

Treasury Committee

Oral evidence: Spring Statement 2019, HC 2056

Tuesday 19 March 2019

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

Questions 1 - 111

Witnesses

I: Robert Chote, Chairman, Office for Budget Responsibility; Sir Charlie Bean, Member, Budget Responsibility Committee, Office for Budget Responsibility; Andy King, Member, Budget Responsibility Committee, Office for Budget Responsibility.

Examination of witnesses

Witnesses: Robert Chote, Sir Charlie Bean and Andy King.

Q1 Chair: Good morning and thank you very much to our panel for being here for the first of our evidence sessions in relation to last week's spring statement. I am going to ask you all to introduce yourselves and then we will get underway.

Robert Chote: I am Robert Chote. I am chair of the OBR.

Sir Charlie Bean: I am Charlie Bean.

Andy King: I am Andy King.

Q2 Chair: I am going to start this session with the same question I and my predecessor have always put to you, Mr Chote: have you come under any pressure from Government officials to alter your forecast?

Robert Chote: No, we have not.

Q3 Chair: Good. Thank you. I want to talk first of all about the process that you highlight and the way that the forecast has been put together. In our report on the Budget 2018, we stated that we expected the Treasury to engage with the OBR on its suggestions for reviewing and improving the forecast timetabling process. You note in the outlook that you work with the Treasury on what you described as mutually beneficial improvement to the process and that these changes have made the process smoother this time around. Is the job done, or is there more room for improvement?

Robert Chote: It has been a much smoother process this time than it was last time. In part, that is because it is a smaller set of forecast changes and a smaller policy package. Part of the reason for the difficulties back in October was the scale of those two things and the Treasury's need to wrestle the two together. There has been less of a challenge on that basis. We did have a very good set of meetings after the last process, working out how this could be smoothed out, in particular in areas where we can help the Treasury anticipate the sort of effects the policy changes they might be thinking about will have when they feed back into the forecast. There is quite a complicated way at the end of the process that the policies loop in back through the economy and the fiscal forecast again. That was helpful.

We underlined again the importance and shared importance of the various elements of the timetable and making sure that we had adequate time for both sides to get to the understanding and reach the decisions that they did. That was all good. As we note in here, clearly it is not ideal that we have the Budget date notified to us well beyond the 10 weeks.

Q4 Chair: I was going to ask you about that. Do you want to say something



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about that? You have the 10-week timetable and I think that you did not get told about the spring statement date until 29 January.

Robert Chote: No, we were asked by the Treasury in good time to be ready for a Budget or a fiscal event within a particular window of three weeks or so, which is helpful up to a point. You need to have a precise date in order to really nail down the forecast process coherently. That is partly because we are relying on a lot of people in other parts of Government to produce inputs. They need to be able to timetable that. It is not just for our convenience; it is for the various stakeholders that we need. That was not ideal. I certainly hope that does not become a practice. It is not enough just to give us, in normal times, a range of dates. You could do that for the Budget in three years' time but it is not going to help us a great deal. You need to nail it down to a date. As you are all too well aware, these are unusual circumstances in terms of parliamentary timetabling. We are conscious of that.

Q5 Chair: There is also an issue about not setting precedents, because the trouble is that once things are allowed to slide and the Treasury is allowed to start pushing the boundaries about dates and everything else, would you share the concern that I think this Committee has that that sets unfortunate precedents?

Robert Chote: Exactly, hence our highlighting it. We were also very grateful for the way you picked up what we had said last time in the report that you made on the Budget. That is very helpful. As I say, these are unusual circumstances and there are plenty of people in the Treasury who recognise entirely the mutual benefit of ensuring that we have a proper, well-timetable process.

Q6 Chair: The Chancellor was determined that this was not going to be a full fiscal event, which he repeated here, elsewhere and all the rest of it. When did you actually know that it was not going to be a full fiscal event? Did you, right from the outset, work on the basis that it was going to be a set of minimal announcements?

Robert Chote: We have a set of deadlines by which we need to be notified of, for example, major changes that are likely to move the economy forecast and other elements. This was always going to be a policy event and therefore timetabled on that basis. The major moving part in the policy package was the changes to departmental expenditure limits, which we would treat as we would do normally. There was also a legacy of other measures that had been announced since the Budget, about 20 or so in total, the changes on universal credit amongst them, and some other tax measures and other things. Although you did not have the full all-singing and dancing Treasury scorecard, we still did have a scorecard of measures to get through.

It would have been very difficult for all concerned if the Treasury had suddenly decided that they wanted to bring through a whole raft of new things that we had not seen before relatively late in the process. We were



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reasonable assured throughout that that was not the intention and, indeed, it did not happen in the end. From our point of view, there was still a policy package that we needed to integrate essentially in round 4 of the forecast, as we normally do.

