I would think that it is likely. It will be a lot of people working part time, for instance, including self-employed people working part time.

Alison McGovern: Professor Elson, if, on reflection, you have any further information about the breakdown of that group that you want to share

with us, we would be happy to receive it.

Chair: Absolutely.

Q127 Alison McGovern: Paul, the benefits freeze is the one that nobody sees, because it happens slowly as each Budget comes forward. Because the cash numbers are kept constant, it is not obvious. Just talk us through the magnitude of the impact of that. How will it be represented? Will it be represented in inequality levels in 10 years' time? How will we actually see the impact of the benefits freeze?

Paul Johnson: The impact is quite substantial. The relevant inflation rate this year was 2.4%. Therefore, in April, benefits for the large majority of working-age people on benefits will be 2.4% lower than they otherwise would have been, had this freeze not been in place. I can't remember the cumulative effect, but I think it is something like 7% or 8% over this four-year period. Benefits will be that much lower than they otherwise would have been. Clearly, they have not been rising as fast as earnings or prices over this period.

It is worth saying for context that, in the period up to 2015, earnings were increasing very slowly. There were some benefits, at least, that were rising a bit faster than earnings. Nevertheless, the long-run impact of that will clearly be, as you suggest, that those on benefits will fall further behind those who are in work. It is a substantial reduction in the generosity of the benefit system.

Q128 Alison McGovern: Stewart covered distributional analysis, and we have covered gender. Is there anything else in relation to universal credit that anyone wants to mention?

Paul Johnson: Can I just remind the world—I'm sure you know this—that this is £60 billion affecting a third of working-age families? This is a huge deal. It is not just a small number of very poor people; a third of working-age households will be affected by this.

Alison McGovern: My constituency office staff will definitely be cheering to hear you say that, Paul.

Professor Elson: Can I add a couple more points about the issues with the design of universal credit? The opportunity was not taken to address them. The first is the payment once a month to one account. There is a lot of concern about the position in which that leaves women in abusive relationships. Before universal credit, they would at least have child benefit or some other benefit coming into their hands. Universal credit will be one payment once a month to one account, leaving women in a very vulnerable position. I understand that, in Scotland, where the Scottish Government have some powers over the roll-out of universal credit, they are going to change this and divide the payment up between the different members of the household. It is a great pity that the opportunity was not taken to think about that here.



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The other issue is that universal credit is really designed with the labour market that we had before the financial crisis in mind—the notion that when you are in work, you have a steady job and you get a monthly wage. That is not the world that most of the people on universal credit are going to be living in. There is a huge fluctuation in monthly earnings, both from self-employment and employment. This is a very complicated system, whereby you have to keep re-filling in this long online questionnaire to claim your benefits. It is ripe for all kinds of mistakes to take place—people being told that they were overpaid and they have got to pay it back, with the associated debt problems that that entails. There is more to do on rethinking the design of universal credit.

Q129 Alison McGovern: One final question. In the Red Book, the changes to the personal allowance and the higher rate will cost nearly £2.8 billion next year. Obviously, one option, if you wanted to seek to resolve some of these issues with universal credit, would be to put an equivalent sum towards universal credit, but that would have complexities. Will you comment on whether we would be better advocating that as an alternative use for that money or whether it would be better to look at some of the universal elements of the welfare state, such as child benefit, which could have quite a positive income effect for people quite far up the income distribution but would actually be targeted at children? Would you comment on that, professor?

Professor Elson: I certainly think it is important to restore the real value of child benefit, which has been eroded by successive freezes or not uprating fully in line with income. It should be made universal again. You can claw it back from well-off women through the income tax system. What this recognises is that, for us as a society, having children and raising children is costly and does not just benefit the people who do it—it has spillover effects for all the rest of us. Therefore, there should be some support from the community—

Chair: Society.

Professor Elson: And from society as a whole—towards the costs of raising these children. That is important. The other thing is that for some women, that is the only money of their own that they get. Particularly in the context of abusive relationships and the ability to leave them, that can be very important.

Chair: My mother would agree with you on that very much.

Q130 Stephen Hammond: Good morning. Thank you for coming to give evidence. Mr Johnson, in two of your star TV performances after the Budget I heard you say—

Chair: Only two? There were lots more!

Stephen Hammond: Well I only had the chance to watch two—I am sure there were lots more.

Paul Johnson: That's two more than I saw.



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Stephen Hammond: You made some comment like, “When it comes to shove, it’s not tax rises or the NHS that Mr Hammond is willing to gamble on—it’s public finances.” I think you also said that any idea that there is a serious desire to eliminate the deficit by the mid-2020s is surely for the birds. I take it from that that you believe borrowing is the only key component taking the strain. Am I right to conclude that? Secondly, what is your view on this change in terms of the credibility of the fiscal rules?

Paul Johnson: Essentially, the story of the Budget was, at the very highest level, extremely simple: the OBR said there will be something like £18 billion more money knocking around in five years’ time and the Chancellor said, “Well I’ll take all of that and spend it on the NHS.” That was essentially what happened. Two or three years ago, when the OBR was downgrading its borrowing forecast, the Chancellor did not say, “Oh, I’d better cut spending or increase taxes to offset it”—he just accepted that. In a sense, there is an upward ratchet if you continue to behave in that way. Given all the circumstances, I am not saying that is a bad thing to do, because it would have been quite difficult not to have provided the money for the NHS and, for obvious political reasons, quite difficult to get big tax rises through. The political economy of this is that, given the lack of a majority in the House, borrowing will take the strain.

What happens next? If the OBR gives him some more good news, then in a sense all is well and he can decide either to reinstitute his fiscal aim to get to budget balance or to spend more of that money on other things. But there has to be a one in three chance that the borrowing forecasts go the other way, and then I don’t think he is going to un-announce the end of austerity and I don’t think he is going to find £10 billion of tax increases, so I think that will just mean borrowing being somewhat higher. We can afford more borrowing in the short run, but at some point you do have to deal with it.

Q131 **Stephen Hammond:** I take it that the credibility of the fiscal rules has not been completely undermined, but have been put on hold for a while?

Paul Johnson: We have seen that—I cannot remember—something like eight of the last nine fiscal rules under both Governments have been jumped rather than met.

Q132 **Stephen Hammond:** We all remember Gordon Brown’s elongation of the cycle, to suit whatever particular happened at the time. Can I also ask—

Chair: Professor Elson is going to come in.

Professor Elson: Yes, I thought this was one of the positive things about the Budget. It gets rid of the idea that it is imperative to have a budget balanced in two or three years’ time. That was never a real economic imperative. It was a chosen goal, which just meant that we could not make investment in our public services.

Chair: I am not sure the Chancellor has really got rid of this. We will ask him on Monday where it is.

Stephen Hammond: He has chosen to postpone that goal, maybe.

Professor Elson: Indefinitely.

Stephen Hammond: It comes to my second question. Mr Johnson said in his answer to me that there is a one in three chance that the OBR's numbers will be wrong. Two things occur to me. We asked the OBR about one yesterday, because there has been some systematic pessimism in their forecasts, so I suppose the numbers could be wrong either way. More importantly, they are suggesting—in fact, they say it explicitly—that they now believe the increase in tax take is structural.

Paul Johnson: Yes.

Q133 **Stephen Hammond:** What do you think is the evidence for that and do you agree with that?

Rain Newton-Smith: Obviously the OBR has published a paper that looked at those previous forecasts. I think they partly based their forecast this time on making a judgment around that structural change. I do not think I would necessarily argue with that, it is important to remember that the overall risk to the forecast has mainly been an upgrade to nominal growth—to the receipts into the public finances—rather than a much rosier picture for growth overall. That is important to bear in mind.

It is also important to remember that some of the fiscal rules are being met. We have debt falling as a proportion of GDP and we will certainly manage to meet the adjusted deficit of 2%. The challenge is around getting to a balanced budget. At some point that seems to have been pushed into the long grass, perhaps for understandable reasons. Those are the main points I would make about that.

Paul Johnson: Again, it is worth putting this in long-term perspective. Part of the long-term perspective is borrowing. It was £150 billion in 2010—10% of the national income. It is now under 2% of the national income, which is below its pre-crisis level and actually below its pre-crisis average. The big story is the huge reduction in borrowing.

Q134 **Stephen Hammond:** So we are making headway?

Paul Johnson: The second thing, in terms of thinking over time, is that we all celebrated the extra money that appeared earlier in the week. If you will remember, the March 2016 Budget forecast a £10 billion surplus for next year. We are now looking at a £30 billion deficit. If you just look back a couple of years, the difference is much bigger than the difference we are seeing at the moment.

Stephen Hammond: But that begs two questions, doesn't it? The first one is that if you look at the November 2015 forecast for growth, it was actually a percentage point higher than it is now.

Paul Johnson: Yes.

Q135 **Stephen Hammond:** How much of that would you conclude is Brexit



effect?

Paul Johnson: There is something close to a consensus among forecasters. We do not do our own forecasts but, looking at all of that, there is something close to a consensus that the economy is around about 2% smaller than it would have been had the Brexit vote gone the other way. You get that either by looking at the impact of inflation, by comparing pre-referendum forecasts with outcomes, or by comparing us with other countries.

Q136 **Stephen Hammond:** On that basis can we almost look at that as a £40 billion swing as a direct impact?

Paul Johnson: There is a £40 billion impact on the economy. That would normally have a smaller impact on the deficit. There have also been a bunch of policy responses.

Q137 **Stephen Hammond:** Do you think it is coincidental that the temporary increase in the annual investment allowance timed at the start of 2019, and the increase in the personal allowance timed to April 2019, are deliberately designed to coincide with any particular event?

Paul Johnson: Easter, do you mean?

Stephen Hammond: Easter is rather late, so maybe we are going to have a splurge on Easter eggs.

Rain Newton-Smith: I can certainly answer some of that question on the annual investment allowance. The temporary two-year increase in the annual investment allowance to £1 million from April 2019 is something we called for. It is important for two reasons. First, we have a structural problem in business investment in this country. Business investment as a percentage of GDP averages 9%, but it is 13% across the rest of the G7. That has been true for a long period of time. At the same time, our overall capital allowances are much less generous than in the rest of the G7.

That increase in the annual investment allowance will help to address the structural problem, but there is no doubt that Brexit uncertainty is having a big impact on business investment decisions now. Eight out of 10 businesses we surveyed say that Brexit is having a negative impact on their investment decisions.

The tools at the Chancellor's disposal to try to encourage business investment are important. Part of the idea behind having a temporary increase is to try to provide a counter-balance to try to get more business investment. That is important for now and for our future productivity growth.

Q138 **Stephen Hammond:** Finally, the scale of fiscal loosening in the US last year has been universally described by most US economists as likely to be inflationary. Do you think the scale of fiscal loosening in the UK at this stage of the business cycle is likely to be inflationary?



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Paul Johnson: Not terribly, but it is interesting that, if you delve into some of the stuff in the OBR report, it suggests that the scale of additional spending within the NHS could push up costs within the NHS. There is the potential for a sort of cycling back and the Department for Health and Social Care asking for more money to cover the cost created by the increased cost that the extra money has created.

You need to be careful, particularly when moving from very small increases to quite large increases in something like the NHS, because it can create an inflationary impact within that sector. However, I am sceptical that it will create a big inflationary impact on the economy more broadly.

Professor Elson: The profound changes in the labour market mean that everybody has had to rethink their ideas about what triggers inflation. The OBR is clearly doing that in its report.

Just one more thing on the Brexit uncertainty. I don't think it only affects investment, although that is very important. It also affects things like the recruitment of staff in the NHS. There may be all that money, but nurses and doctors from other EU countries may not want to come anymore, and those who are already here may decide to go back. Labour market uncertainty is also important.

Q139 **Charlie Elphicke:** I was going to ask about modernising the tax system for the digital age. However, I just want to make a couple of supplementary points to Mr Hammond's questions. First of all, Rain, you talk about Brexit uncertainty, saying that there wouldn't be uncertainty if we were remaining in the European Union and that more people would be investing. The CBI was also enthusiastic that we should've joined the euro, saying that that would lead to increased investment.

Nevertheless, the truth is that UK corporates are sitting on about £750 billion in cash balances. Everyone has been going on for years about how to get British businesses to invest. What is the answer, and will time-limited and very generous investment allowances, including for long-life assets, actually get big business to make the investment for which people have for so long been calling?

Rain Newton-Smith: I have just one point to correct. The CBI did not call for the UK to adopt the euro full stop. It said that we should adopt the euro when the economic conditions were right. That did not come to pass. That is often put out there in the media but it is actually untrue. I just wanted to correct that.

On how we can get UK businesses to invest, as I said earlier, it is a structural issue. One encouraging thing in the Budget was the Chancellor's announcement that he will introduce a capital allowance for buildings and structures. At the moment, we are the only country in the G7 that has no allowance for buildings and structures. If you put that alongside the business rates system, which clearly disincentivises investment in buildings and structures—commercial properties, factories, pubs—having an allowance for buildings and structures is important.



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We would be hopeful that that will go some way to address some of the structural issues around investment in the UK.

More can be done in terms of how we encourage long-term finance, and certainly the Government have looked at this in the past. Looking at the whole patient capital review, unfortunately, there is no golden bullet for business investment. I think we need to look at the whole tax environment: what makes the UK attractive to international investors, and also the environment for businesses here in the UK.

Q140 Charlie Elphicke: Mr Johnson, Mr Hammond talked about the balanced budget going into the distance, and that we might be running structural surpluses. What impact would that have on interest rates, particularly debt interest but also wider interest rates, and indeed the strength of the pound in foreign currency markets?

Paul Johnson: My guess is that what we heard on Monday is going to have very little effect on any of those things in the short to medium run. The very low debt interest rates are a reflection of all sort of things, including confidence in the UK's ability to pay back, but also lack of confidence in investing in many other assets. The point at which this becomes risky and starts to have the sort of effects you are describing is when people start to lose confidence in UK institutions. We have benefited for centuries from a fairly stable set of political institutions and a fairly stable set of policies. The markets clearly remain fairly confident in that, and if we end up in a world with much higher inflation or much less confidence, then we might risk some of that. At the moment, it does not seem to me that we are terribly close to taking very big risks on the basis of this change in fiscal policy.