Q7 Chair: The questions do not have to be just answered by Mr Chote; please, other members of the panel, feel free to chip in. In the outlook notes, I think you say, "As usual, the BRC requested changes to almost all the draft costings prepared by Departments". Are you surprised or disappointed that Departments still seem unable to match what you ask for at first go?

Robert Chote: No, that is entirely to be expected. That is not evidence of a weakness in the quality of the material that we are getting. There is a whole lot of judgments that typically have to be made on the basis of any costing that we are handed. We would expect most of those to move around. We will be talking with the officials about the costings, the evidence base, the assumptions you are making about behavioural changes and what the data is underpinning the tax base, for example, that you think the policy is acting upon. As I say, that is not a reflection of quality.

Andy King: Whenever we are scrutinising these things, we are reading what the officials have produced and trying to understand whether it matches what will happen in the real world. A lot of the questions we ask are essentially, "Does the model you are using deliver an answer that will match the real world? If not, do we need to tweak something?" Often the changes are relatively small and based on the insights of the analysts once you have asked those questions.

Q8 Chair: On the DWP side of things, you had to revisit the 2018 package of universal credit measures and you said that, "DWP analysts were not aware of the Budget income tax personal allowance measures". You then explain the knock-on effect of those. Is it usual for Departments to be so unaware of what another Department is going to be proposing in terms of being able to then give you a better idea of costings?

Andy King: Where there are parts of a policy, which is an HMRC lead, that have an implication for DWP, that is one example where there can be these information barriers. Ideally, the process should be that, if the Treasury does not want the information to flow within Government like that, there has to be a process to ensure that it is captured in a different way. This time it was not. The effect here was relatively small. The larger effects were the delivering at speed mistakes that I think we were worried about at the time.

Q9 Chair: Is that the fact that because you got the information so late from DWP, there was a potential knock-on effect on the numbers?

Andy King: Exactly. Universal credit is a relatively complicated beast. It is modelled in a very complicated way. There are a lot of inputs and outputs. When different options are being considered and changes are



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being made at high speed, simply the quality assurance processes cannot be followed through in full. There were a couple of items where the wrong input was in and you only found that out later.

- Q10 **Chair:** On this joined-up approach, in this case it was a relatively small impact but it could be potentially larger in other circumstances. Have you fed that back to the Treasury: that this was a finding from 2018 and they are therefore going to have to work out a way to share that information in an appropriate way?

Robert Chote: We made that point as part of the wash-up process after last time. As Andy says, there is always this particular challenge here if you have the interactions between the tax and the benefits system. HMRC is a different beast from DWP in that sense. There is a political process to go through, as well as an official one. One of the things we did highlight is that if you are going to announce a policy package in which you have these elements that interact, if it is not done in good enough time for us to be able to go through the QA process, do not be surprised we are going to write that down and highlight it. While it is not naive, you can understand that there are reasons why some of this stuff is not surfaced across Whitehall weeks in advance.

- Q11 **Chair:** Before I bring in Catherine, I want to turn to this issue about Nissan and what is or is not a contingency liability question. You discussed the assurances provided by the Government to Nissan in 2016 in the outlook. You note, "An offer to make a payment that is contingent on a specific decision might reasonably be considered a 'contingent liability' in a broader sense". Are you expressing the view here that what the Government have offered to Nissan, as set out in that letter in 2016 that has only just surfaced in public, should have been disclosed as a contingent liability?

Robert Chote: Looking at the response that the NAO gave you—you and the Committee asked them to take a view on this—I take that as reading that the letter of the rules in managing public money has been followed here. I am not querying that there is anything that has gone wrong in that process there.

From our point of view, the issue is less whether something constitutes a contingent liability per se but whether it poses a fiscal risk. Is the Government essentially making a commitment of the form, "We will pay X amount of money to somebody under the following set of conditions"? That is a discretionary choice, and then if those conditions are met, the money is paid and it is effectively not a discretionary choice there. In the context of this particular letter, the NAO is saying that because it was an issue about this being subject to business cases being prepared as well as whether the production is kept in the country, that did not meet that criterion. What we will want to do when we get to the fiscal risks report in the summer, perhaps with the NAO, is see how often there are things they are aware of that fall in this relatively grey area.



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It has to be said that the amount of money concerned in this is not of a fiscally consequential nature. It is not a scale fiscal risk in that sense. It was striking that in the wake of the fiscal risks report, the Treasury made much of the fact that it had beefed up its process for the notification, the consideration and the approval of contingent liability commitments across Government. We will want to ask a few more questions about whether that is therefore accurately reflecting the nature of the fiscal risks that are created. Are there fiscal risks out there that do not meet the NAO's definition of a contingent liability but which we should still be concerned about? I have no idea whether there are many of these and if many of them are very big. It is worth kicking the tyres on this a bit.

Q12 Chair: Do you have a view about whether such risks or potential payments should be disclosed to Parliament and the public?