Q141 Charlie Elphicke: I was looking at table 2.1 of the Red Book. The tax policy decisions are a £4 billion to £5 billion giveaway over the next two years, or a bit over that, and the total public spending policy decisions are more like a £90 billion spending increase. Are you saying that that is just fine, that we do not need to be concerned, and that it is all perfectly manageable?

Paul Johnson: It is fine in the short run. It is a perfectly plausible choice in the short run, but you clearly cannot keep doing it. The risk that it runs in the medium run is that debt is falling very, very slowly as a fraction of national income over this period. I mean, once you strip out Bank of England activity by 3% of national income over five years, that is a very small reduction in debt from a level that is much more than twice where it was pre-crisis.

The longer-run risk is that, with the level of growth that we appear to have and the oddness of some of the accounting around student finance and so on, even if we stick with a deficit of 1% to 1.5% of national income—which is pretty low—that debt may not go down over time. Building in a couple of recessions, which we will have over the next 20 years, it may even go up over time, so my point is not “You can keep doing this.” My point is “You can do it now and sort it out later. You do not absolutely have to get



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to zero deficit in 2025—the world won't fall apart if you don't—but if you keep increasing the deficit, then at some point, clearly, it becomes a problem." I cannot tell you when that problem will be. I would not panic over this, but if we get this every year for the next 10 years, I would start to panic.

Q142 Charlie Elphicke: Does that then increase the risk of tax increases being necessary, if there is any variance in the near term?

Paul Johnson: My view is that tax increases over the next decade just will be necessary because the amount we are spending on health is rising very fast. Unless we are willing to accept a very different kind of health service, and depending on social care, pensions and so on, that will continue to rise. If you look at the performance of most other public services, which have genuinely had big cuts over the past seven or eight years, it is not obvious that there is much scope for reducing spending there. My view is that taxes will have to rise just to maintain the sort of welfare state that we have at the moment. An alternative is to have a different sort of welfare state, but we do need to have that kind of conversation.

Q143 Charlie Elphicke: Professor Elson, is the Chancellor going to need to raise taxes with this policy?

Professor Elson: I certainly agree with what Paul has just said. In the longer run, the demographic changes are such that there has to be a rise in taxation and some new tax handles—some more creative thinking about what kind of taxes we need to fund the investment in social care that we must have, unless we are prepared to let old, frail people live out the end of their days in terrible pain and loneliness, with a lack of dignity. If inheritance taxes are off the books, there will have to be some thinking about something like a tax on receipts—a tax on the gifts received. I don't see that the tax system we have at the moment is fully equipped to deal with the rise in revenue we will need, but it is absolutely clear that we will need that in the longer run. In the last 60 years, the Budget has been in surplus on only eight occasions and the ceiling hasn't fallen in when we have not had a budget surplus. There will definitely need to be some ways of increasing tax revenue to get the kind of public services—particularly health and social care, police, justice and education—that people say they want.

Q144 Charlie Elphicke: Mr Johnson, on reading this Budget, can you discern and articulate that there is a long-term economic plan, and can you explain to the Committee what you believe it is?

Chair: All in about 35 seconds, please!

Paul Johnson: I would struggle to do that. I would re-summarise the Budget as finding some extra money from lower borrowing and spending it on the NHS. Despite the fact that the Chancellor spent an hour and a half speaking, there was not much else in there at all.

Q145 Charlie Elphicke: There is a large increase in spending. Can you discern



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any public service reform to ensure greater productivity or to reform public services more widely?

Paul Johnson: Not in the Budget.

Rain Newton-Smith: I would add a couple of things. One important announcement in the Budget was the extension of the national productivity investment fund. The Chancellor has set out a long-term commitment on the amount of money that has been allocated for public investment in capital, infrastructure and R&D, which will increase from 1.6% or 1.7% of GDP to more like 2.2%. That is really important and shows a long-term commitment.

I certainly agree with Paul on the debt dynamics. With an ageing population over the long term, we will at some stage need to see an increase in taxation from somewhere. There are more policy choices to be made. As I said earlier about the comprehensive spending review, there are certainly things that we need to think about in terms of education and spending per pupil. On the NHS, it was important that the Budget set out a plan around how that money is spent. Thinking about public procurement in the NHS and across Government Departments is really important. Thinking about how we can get more innovation in our public services is really important, particularly with the advent of new technologies—having a focus on that is vital.

Paul Johnson: Rain's point about investment spending reminds me of something important. The Chancellor is not being given quite enough credit for his first autumn statement back in November 2016, when he significantly increased planned investment spending, at a time when day-to-day spending was still being squeezed, to its highest sustained level for the last 40 years or so. One of the oddities about Monday's Budget was that he used some of the unallocated additional capital—he had announced it a couple years ago—to help fund some of the other spending increases. As some of that was unallocated, the OBR had already put into its forecast that they did not expect that it would be spent anyway. We have got this very odd budgeting world in which the Chancellor says, "I'm going to spend this much—I haven't decided yet where it is." His fiscal watchdog says, "Well I actually believe we're going to spend it", and then he says, "No, actually I'm not going to spend it."

Q146 **Charlie Elphicke:** Finally, my constituents in Dover and Deal are deeply concerned about the pressure on the high street, while big, international internet companies effectively run mail order businesses, fail to contribute at all to our tax system and fail to contribute at all to our high streets. The Chancellor has had a go with the Amazon tax in the Budget. What do you think, more broadly, is the way to address this problem so that we can ensure a level and competitive playing field for our high streets to continue to thrive, even in the digital age?

Paul Johnson: It is quite important that the digital services tax the Chancellor announced had very little to do with online sales or, indeed, Amazon. Amazon might be caught a little bit, but only because of the sort



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of person-to-person sales that go on across its platform. It really did not have anything to do with online sales; it was much more to do with trying to capture—at least in principle—some of the value created from advertising and the networks created on things like Facebook, Google and so on. To answer your question, I do not think it is even a tiny step in the direction that you describe.

Rain Newton-Smith: Just to add to that, an OECD process is trying to look at how we modernise taxation in light of a more digital economy and, as we have seen in news reports overnight, the US reaction to the announcements of a digital services tax in the UK. If you really want to make progress on this, you have to work multilaterally. We should let that OECD process work.

This also highlights that there is a real challenge in the UK in terms of how the business rates regime works and how that makes it harder for businesses with a large physical presence to compete in an online space. We have to remember that most of the people who have a big physical presence also have an online presence, so we have to be careful when we introduce new taxes that we do not add additional distortions. One of the challenges with the digital services tax is that it is quite innovative but it requires Government to define certain business models, be they search engines, social media platforms or online marketplaces, and tax the revenue from those business models. The challenge with that is that you can disincentivise businesses from becoming more digital and adopting digital technologies. That is an area where the UK falls behind internationally. One of the challenges is looking out for the unintended consequences.