Robert Chote: That is presumably down to the rules of managing public money. The NAO is policing that and they have effectively said that the accounting officer at BEIS made the decision on this and they think that was a reasonable decision based on the rules that are in place now. From Parliament's point of view, there is a question of whether the process is being handled correctly. The NAO seems to be saying that it is. There is a separate question for you and more for us of whether that is therefore capturing fiscal risks in a way we think is helpful given our responsibility to look at the risks and the underlying health of the public finances.

Q13 Chair: Are you not also saying that if it looks and smells like a contingent liability then it probably should be treated as a contingent liability? The NAO perhaps has stuck a little bit too much to the exact black-and-white letter, as opposed to thinking whether this is something that should be disclosed and in the public domain.

Robert Chote: If it walks like a fiscal risk and it quacks like a fiscal risk, it is probably a fiscal risk. Whether that then matches up to what Parliament has required Departments to notify themselves as a contingent liability is a slightly separate question, steeped in accounting theology. From our point of view, if the Government are saying, "We will pay money under a certain set of circumstances", and those circumstances arise, it does not have any choice about it and then it looks more like a fiscal risk. It is worth us looking at whether there are more episodes, agreements or statements of this sort that we ought to look at.

Q14 Catherine McKinnell: Talking about walking, quacking fiscal risks, the forecast continues to assume a smooth transition to Brexit along the same lines that you have been doing since the referendum, but the foreword does make it clear that you will review these assumptions as and when, or if, a withdrawal agreement has been approved by the UK and the EU. Your remit obviously must be based on current policy; however, given the Government have been consistently unable to command a majority in the House of Commons to get their withdrawal agreement passed, can you envisage a worse time or worse



circumstances in which to be predicting our economic forecasts?

Robert Chote: It is fair to say that when we saw on which day and on which hour our forecast fell relative to your great considerations, there was a bit of eye-rolling. On the basis of when we had to close the forecast and indeed the way in which the situation remains unresolved as of this date, that was the appropriate way to proceed on the basis of the requirements that you set down on us, in terms of basing this on current Government policy, though not necessarily on Government policy objectives being delivered. For the time being, it has to remain on that basis.

- Q15 **Catherine McKinnell:** The North East England Chamber of Commerce described last week's spring statement as a slightly surreal event with the complete lack of certainty over Brexit rendering any growth forecasts meaningless. Would you share that view?

Robert Chote: I would not. Our forecasts are predicated on a relatively smooth, non-disruptive outcome. The long-term implications, or rather the implications that really matter for the medium-term forecast and long-term health of the public finances, are considerations around productivity. That will be shaped more by the evolution of the political agreement and where we get to in long-term trade relationships than the nearer-term issues.

At the moment, you have this binary position of either something relatively smooth or a more disruptive outcome. It is not valueless to explain as best we can what we think the relatively smooth outcome would look like. As we discussed when we were with you last time, if we are in a world in which the logical interpretation of Government policy at the time is that you end up in a disruptive outcome, we would take that into account at the fiscal event where we are asked to produce a forecast where that is relevant. It will not be easy to do it. There are questions about the scale of the short-term hits to the economy, crucially how persistent it is, what impact it has on the composition of economic activity, implications of the public finances and a whole set of policy choices. What does the Bank of England do in response to this? What do the Government announce in terms of that? When we get to that point, if it ever arrives, we can bring that in as best we can.

- Q16 **Catherine McKinnell:** You are describing the responses to a very disruptive outcome. Is it really as binary as that? Even if a withdrawal agreement does pass, does it, in terms of your forecasting, really provide that certainty, given that it will be a 21-month period of negotiating a new UK-EU FTA, with the inevitable debate that there will be in Parliament around that issue? Therefore, do your forecasts predict that there will be continued uncertainty for that prolonged period of time, even if we do avoid the immediate chaotic Brexit that you have forecasted for?



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Robert Chote: There clearly would be continuing uncertainty around the eventual shape of the trade of the regime.

Q17 **Catherine McKinnell:** Is that all accounted for in your current forecast?

Robert Chote: We have, effectively speaking, an underlying assumption that some of the current uncertainty is taken off the table if you proceed and the immediate concerns and possibility of a disruptive exit pass. That is one of the reasons why we have business investment picking up from its relatively weak performance recently, over the course of the forecast. In that sense, there is an implicit or explicit view within the forecast that you are taking some of that uncertainty away and that moves forward. By not having the disruptive exit, you are removing a tail risk from the economy but that still leaves a huge amount of uncertainty. We have the migration regime, of course. We still have consultations so it is not possible to take that on board concretely. There is also trade. As we have often said, Brexit is a process, not an event. Mixing metaphors, more and more pieces of the jigsaw will be put in over time.

Sir Charlie Bean: On the path of investment, although we have some recovery predicated on a resolution of taking out some of the worst downside risks, the sort of investment growth rates that we have are lower than you would expect at this stage of the cycle. That reflects the fact that we would still expect uncertainty about the long-run trading regime to act as a dampening factor on investment, even in the event of a smooth movement from where we are now into the next couple of years.

Q18 **Catherine McKinnell:** I was going to ask you, Sir Charles, about the mention in the survey evidence of building up stocks ahead of Brexit. In February, the Governor of the Bank of England told us that there are simply not enough warehouses in the country to stockpile sufficient goods to cope with a no-deal, no-transition Brexit scenario. That suggests to me that there is no way that the UK can actually prepare for such a scenario. Politically, it has been decided that it should not be on the table anymore but, from your perspective, have you factored that in yet to any of your economic forecasting? Is the removal of it from the table going to improve your projected forecasts?

Sir Charlie Bean: One of the reasons that stock-building appears to have been strong in the recent past is precisely because businesses have been taking precautionary action. One of the upside surprises on the data in the past two months has been on stock-building offset by weaker investment and weaker net trade. You are right to say that there is anecdotal evidence that warehouse space is in short supply. That may mean nevertheless that businesses have some other spaces they can use. I would not say that there is a hard barrier on the amount of stocks that are being accumulated but it is harder for businesses to take that precautionary action now.



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What you would expect, if you take the risks off the table, is that businesses would run down those stocks. There would presumably be a period later on in the year where stocks are unwinding. Given most of the stocks will be imported goods, that will also be reflected in weaker imports for a while. It does not necessarily map across a lot to GDP because there is less inventory-building and less imports; they net out for GDP as a whole. It does not particularly affect the profile of GDP.

- Q19 Catherine McKinnell:** Different businesses are impacted in different ways. I have recently met with local businesses in my constituency. They have been very clear that SMEs just do not have the time, capacity or resource to even plan for Brexit at the moment, certainly not the multiple Brexit scenarios that we can potentially anticipate. These are the very companies that are much more exposed to the impact of Brexit, particularly if you are a small business in the north-east where the majority of your trade is with, or certainly those who you are supplying to trade mostly with, the European Union, and they are therefore much less able to absorb any of the economic shocks. Has there been an assessment of the risks associated with particular businesses in particular parts of the country that may be more affected than others?

Sir Charlie Bean: That may be true but you would have to ask the relevant Departments in Whitehall whether they have probed on that. You are absolutely right that small businesses in particular do not have the spare management capacity to be doing a lot of planning in that territory. Bigger companies may be able to devote resources to it but there is a limit to the range of scenarios that people can envisage. The thing about these sorts of disruptive events is that it is easy enough to talk about them in the abstract but working out how they permeate through the economy is almost completely impossible. It is exactly like the aftermath of the collapse of Lehman Brothers in many ways. A lot of the linkages you do not realise until you are actually living through it. In that sense, there is a limit to how much a business can do to prepare for it.

- Q20 Stewart Hosie:** Robert, have you calculated the impact that no deal would have on public sector net borrowing in the short and medium term?

Robert Chote: No, we have not. We have produced the forecast on the basis of, as I say, the central assumption based on Government policy and the broad-brush assumptions that we have made so far. We have not explicitly modelled that. We would do that, obviously, if that becomes the central thing, but one of the things that Parliament has told us in legislation to do is not to produce different scenarios for different policy outcomes. We do different scenarios for different economic circumstances but not on the policy side.

- Q21 Stewart Hosie:** Given that Parliament has not yet approved a withdrawal agreement, do you think it would be prudent for the Government to ask you to now carry out a forecast on a no-deal scenario



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and indeed a forecast potentially implying a prolonged extension of Article 50? Would that be a sensible thing for you to do if you had the time to do it?

Robert Chote: The Government have produced an assessment of their own of different outcomes. In terms of the extension, we come back in part to the notion that in the long term it is about the impact of productivity changes, the consequences of a long-term set of trade relationships and immigration policy that you end up with. At the moment, we are assuming on the basis of the draft withdrawal agreement a two-year transition period. That is not enormously consequential for the GDP forecast; it delays the point at which we assume that the change in aggregate trade barriers reduces the pace of import and export growth. That happens anyway in a way that is symmetric and has an offsetting effect on GDP growth. If you were to have an outcome of your current deliberations that ended up either eating into that period of transition or extending it from the current end point to somewhat further into the future, it is not clear that on its own would have an enormous impact on your initial forecast.

Q22 **Stewart Hosie:** You would need to know, in short, whether the Government's intentions, for example in relation to immigration, were the same as are currently implied, or whether they were to change.

Robert Chote: Yes. Specifically on immigration, there are a set of proposals out there that the Government have put forward but they have been very clear that these are out for consultation and the terms of the consultation are such that we have to wait and see what that ends up being firmed up as. It may well be that you know more about where that is going to end up before you know where we are going to end up in terms of the steady state trade relationship with the EU, I presume.

Q23 **Stewart Hosie:** If the Chancellor was to announce an emergency Budget in a no-deal situation, which is certainly possible, would you have the resources and capacity to provide him with the revised necessary forecasts?