Paul Johnson: In response to your very specific question about the high street and online retailers, it might be interesting to look at some pilots and experiments that the Scottish Government are running, whereby they are giving councils the ability to charge higher business rates on out-of-town warehouses and so on. They are running that pilot and we might be able to learn from the effect it has.

Professor Elson: The example that Paul has given is a good one. The regime of subsidies to attract these large out-of-town distribution centres that function through digital platforms should end, and we should think about how we can tax. It is always easier to tax something that is fixed like a warehouse; the big difficulty is in taxing the profits of companies that can easily transfer the profits to Dublin or wherever else. I do not think we have to call it an “Amazon tax” because the Americans are already saying that this is discriminatory against them.

Paul Johnson: The point about subsidies is important. On one hand we are saying that there is a big problem with these companies, and on the other, the Welsh Government has just given a whole pile of money to attract them to build a warehouse in Wales.

Chair: Good point. Thank you.



Q147 Catherine McKinnell: In his Budget statement, the Chancellor referred not only to a deal dividend, but to a double deal dividend. Is that something that the CBI is expecting to see?

Rain Newton-Smith: He was referring to a couple of things by that. He was partly talking about keeping back some of the surplus that he has in the event of a no deal Brexit. Were we to get a good deal with the European Union, he might be in the position to spend some of dividend. What we have to remember is that avoiding a no-deal outcome is avoiding a much worse outcome. It's not improving the central case. What the OBR is forecasting and what most forecasters are assuming is that we get a deal, and those forecasts are based on that. It is a real challenge and the problem at the moment is that the clock is ticking day by day. We know that one in five businesses have already triggered contingency plans that are non-reversible. As each week goes past when we don't secure a deal with the European Union, unfortunately investment and jobs are lost in the UK.

When we get a deal secured with the European Union, I think we will all breathe a sigh of relief. Our sense is not that we will suddenly see a big increase in business investment. The overall terms of that agreement in the autumn will likely be quite high level. The full details of our trading arrangements with the European Union will become more apparent over time, and hopefully we will gradually see some of that investment return to the UK. Businesses tend to plan their investment cycles once a year. It is not that all those plans will be remade on 1 January on the basis of a deal being agreed. I think we will slowly see confidence return to the UK. The problem at the moment is that most of it is mitigating the chance of a very bad outcome. It is not that we will see a sudden upside once a deal is agreed. It is basically avoiding that wasteland of a no deal that we need to focus our efforts on.

Q148 Catherine McKinnell: Does anyone want to add anything else? Are other economists predicting a dividend from Brexit or from the striking of a deal over Brexit?

Paul Johnson: I agree with what Rain said. Certainly the OBR have constructed their forecast on the assumption of a decent deal. They are not constructed with a probability of no deal built in. That said, there are some forecasters in the City who do take the view that if we get over the hump of this uncertainty, there will be a sigh of relief and some additional investment and therefore a bit more growth in the short run. There are certainly a number of forecasters who think that next year we might do a little bit better than the OBR thinks we'll do if we get over that. It is the one plausible dividend that there might be. If we avoid disaster, people will breathe a sigh of relief and things will be a little bit better, but that's absolutely not built into the OBR forecast.

Professor Elson: There will still be quite a lot of uncertainty. If there is a high level agreement, as Rain said, it will be in very general terms. There will be at least two years of uncertainty about the transitional arrangements and exactly what they will be, so I think a lot of people will



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be holding off until they have a lot more information about what that is going to be. The uncertainty won't end once the high level deal is signed.

Chair: Sadly not.

Q149 **Catherine McKinnell:** Is that not something that the CBI is picking up from its members? What does that deal need to contain for it to give the level of certainty that is required to increase investment?

Rain Newton-Smith: From where we are right now the most important thing is that we secure the withdrawal agreement and then move on to having the shape of what the final economic relationship will be. I think it will be hard to have sufficient detail set out over the course of the autumn for companies to know exactly what tariff regimes will be operating under what sort of regulatory alignment across all different sectors. We have to understand that in some sense our relationship with the European Union is incredibly complex. To get the full details will take time. That is why getting into that transition period is so important, because it gives certainty to businesses that will be operating under the rules that we are operating now during that transition period. It at least gives certainty for businesses up until the end of December 2020.

Q150 **Catherine McKinnell:** But is two years of the transition period enough to unlock the level of investment that it is being suggested will come from reaching a withdrawal agreement—in terms of calling it a dividend?

Rain Newton-Smith: Again, I would not necessarily be in the shape of calling it a Brexit dividend. As Paul would say, most forecasts for growth in the UK, of about 1.5% or a bit stronger or weaker than that, are all predicated on the UK securing a good deal with the European Union, and that being set out over the autumn—at least the shape of that deal getting into the transition period. Once we are in the transition period it may be at some stage we need longer to negotiate the final economic relationship, but what is clear at the moment—what is on businesses' minds—is getting into that transition period in the first place.

I think what we know from businesses is that avoiding a no deal outcome is what they need to be able to even plan any significant investment in the UK over the long term. I think when you look at the OBR's forecast over the long term, assuming we get a good deal secured with the European Union, you could say over the longer term there is that side to the forecast.

Q151 **Catherine McKinnell:** What is a good deal? That is the question I asked. What does business need to see? What is this good deal that business needs to see?

Rain Newton-Smith: I think essentially what we need to see is clarity, first and foremost, on tariffs. Having an agreement on goods—

Q152 **Catherine McKinnell:** But that is not going to be contained in the withdrawal agreement. We are not going to have that, so how are we going to get this dividend that is being talked about?



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Rain Newton-Smith: I think the challenge is we are not going to get an immediate boost to growth as soon as that deal is agreed. It is more about avoiding a very bad outcome.

Q153 **Catherine McKinnell:** But that is what the Chancellor said in the Budget.

Rain Newton-Smith: I cannot speak for the Chancellor. I know he will be providing evidence later this week, and that is probably one for him. What do businesses want? They want to know what is going to happen to their people, most importantly. We have got to remember there are a lot of EU citizens who are working and contributing to our economy at the moment. I would say that is one of the issues at the forefront of businesses' minds if we are in a no deal scenario. While the UK has provided some guarantees, their status is not fully guaranteed. It is also about tariffs; it is about regulatory alignment, which sounds very high-level, but it is essentially: can aeroplanes fly, can I ship drugs across borders, can food go across borders? Businesses need to see those sorts of guarantees. That is what they need guarantees on.

Q154 **Catherine McKinnell:** Presumably none of that is going to come when the withdrawal agreement is arranged. We are going to move into a transition period, which, as you say, is a breath of relief, but all it is is a stay of execution, if you like, for what an eventual deal will bring. Do you think that is enough, though, to reach a withdrawal agreement to give business the confidence to start investing? Do you think there is a big backlog of investment waiting to come, and will it be made on the basis of a two-year transition period?