Robert Chote: We will produce a forecast when the Government decide to have a fiscal event and to produce one. Clearly, the more notice you have of that, the more you are able to go through the usual depth of forecast process that you would want to do. In a curtailed timetable, you may have to do it in a more rough and ready way. There is no absolute point in terms of how much time you would need, but the more notice you have, the better. The other point to bear in mind is that, as we explained earlier, we are reliant on input from a lot of Government Departments for analytical work. In the circumstances you are describing, Government Departments might have quite a lot of other things on their plate as well as servicing our needs.

Q24 **Stewart Hosie:** Indeed, and that leads me to my next question. Given that circumstance, which could happen, I am assuming that you would



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want at least the 10-week notice period, in order to make sure that what you were doing was as robust as it could be?

Robert Chote: We would obviously always ideally like the 10-week period. The legislation is explicit that it is 10 weeks in normal circumstances. These would not be normal circumstances. I would not be astonished to discover that we were asked to produce something at slightly shorter notice. As I say, we would be very clear in the document where that had required us to do things differently. If it was shortened down, you may have to end up using more ready-reckoner approaches, rather than the full blown bottom-up forecast we do normally.

Andy King: In the circumstances that you are describing, in terms of the round-to-round forecast process that we go through, we would be learning a lot about what was happening between each round. Normally, we try to make all our big decisions at the start and then refine over time. That is unlikely to be how things would pan out. When the financial crisis was happening and the forecast at the end of 2008 was happening, we were revising massively between the rounds as data flowed in and we learnt about what was happening.

Q25 **Stewart Hosie:** In the economic and fiscal outlook, you state that you have requested guidance from the Government on the policy assumptions you should make in the event of a no-deal exit from the EU. What additional information do the Government need to provide for you to produce such a forecast?

Robert Chote: In the event that we reached the point where no deal would be the central assumption underpinning the forecast, things like, for example, the schedule of tariffs would have been something that we would have needed time to look over. As it happened, with the way the timetable did come out, that was not necessary. The tariff schedule was then published; I forget which day it was.

Chair: It was that morning.

Robert Chote: If we had had to jump on to the no-deal horse at that point, we would have needed to know about that a good deal earlier to be able to look at what we thought the likely implications were. It is not simply a question of taking the size of the tariff and multiplying it by the last import number you have thought of.

Q26 **Stewart Hosie:** Can I just digress slightly? Let us say you are in that position, you have the tariff schedule, that is all good and well, you are in to your programme of assessment and then, as we have seen today, Commissioner Hogan from the EU says that the tariff schedule is illegal. Can you take that information on board, or do you only take the information that comes from Government policy?

Robert Chote: Whether something is legal or not is clearly not an area of our expertise. It would be something where we would need to ask the Government what the basis is that they have for concluding that this is



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legally possible, and then we would have to reach a judgment on that, perhaps asking for other alternative advice. It would be overegging it to say that we would give a more legally informed answer to that question than others would.

Chair: You will have the lawyers on standby.

Robert Chote: We do not have the budget to have lawyers on standby at quite that level.

Q27 **Stewart Hosie:** In the recent forecast evaluation report, you indicated that post-referendum inflation increased borrowing by £3.9 billion relative to the March forecast. Does that shed any light on one way in which a no-deal Brexit might impact on public finances?

Robert Chote: The impact of a change in the exchange rate would presumably be one important consequence of this. That does impact via inflation, in particular RPI inflation and then on to debt interest bills. This would be part of a broader constellation of presumably market and economic responses that you would want to take into account. Yes, we did highlight that was a direct effect that we had tried to take into account in the November 2016 forecast and looked at thereafter. For example, among other thing, changes in interest rate expectations would be a very important input in to what we thought was going to happen on debt interest as well as RPI.

Q28 **Stewart Hosie:** I presume, therefore, that you would agree with the withdrawal analysis that there would an extra 2.4% of borrowing associated with no deal in the long term?

Robert Chote: In that world, we would have to look and see whether that was the right sort of number. They are predicating that on a particular set of assumptions about how the economy would perform. As Andy said, in the process of going through that forecast, I suspect we would be learning more about that than you would do if you were staying here and trying to predict it in advance.

Q29 **Stewart Hosie:** I have one final technical question on table 311 in the economic outlook, on the dollar per barrel oil prices. You have it from 1920 following annually by 18%, 14.5%, 14.4%, 14.7% and then 15%. That is what it says here.

Robert Chote: That is the dollar fall. Most of these are the percentages. That is the dollar.

Andy King: It is dollars relative to the last forecast. It is a flat change.

Q30 **Stewart Hosie:** I am not quite clear about this because it says at the top percentage change on the previous year. Is that 18%, followed by 14.5%, followed by 14.4%, followed by 14.7%, followed by 15%? If it is, it implies the dollar per barrel price is down 50% over the forecast period, which did not strike me as right.



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Andy King: Maybe it is not quite clear in the table but it is percentage change unless otherwise specified, and this one is otherwise specified as being dollars per barrel. That is describing the level of the price, which, as you can see in the previous table, runs at \$62 up to \$65. It is \$15 lower than our previous forecast.

Stewart Hosie: That is helpful. I wanted to clarify that. Thank you.

Andy King: We do have a chart of the oil.

Chair: It is a memory test now.

Sir Charlie Bean: There is table 312 on page 37.

Robert Chote: As you can see there, it is basically a level shift. We use the futures curve in the near term and then assume constant yield thereafter.

Q31 **Colin Clark:** You have already touched on tariffs, so bear with me. The Government have produced a tax information impact note on setting the majority of tariffs at 0% for a period of 12 months in the event of no deal. We have already discussed that we do not know the timing of that no deal; it may be shorter than we thought. It says that in the event of a no-deal scenario, full estimates of the Exchequer impact will be produced and set out at a later date, subject to scrutiny by the Office for Budget Responsibility. What I am getting at is exactly what you said: considering 29 March is the legal date, is that even plausible? How much work have you already done?

Robert Chote: We would only take that into account if you were in a no-deal world and that was current Government policy at the time. We would then take it on board along with every other policy announcement that is made at that stage. The particular issue here would be that that tariff schedule is for one year, so we would also need to clarify with Government what the default assumption would be about what happens subsequently, because that is only the first year of the forecast. It is not something we have looked at in detail yet. You would look at it in that eventuality.

What you can probably say is that if you look at the numbers there, we are dealing largely with cars. That would be the dominant effect here. If you were doing this or if other people were doing this, they could look back at what the amount of imports was that you would think would be subject to these tariffs. You then have to take into account behavioural changes, how people's behaviour might change and what might be quite considerable compliance challenges in doing this. One issue is that there are different tariffs for finished and non-finished vehicles. What would the process be? How easy would it be to have an unfinished vehicle where all that needed to be finished was sticking on a wing mirror? That is then a finished vehicle. If you are treating those two things differently, what is the process for deciding how that actually operates in practice? Those are the sorts of question we would want to ask in that sort of world in



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addition to taking a list of numbers and multiplying them by another list of numbers.

- Q32 **Colin Clark:** On that basis then, inasmuch as it is such a moveable feast, how long would it take you if we were not charging towards the date of 29 March? How long would you have expected to take to evaluate this?

Robert Chote: We would expect to be given the same sort of notice that we get of a policy change in a normal forecasting round. Here, you have something that might have implications for inflation so you would want it notified in sufficient time to be able to take that into account in the economy forecast when you were doing it. It would be doable within the normal forecast round timetable.

Colin Clark: For the clarity of the report, how long?

- Q33 **Chair:** Could you do it within 10 weeks?

Robert Chote: Yes. A lot would depend on what sort of questions we came up with for HMRC on exactly how this would be implemented and those sorts of questions. How in practice would you distinguish the difference between a finished and unfinished vehicle? We would be thinking about that and how straightforward it is to roll this out in concrete delivery terms.

Andy King: There is also a link with the Northern Ireland border where we would just be asking lots of questions, as I said earlier, about how this would happen in the real world. Running it through a spreadsheet is relatively simple; working out all the real-world ways in which the spreadsheet answer is wrong and needs changing is what takes the time. It is hard to say how long because it depends how difficult it is to answer those questions.

- Q34 **Colin Clark:** The Chancellor said in a letter to this Committee that setting the temporary tariff would maintain open trade on the majority of UK imports to support consumers and business supply chains but retain necessary tariff protection for particular sectors of the UK economy. Have you done any work on that yet?

Robert Chote: No.

- Q35 **Colin Clark:** You have not evaluated that yet.

Robert Chote: No. In the world in which that is policy and part of the central policy assumption, we would do on that basis. It is not our job, on the basis of the instructions you gave us in legislation, to say whether this is a good or a bad thing. On that basis, we would take into account if that was the central policy assumption.

- Q36 **Colin Clark:** Would you expect Government to produce detailed sectoral and regional analysis to identify the full impact of reducing the majority of tariffs to 0% for 12 months? Is that relevant or doable?



Robert Chote: The sort of modelling work that they have done in the past has looked at regional and sectoral implications. I presume if that technology is there, they could apply that to this.

Q37 **Colin Clark:** One of the biggest sectors that they are clearly trying to protect is food and agriculture. We export £21 billion but we import £46 billion. You would have to measure whether or not, in that sector, that is deflationary or inflationary.

Robert Chote: We do not produce a central macroeconomic forecast. We would have to worry about it in terms of the concern that it affects the overall macroeconomic forecast and the variables that we care about in terms of the way they drive the fiscal forecast, amongst them prices and inflation.