Rain Newton-Smith: My sense—it is obviously hard to know exactly the components of business investment—from talking to companies is that they do not have a button that they are ready to press as soon as we have that deal secured. It is more that, once we have that deal secured they at least can breathe a sigh of relief that we are not, hopefully, falling into a no deal territory, but obviously that deal will have to be ratified by the European Parliament, and here in the UK, so there are lots of steps along the way. They then would need to wait over the course of time for the details of that final economic relationship to be negotiated, and to be communicated to businesses. As others have said, there is not a certain day when all Brexit uncertainty goes away. Our trading relationships will become clearer over time. Business investment, hopefully, but only gradually, will build up and become stronger than it would have been otherwise.

Q155 **Catherine McKinnell:** How do you think businesses are going to respond if there is another fall in sterling?

Rain Newton-Smith: That is certainly a challenge, and certainly a risk. There is always a chance, if a good deal is secured early and we have lots of clarity, that we could see some upside to the exchange rate as well. I think if you talk to the businesses now, and looking at the impact on consumers and on households, the biggest effect of the referendum vote has been the impact on sterling and what that has done to inflation. It has led to much higher inflation, which has made it challenging for businesses



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in terms of higher costs in their supply chains. It has certainly put a real squeeze on household incomes in real terms, which has led to a slowdown in household spending. That has had a big impact on our high street retailers, and we have seen the fallout from that.

We have seen some benefits from the weaker exchange rate on our export orders, but what is really interesting is that in our latest manufacturing survey, we have suddenly seen manufacturing optimism fall sharply. We have seen investment intentions in the manufacturing sector fall to their lowest level since 2009. We are really seeing a tangible impact on our manufacturing industry of the uncertainty around Brexit.

Q156 Catherine McKinnell: Does anyone have anything else to add? I was going to go on and ask about wages, unless you have got something to add about the deal.

Paul Johnson: I echo that. I think it is odd to refer to a "dividend". Essentially what I think is being talked about is avoiding something really very bad. If you think of that as a dividend, well, fair enough, but I don't think normal English would support that.

Q157 Catherine McKinnell: That is very helpful. Thank you.

The OBR has lowered its estimate of the equilibrium rate of unemployment to below 4%, which you think would be good news for job creation, but there is still some question over pay growth and the likely impact over that time. What do you think about the trends in wage growth? We see positive news in terms of employment figures, but it does not seem to be reflected in wage growth. Professor Elson, you referred earlier to the way people work in the modern economy. Is that feature being reflected, or are there other factors in business thinking that are causing wages not to rise commensurately with the increase in employment?

Rain Newton-Smith: More broadly, we have seen a lot of job creation over the recovery, but wage growth has been a lot more subdued. We know that our overall productivity growth has been very weak, and that is one of the reasons why wage growth has been weak. All economists would say that it has been a puzzle why productivity growth and wage growth have been so weak. Wage growth is picking up, and that will probably continue, but the pace is quite hard to determine.

One of the things that businesses talk about to us is that, while uncertainty is having an impact on investment, it is also having an impact on wage setting. There is something about the wider uncertainty piece that is making it harder for businesses to look at increasing costs and wages. In some sense, they need the productivity growth to come first, before we see the wage growth following.

Q158 Catherine McKinnell: Do you think the challenge is that, given the nature of the modern workplace, workers are less able to bargain for higher wages? Is that a feature that we are seeing in the economy? You are nodding, Professor Elson.



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Professor Elson: This is the reason why the OBR lowered its estimate of the equilibrium rate of unemployment to below 4%. We are not seeing the translation of rising employment into rising wages in the way we did before the financial crisis. These headline indicators of employment and unemployment are less and less good as indicators of what is happening in the labour market. We have had this very big growth in self-employment of two kinds—high-end self-employment and a lot of self-employment at poverty earnings. Even people who are employed have fluctuating monthly earnings. There is a lot of part-time work—a lot of the growth in employment has been part-time work.

I always ask, “Why can’t you do it in terms of full-time equivalents?” For many women, if you just look at the employment gap, it is not so big—it is lower than it used to be, certainly—but if you adjust it for hours of work, there is a much bigger employment gap, because a lot of the jobs growth has been in part-time jobs. It is the same for men. It is a more uncertain environment for people in terms of earning an income because of both the insecurity of employment in terms of the legislative framework and the insecurity of self-employment in terms of the unpredictability of exactly what you are going to earn.

One thing we have not mentioned at all, and that is not mentioned very much in any of the Budget documentation, is the rise in household indebtedness. There is a huge rise in household indebtedness, which is what has been able to keep the economy afloat with its flatlining real wages. It is at levels, I think, that are equivalent to what they were on the eve of the financial crisis, and that is a fragility in the economy that we ought to pay more attention to.

Chair: The OBR touch on that, actually. They also talk about the saving ratio having come down. We obviously did our inquiry into household finances partly for that reason, and I am sure we will return to that.

Q159 **Mr Simon Clarke:** Thank you all for coming in today. I want to touch on austerity and go back to some of the issues around balancing the budget. I am concerned about the trajectory that we are striking, and to quote from the OBR, “This is the largest discretionary fiscal loosening at any fiscal event since the creation of the OBR.” On page 16 it says that, taken together, the changes that were announced on Monday, “turn the £3.5 billion surplus in our pre-measures forecast for 2023-24 into a £19.8 billion deficit.” Have we become constitutionally incapable of running a balanced budget?

Paul Johnson: As Diane said earlier, we have not run balanced budgets very often at all in the past, so I think the question is more—as I alluded to earlier—whether we are in danger of constitutionally ratcheting up the future deficit. There is evidence for that, as I said. When the borrowing figures have looked worse, the Chancellor has not responded by cutting spending, and when they have looked better, he has responded by increasing spending.

Mr Simon Clarke: Exactly.

Paul Johnson: If you do that all the time, obviously you end up in a bad place. There are obvious political reasons for it, and there are clear demands in the public services, so you can understand why we are where we are, but I think I agree with you that that is sort of where we are.

Q160 **Mr Simon Clarke:** That is an absolutely devastating state for an advanced western economy to be in. If we had a Labour Government, spending would increase, and borrowing and taxation would rise commensurately, but it seems that a Conservative Government are also completely unable to grip the public finances. I appreciate that we have brought things down, but the consensus of the panel today seems to be that tax rises are utterly inevitable. Is that fair?

Paul Johnson: I think they are. Clearly, I cannot speak for what a Conservative Government with a working majority would do, and it might be something rather different from what it is doing at the moment.

There are several things wrapped up in what you say. Clearly, if a new Labour Government were to implement its manifesto as of 2017, that would imply very big spending increases, very big tax increases and substantially more borrowing than is planned at the moment. Actually, if you look at those spending increases, they are not dealing with the sorts of issues that I think will push taxes up, because there was less in that manifesto for the health service, for example, than in the Budget earlier this week, so on top of that, there would be additional tax rises going forward.

But none of this is inevitable. There are big political choices here. There are two things worth saying. First, tax, as a fraction of national income today, is at a historic high for the UK, but only just, and it is not at all high by western European standards. Clearly, France, Germany, the Netherlands and so on run very effective economies with much higher or significantly higher tax burdens. On the whole, those tax burdens are a result of a broader tax base, so it is not that they have whacking great taxes on companies and—

Q161 **Mr Simon Clarke:** What does that mean then?

Paul Johnson: It means they charge VAT on a lot more things than we do. We have an unusually narrow VAT base and quite a low VAT rate by continental standards and—

Q162 **Mr Simon Clarke:** I can only imagine the pain we would inflict by—

Paul Johnson: Indeed.

Mr Simon Clarke: That would be totally unviable politically.

Paul Johnson: I am just offering the comparison.

Mr Simon Clarke: This goes back to the constitutional unviability of our—

Chair: The Clarke chancellorship.

Q163 **Mr Simon Clarke:** I am just absolutely appalled at the way we seemingly



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cannot get a grip—it is just endless borrowing.

Paul Johnson: The biggest difference is that they have much higher social insurance contributions.

Professor Elson: But we are already imposing a lot of pain. It may not be pain that comes through taxation, but it is pain that comes through underfunding of vital public services. There is a huge social deficit. We brought down the budget deficit, but the social deficit is way, way, way up. We have not brought the social deficit into the same document as the fiscal deficit. That is an innovation that it would be worth thinking about. At the same time as we have brought the budget deficit down and borrowing down, household indebtedness has gone up. It is actually that rise in household indebtedness that is keeping the economy afloat, in many ways. Households, of course, have to pay much higher interest rates than Governments, and there are certain things that we need to fund collectively as a country—as a society—and consume as a society. We cannot all go out and buy, with the increased money we have from the tax reduction, a better health service or a better education service.

Q164 **Mr Simon Clarke:** No one is arguing that. I suppose my point is that there are social costs to having a public financial settlement that is totally unaffordable. Austerity follows overspending as night follows day, because the two are intrinsically linked. Mr Johnson, aren't the UK public finances just left extremely vulnerable to future cyclical downturns? We will not have the fiscal firepower available to keep bailing ourselves out every time we cock up.

Paul Johnson: There is clearly more risk of that now than there was. The story of the last 10 years is that debt was at a relatively low level in 2008 so we were able to much more than double outstanding debt. We have managed that, and interest rates are very low, so the cost of servicing that has not been terribly high. Were we sure that we would continue to grow even at the rather feeble rate that we are growing at the moment into the future, we could afford to run the kind of deficit we have at the moment. We can be reasonably sure, actually, that there will be some recessions coming around the corner. What we do not know is how big an impact they will have on debt, but if they have an impact on debt, that is going to take our debt burden to more than 100% of national income. At what point that becomes a problem we genuinely do not know. In a sense, there is a small probability of a big problem—I think that is the way to look at it.

Returning to what I said earlier, the absolutely crucial thing here, the reason it has been very easy to run a very big debt and one of the reasons that interest rates are low—this is a serious message, in a sense—is that political stability, and the stability and trust in our institutions, are more important than anything else in that context. In a world of political stability, in a world of trust in those institutions, in a world in which there is confidence that whoever is Chancellor will, in the medium to long run, keep a grip, I think everything will be fine. Once you lose that, you can lose it quite swiftly.



Q165 Mr Simon Clarke: I can think of one or two people who would probably lose that grip quite quickly were they to become Chancellor. Rain, you have been making copious notes during these exchanges. I am very conscious I have not brought you in.

Rain Newton-Smith: I agree with what Paul said. The only thing I would say is that a balanced budget is not a goal in itself. You need a credible fiscal plan and to make sure your public finances are sustainable over the long term. I would just come back to what I said earlier: debt is falling over this forecast. That is important. There is a difference between allocating spending on capital versus current expenditure.

Mr Simon Clarke: I accept that.

Rain Newton-Smith: The focus on increasing our capital expenditure as a proportion of GDP is important. If you step back and look at the macro picture as well, we have to recognise that growth in the UK has slowed from around 2.5% on average over the past few years, and we have settled down to a period where growth is around 1.5%. Particularly with the uncertainty we have at the moment, this probably is not a moment to pursue further fiscal tightening, so I understand why the Chancellor has taken the path that he has.

I think we have to be mindful of the longer-term picture. It is almost looking out to 10 years ahead, when you look at the dynamics that follow from an ageing population. Actually, interestingly, the one element we have not talked much about so far is migration and the choices we make as a country around that. With an ageing population, if we choose to tighten our migration much further from where we are now, that will have an impact on our public finances. We know migration has been a net positive for our public finances. Making different choices around immigration will also have impacts on our public finances and on our growth over the long term.

Professor Elson: I have just one final addition. The way that Governments raise and spend money, and particularly the kind of investments they do, influences the rate of growth. We have had this very sluggish recovery in growth terms, at a time when we have been focusing all the attention on getting the budget deficit down. If you want to get the growth up, there is a lot of investment that needs to be done—private investment, but also public investment.

The public investment that needs to be done is not only the bricks-and-mortar investment—it is also the things that we have discussed, like investment in apprenticeships and technical education, or investment in schools and in childcare. We need a very broad frame when we are thinking about public investment. This rather narrow definition of what counts as capital spending and what counts as current spending does not really enable us to do good investment plans for human capital, because we say, “We’ll build the hospital, we’ll build the nursery, we’ll build the school and that’s okay—we can borrow to do that,” but in terms of staffing those hospitals, schools and nurseries, which you have to do to get the



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return on the investment, our accounting system says, "No, that's current expenditure. That's not something that you can easily fund." We also need to think about the way we need a combination of conventionally defined capital and conventionally defined current spending in order to get the investments in human capital that we need.

Q166 Mr Simon Clarke: Which would be the least economically deleterious taxes to raise, were we to end up in that situation? That is to all three to you. This is not a question I even like asking, but let's ask it and find out.

Paul Johnson: If you want to raise taxes, you have all sorts of options. Frankly, putting a couple of pennies on the basic rate of income tax isn't going to do a great deal of economic damage. It might do a lot of political damage, but it is not going to do a great deal of economic damage. You could increase council tax on expensive properties, because they are undertaxed relative to cheaper properties. You could impose national insurance contributions on pensioner earnings and on some pensions in payment, because they have escaped those. You could extend the VAT base. I am not saying that is politically possible, but from an economic point of view you certainly might want to do that. There are lots of things that you could do that would improve the efficiency of the tax system, or not do too much damage to it, to increase revenues. I accept that most of what I have said is not something that you are going to find in any party's manifesto.

Q167 Mr Simon Clarke: That is exactly the problem—and so the merry-go-round goes on.

Paul Johnson: It is exactly the problem. There are also damaging ways of raising taxes. Imposing £20 billion of extra taxes on companies is not a great idea from an economic point of view. You cannot easily get lots more money out of people on high earnings. They are the group that have had by far the highest tax rises over the last 10 years. You can get more money out of accumulated wealth. One thing we have seen is that wealth as a fraction of national income has grown very sharply in the last 20 years, but taxes on wealth have not grown at all over that period. That is about housing and it is also about other assets. It is largely also about achieving intergenerational equity—we have seen the older and wealthier doing very well relative to those of working age. To get to a politically acceptable solution, which is also equitable and efficient, you might want to look in that direction.