Sir Charlie Bean: We would need to take a view about how the tariffs would feed through to domestic prices in the particular categories. It is not obvious that tariffs are entirely passed through. In some cases, the foreign producer may absorb the tariff. One of the questions we would be throwing at the Department producing the numbers would be whether the assumption that it passes through sensible. There is then the question about leakage and the compliance question. Because these are quite tightly targeted tariffs, there is more scope to redefine a product so it falls in a different bucket. We would need to take a view about how much of that might happen and then put all that together to look at, say, the overall effect on consumer prices. I should say, thinking about this in the context of doing this in a forecast, that the tariff effects would be completely swamped in all likelihood by the exchange rate effect. It is pretty small beer, in all likelihood.

Q38 **Mr Clarke:** Gentlemen, if I can take you on to business investment, which is obviously something you focused on in the report. Chart 2.3 of the Bank of England's inflation report from February shows how the fairly marked improvement that we witnessed since 2010 has stagnated in recent years. To what extent is that directly attributable to the Brexit vote?

Sir Charlie Bean: A good chart here is 3.3 on page 28, which gives you non-dwellings investment since the referendum for the UK and other G7 countries. A good chunk of that is business investment. Pretty much in all the other countries it has grown by about 10%. That is roughly what we would have expected given the UK's position in the cycle in early 2016. It is reasonable to attribute most of the shortfall that you see here to a Brexit effect. There is nothing obvious that has happened in the UK independently that would have acted as a drag on investment.

If you were thinking about the overall slowdown or shortfall in GDP growth, that is not all investment. Part of that is net trade as well. Purely in terms of investment, I would attribute most of that shortfall to the effects of uncertainty, which you would expect to unwind once the



uncertainty is resolved. You would expect a good fraction of that to unwind in due course.

- Q39 **Mr Clarke:** How much and how quickly are the questions that then arise from that. That is hugely important in terms of the impact both for productivity and wider economic growth. Assuming resolution was achieved next week, which is a possibility, how swiftly thereafter do you think you would see a return to trend expectation?

Sir Charlie Bean: I do not think a resolution of the uncertainty next week is possible. It precisely goes back to the earlier discussion about potentially having several years of consideration about what the ultimate trading regime is, and also what the migration regime is, which could potentially alter.

- Q40 **Mr Clarke:** What about if the fundamental question of whether we are leaving or not was to be settled next week by a vote in the House of Commons? Leave aside the political complexities. Assume that the direction of travel had been decided.

Sir Charlie Bean: If you really did literally resolve the uncertainty and people were confident about where the economy was going to be aimed in future, you might expect a reasonably quick bounce-back, not all in one quarter but over the space of a couple of years. You would not necessarily get all of this back but you would certainly expect businesses that have put things on hold, which now have clarity about where things are going, to say, "Okay, we can go ahead with that". The likelihood, to be honest, of resolving that uncertainty is close to negligible. The reality must be, surely, that even if you take some of the worst downside tail risks off the table, there is still going to be uncertainty, which gradually businesses will learn about and the uncertainty will gradually get resolved. A more plausible story is that it comes back over several years.

- Q41 **Mr Clarke:** You think, nonetheless, that in that scenario that latent capacity will indeed, over time, come through in the real economy?

Sir Charlie Bean: Yes, and indeed in our central forecast some of the justification for the recovery in investment growth is precisely a resolution to some of that uncertainty. That is why we have investment growth picking up to about 2.5% a year, though still below what one would expect given where we are in the cycle and with unemployment at low levels. You would have expected business to want to be doing a lot of investment at this stage, substituting for use of labour with capital and so forth.

Robert Chote: You can see on chart 3.25 on page 53 the fact that you have had this particular weakness in business investment in recent quarters, with four successive declines. The forecast is assuming that it rises as a share of GDP over the course of five years but that you do not get back to where you otherwise would have been.



One point that is always worth making with business investment is that this is not the strongest part of the data for the national accounts. You can see big revisions to what you thought was happening to it in the past, let alone where you think it is going in the future. One should always be cautious about that. If you look at the way in which the economy has performed and look at the forecast we made immediately after the referendum, so taking into account the vote but not a long-term view of where that was, to begin with business investment held up better than anticipated. It then weakened more significantly and is now, as it were, negative. It is below, over the full two and a half years, where we would previously have anticipated it to be at that time.

Again, it underlines this point that at the time of the referendum, yes, you would expect it to weaken business investment, but knowing over precisely what time horizon that shows up in the data, over what time horizon it affects businesses' decisions and then how that is reflected in the data is not straightforward.

Q42 Mr Clarke: No, of course. Indeed, you enter subjective territory around human sentiment, which is very hard to model at the best of times, even in the most benign circumstances.

Robert Chote: This does not just apply to business investment but the notion of how business and consumer confidence and behaviour respond to fundamentally big political changes as well as concrete economic ones is not easy.