Q168 Mr Simon Clarke: I am allowed only one more question—this really is fascinating. To get quite specific, the OBR reported that the Government have decided to reduce departmental capital spending. Perhaps this ties back into your point, Professor Elson, about the nature of capital and current spending. The Government have decided to reduce departmental capital spending by over £2 billion on average from 2021 onwards, which the Treasury doesn't even have in the scorecard. What is the likely impact of that decision on Government Departments?

Paul Johnson: It is hard to know what the impact is, because most of that was not allocated in any case. First of all, I do not think the



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Chancellor has had quite enough credit for the large increase that he announced two years ago. Essentially, what this is doing is cutting back that increase a little bit, and it is essentially mostly cutting back stuff that the OBR thought that he was not going to be able to spend in any case. Ideally, one would have been pushing that money forwards so that it was still going to be spent, but in a more planned way.

It remains the case that while Government investment spending is high by historical standards in the UK, it remains low by international standards, so there is certainly a case for increasing that gradually in a planned way over time. It is not terribly encouraging to find an announcement from two years ago being un-announced today, partly on the basis that nobody believed it would have been spent anyway.

Q169 Mr Simon Clarke: Is that the subject of broad agreement?

Rain Newton-Smith: Yes. Some of the time, some of that capital relates to capital underspend, so it partly relates to the capacity of Government to spend some of that capital investment, particularly if some of that is large infrastructure projects. One of the challenges we have is that there are a lot of capacity issues in the construction sector, and again, access to skills becomes so important. If we are going to deliver on these big capital projects, we need to make sure that we have the skills to deliver them as well.

Coming back to your earlier question, one thing I would say about taxation—just to pick up on what Paul was saying—is that you could do something around council tax. I would also highlight wealth taxation. We know that inequality of wealth has increased, but taxation on it has not necessarily changed, and one of the distributional impacts we probably haven't spent enough time talking about is the intergenerational impact. The Resolution Foundation, through the commission on intergenerational inequality, did a lot of good analysis of the impact of public finances and policy decisions on different generations. To my mind, the big challenge over the next decade is going to be how we account between different generations.

Mr Simon Clarke: That is fascinating. Thank you very much.

Professor Elson: Land tax, wealth tax and gift tax. We need to think about these new tax handles.

Chair: Talking about social deficits, we are going to come on to the final bit about social care. Wes?

Q170 Wes Streeting: Yes, although I would just say that lots of pensioners watch BBC Parliament, so I hope you have good security at home if you are suggesting national insurance rises for pensioners. Good luck with that. The Prime Minister was not nearly so ambitious in the last manifesto, and look what happened to her.

I do want to address the issue of social care, because I see the consequences of failure to invest in social care, and I am sure that



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everyone around this table is seeing those consequences as well: both the poor service that people receive, and what look like disproportionately high bills landing on the mats for families. The overall funding pressures on the system are well understood, as is the fact that if we do not invest in social care, we end up paying a lot more anyway through increased burdens on the NHS, as well as the associated additional social costs.

Given that we understand all that, what on earth do you make of the limited amount of money that came forward in the Budget? It seemed to me that what the Chancellor did—aside from the £20 billion for the NHS and the tax giveaway—was to carefully sprinkle hundreds of millions of pounds across different Departments and areas of spending, to generate exactly the sort of headlines he managed to achieve off the back of the Budget. In reality, the amount of money going into social care is dwarfed by the pressures on the system and the increased demand, so has he gone far enough to stave off social care crisis? Maybe we will start with you, Professor Elson, since you have touched on this already.

Professor Elson: Definitely not. A very, very small amount of money has been allocated, and it is temporary funding. The big problem is that local government funding is set to take further big hits, and social care is really something that comes out of local government budgets. With the way the system is at the moment, it is all bound up with the funding for local government. We need to start thinking more profoundly about this and start thinking about having a national social care service in the way that we have a national health service, in particular given the idea that we need somehow to have lower business taxes for small businesses, to revive the high street and so on. We need to think more boldly for the future.

There is of course the long-promised Green Paper, which seems to be attaining rather mythical status, and we wonder “Will it ever come?” You can understand that there is a reluctance to do it because it is going to require more taxation—there is absolutely no doubt about that. The costs to the system will have been increased by the announcement of the increase in the minimum wage, the living wage, which I welcome—it is good and should even have been higher—but it means that funding the social care system will be even more difficult, and there is nothing in the Budget to address that issue.

We have daily accounts of private social care providers being in trouble or on the verge of bankruptcy. Who is going to rescue them? I do not think this Budget really did anything to address that. I can understand why, in these very uncertain times, it might not seem that something can be done immediately to address it, but it has got to be done and we have to have that Green Paper. We have to have some broad agreement in society and proper cross-party agreement on how we are going to fund this. It is going to mean more taxes; you cannot dodge that. Everybody has to go out and sell that idea, and the idea of what we get back from paying those taxes.

Q171 **Wes Streeting:** Indeed. Mr Johnson, in the past, the IFS has been quite



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clear in setting out the outlook for health and social care, and in warning of some of the pressures on the system from a fiscal point of view. The Alzheimer's Society says that the money in this Budget "only just staves off total collapse" of the social care system. The Association of Directors of Adult Social Services said "This is still far short of the £2.35 billion that ADASS identified would be needed for social care to stand still in 2019/20". The NHS Confederation said that this is "clearly inadequate" and that "Social care remains the Achilles heel". What is your assessment of this Budget—has it staved off total collapse? How worried should we be and how urgent is the social care Green Paper?

Paul Johnson: I cannot speak to whether it is exactly the right amount of money in terms of staving off collapse, but two or three things are worth saying. First, across the piece, local government spending has fallen by about 20% over the last eight years, and of course social care spending is the biggest part of local government spending. Adult social care spending has been relatively protected within that. It has only fallen by around 10%, at a time when both the older population is growing and the cost of demands from people of working age using social care, which we often forget, have been growing quite fast for all sorts of reasons, partly to do with people living longer with very debilitating illnesses.

The pressures have clearly increased. Part of the consequence of that is a lot more people—in particular, older people with somewhat less severe problems—are getting no social care. Within the current system, it is clearly funded significantly less well than it was a decade ago. That is creating pressures which are differential by different authorities, because different authorities are being affected differently, both by ageing and by the cuts that they have had.

There is an issue with the current system. I think it was a year ago that the Chancellor put more money into social care, and he has put a bit more money in now, but these look like sticking plasters. As you say, there is nothing in there for the year after next, and nothing much for local authorities and social care providers to plan on.

There is a question about funding the current system appropriately, and then the separate question "What is the long-run settlement that we are after?", and the way to think about that is, "How do we get collective insurance of the generation that is going to need social care?", because at the moment you either get nothing or means-tested social care, or you pay for the lot yourself. That implies finding some way across a generation, for example—or perhaps across generations—of, as Diane was saying, finding more money to do that in a way that should make everyone feel better off, because it obviates the risk of losing all of your savings, losing your house and not having what you need to look after yourself when you are ill. That isn't free, and that means a serious way of saying that it is some fraction of the value of people's houses at death or some fraction of other wealth holdings or income that they have, in order to provide that insurance, such that they don't face catastrophic costs later on. Again, from a technical point of view, that is soluble. The issue is,

as we have seen over the period since at least 2009, that it is much harder to achieve from a political point of view.

Q172 Wes Streeting: What assessment have you made of the funding gap in social care, both now and in the medium term, in terms of how the pressures on social care will to grow for the reasons you described?

Paul Johnson: We did some work with the Health Foundation on this earlier in the year. I can't remember the exact numbers, but my sense is that, just to keep the current system going, you need to find 3% to 4% real a year. As I say, that is just to keep the system as it is at the moment. That is a substantial amount over time.

Q173 Wes Streeting: Both you and Professor Elson acknowledged that, when looking at how social care needs are met, this is a case not just of health budgets but of local authority budgets. We have already seen local authorities go to the wall or on the brink of going to the wall. What assessment have you made of the pressures on local authorities? How many more can we expect to go to the wall if there is not a serious attempt to address local government funding more generally?

Paul Johnson: We are not in a position to say that one, two, three or more will go to the wall, but a number of things are worth saying. First, as I said, overall there has been a 20% cut in local government funding, but much bigger cuts in some areas—largely those that were more dependent on central Government funding. In other words, metropolitan and poorer areas have tended to see bigger cuts in their spending than that 20% average.

Secondly—this is an important point, actually—local authority chiefs accept that, for the first four or five years, they found it pretty easy to cope with pretty big cuts. There was a lot of fat. That fat has gone in most areas now, and they are now genuinely struggling. One of the interesting things in the public finance numbers—the OBR comments on that—is that, despite all of that, they are still adding, on average, to their reserves. That is partly because they are worried about the future. There are clearly a lot of differences between local authorities, but one of the reasons why borrowing is coming in lower than expected this year is that they are spending less than expected. That is a cost of the uncertainty that they feel, in terms of where the future is. One of the things we have not discussed is that there is a cost to putting off the spending review. We were expecting at least a spending review total in the Budget, and we didn't get that. Budgeting for local authorities with that level of uncertainty is extremely hard.

Finally, it is not just that they have uncertainty about the total level of budget. Under the fair funding review each individual council is subject to considerable uncertainty about the share of that budget they are going to get. It is a pretty tough life for people running these things.

Q174 Wes Streeting: I just want to probe further the point about reserves, which are a source of political knock-about. When local authorities complain that they are under immense funding pressures, people point to



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their reserves and say, "How can that be true?" It is a reality for people managing local authority budgets that you cannot always accurately predict what the demands will be on your children's social care budgets or your adult social care budgets. If you have got someone in need or in crisis, you certainly shouldn't say, "I'm sorry. That pot has run out, so we're not going to intervene in this case of a child at risk," or, "We're not going to intervene to stop this adult dying." You spend the money. That's what the reserves are there for. How well are we able, at a macro level across local government, to make determinations about the extent to which local authorities are having to dip into their reserves to fund those sorts of pressures?

Paul Johnson: I don't have the broken down information on that at the moment. CIPFA will probably have that information on the LGA, but I am afraid I don't have that.

Q175 **Chair:** Just one final question on IR35. It might be best directed at Ms Newton-Smith. What impact do you think the changes will have on the labour market? Do you think private sector businesses will change employment practices? Is there a problem from the CBI's perspective, and do you think that private sector businesses will change their practices as a result of the changes the Chancellor has proposed?

Rain Newton-Smith: Everyone recognises that the system needs reform. In terms of what was announced at Budget, it was welcome that small businesses were exempt because of some of the challenges around the administrative burden. Obviously that is proportionately higher if you are a smaller business. What's most important is that it will be implemented from 2020. As with any change in legislation or regulation, giving businesses time to prepare is really important, particularly where in some cases it requires investment in IT systems or having someone within an HR department who can do the determination for individuals, whether they are employees or self-employed, because essentially it shifts the burden on to companies.

One of the challenges is that, as much as HMRC may find it difficult to decide whether someone is self-employed or a contractor, it is hard for companies as well. Again, having that time is important, and it does involve cost. We have seen that the set-up costs involved can run up to £7,500 in some cases, and for some businesses the overall cost of compliance can run into hundreds of thousands of pounds. Businesses recognise that this change is coming and that it was something that needed to be implemented.

Another point I would make is that we really need to learn the lessons from how it has been applied in the public sector, because there have been challenges in implementation. We really want to learn the lessons from that. We want to look at the evidence and then apply the lessons learnt to how it is applied in the private sector.

We know there are some challenges with the online tool for determining whether people are employed or self-employed. More fundamentally and



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stepping back from the issue, you would ultimately—in some senses this is looking at the tax treatment—probably want to do it in a more holistic way and have a better alignment between the taxation of employment and self-employment and also the rights associated with it. One of the challenges with this is that you are addressing one element of the tax determination without also addressing the rights that are accorded to employees and the self-employed at the same time.

Q176 Chair: In the same way that we have been waiting a long time for the Green Paper on social care, we are awaiting further follow-up on the Taylor review on working practices. Does the IFS have a view on what this might do to the labour market? Is it something the IFS has looked at?

Paul Johnson: The fundamental point is the same as Rain's, which is that this is a sticking plaster because we have a very odd tax system that treats people doing very similar things very differently, so it's hardly surprising that people try to take advantage of that. It's going to be administratively costly to ask companies to try and sort that out. Looking at the amounts of money that are expected to be raised, I think the presumption here is that the contracting companies will be much more conservative about it than the personal service companies contracting with them, so they will bring more into the employer-employee net. What you see in the numbers again, though, is that you have got quite a lot of money in the first year and then that dissipates over time on the basis of a presumption that people will change their behaviour to avoid being in the net. Again, there is the evidence of the cost, economic and administrative, that a really rather bizarre tax system creates. So it's a sticking plaster, but an understandable one, given how the Chancellor couldn't introduce even a very small change to the tax treatment of the self-employed a couple of years ago. But when you've got this great big divide between how you tax very similar things you are going to end up putting loads of complex legislation around it, and that's what we are seeing.

Q177 Chair: We talked about retrospective legislation earlier on. From businesses' point of view, both businesses who might employ more people because of the change, but also those who have been self-employed or contractors, are people reassured that this will not be applied retrospectively?

Rain Newton-Smith: No, certainly not. As I said earlier, having time to prepare and put in those systems is important. Also, individuals are obviously making choices, and they want to make those choices based on full information. They don't want the rules of the game changing retrospectively.

Q178 Chair: Is there a gender element? Is there a breakdown?

Professor Elson: We have not looked at it. It might be something we could do. I concur with the points that have been made by the others.

Chair: Thank you very much indeed. I know it's been a very busy week analysing it all since Monday, but we are very grateful to you for your



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evidence. It's been very helpful for our next session, which is for the Chancellor on Monday afternoon. Thank you.