Q43 Mr Clarke: One of the alternative scenarios is that we enter a long extension of Article 50 in the weeks ahead. Were we to end up in that scenario, which I think would be undesirable for all sorts of reasons, with the potential for a future no-deal outcome to stretch ahead long into the future, would that presumably maintain the ongoing weakness in business investment, or do you think there would be some amelioration?

Robert Chote: The longer a greater degree of uncertainty persists, fairly obviously the weaker investment would be. The issue here would be whether an extension to Article 50 was delaying to the same degree the point at which you know where you are going to end up in terms of the long-term trade relationship, or whether you are eating into the transition period that we are already assuming here, in which case, whether you call it a transition period or an extension is neither here nor there in terms of the economic consequences.

Q44 Mr Clarke: In terms of measures that are open to policy-makers at a time of such high uncertainty, the economic and fiscal outlook says that tax measures announced in the last Budget do provide some measure of support for business investment. What scope do you think there is for policy to stimulate investment in the current climate?

Robert Chote: It is not our job to say what policy ought to be. If you look at the sorts of changes we have had in the past, for example if you have changes in the corporation tax rate, we reflect those fairly



straightforwardly in terms of what that implies for the cost of capital and what that implies for business investment. This comes back a bit to Charlie's point. If you are in a world of deep-seated uncertainty about what it is companies ought to be investing in, because they do not know what your end state trade relationship is and what sort of labour they are going to be able to get access to, making investment cheaper at the margin through tax measures is not necessarily going to be as powerful an instrument as it otherwise would be. Is that fair?

Sir Charlie Bean: Absolutely. The sort of environment we are talking about is one where many of the conventional instruments you might think of, which include things affecting the cost of capital, investment allowances and so forth, are likely to have less purchase. There are circumstances in which policy instruments are not as effective as we would wish. Uncertainty shocks are things that are very difficult to use as policy instruments to lean against. If there is a general decline in demand for some reason, then there are those fiscal and monetary instruments we can use against them, but in terms of heightened uncertainty about the environment that leads decision-makers to be cautious, it is quite difficult to lean against that effectively with conventional policy instruments.

Q45 **Mr Clarke:** My final question is on the hangover effect that this has on long-term productivity and growth. Do you think there is a case for revising your estimates of trend productivity, given the ongoing weakness in business investment and given that you would perhaps expect there to be a spill-over from one to the other?

Sir Charlie Bean: First of all, what we are discussing, in terms of the impact of Brexit and productivity, is still relatively small compared to the big uncertainty about why productivity has been so weak over the past decade. It is about 20% below a continuation of the pre-crisis trend. This is huge. You can debate about how big the effects of Brexit may be one way or the other, but they are small compared to that shortfall. For a long time, we—when I was at the Bank of England it was the same—expected a slowdown in productivity growth to be temporary and that we would resume pre-crisis rates. Eventually, we recognised the reality: it looked like that return to past trends was not immediately on the horizon, which is why we shaded down our productivity trend a year or so ago, whenever it was. Personally, I am still reasonably optimistic about the longer term.

Having said that, this is an area where there are lots of theories out there and we really do not understand what is going on. It is reasonable to say that, because of the Brexit considerations that we have been talking about, maybe we ought to be playing around with that trend, but there is a dangerous illusion of knowledge here. Because there is so much background uncertainty now, and we are talking about what are really quite small tweaks in the path, it would be sensible every forecast round for us to be trying to fine-tune this. If we get evidence that really



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suggests that we should make a significant change to the medium-term outlook then we would do that but it would be motivated by observing what has been happening, rather than a change in the likelihood of the Brexit regime.

Robert Chote: When we made the initial post-referendum adjustment back in November 2016 on productivity and we brought down expected potential GDP and productivity growth, at that stage the investment through to capital deepening argument was quite an important part of that. We took a chunk out on that basis. As Charlie says, in terms of knowing at this point how good or bad that judgment was at that stage as a guide to where you are in the medium and longer term, we are not that much wiser than we were back then.

Mr Clarke: It is like Zhou Enlai on the French Revolution: it is too early to say.

Q46 **Rushanara Ali:** Good morning. The economic and fiscal outlook highlights the declines in consumer confidence surveys and in retail sales at the end of last year as signs of a consumer slowdown but both retail sales and the GfK consumer confidence index have improve since the new year. Overall, is there any strong evidence that households are retrenching spending in advance of Brexit?

Sir Charlie Bean: I would not have said there is strong evidence. In terms of our forecast, we have a pretty flat savings ratio, which means consumption is growing in line with income. There is a soft patch for real household income growth in the short term through this year and then it picks up a bit as you go out through the forecast period, partly on the back of a pick-up in productivity growth and, with it, real earnings growth.

Q47 **Rushanara Ali:** There are regional variations.

Sir Charlie Bean: There are, but of course we do not get into detailed regional forecasting or anything like that. It is plausible there should be some regional variation, yes.

Q48 **Rushanara Ali:** There is a report by PwC, which shows quite an interesting difference between the north-east and London, which reflects the expectations and attitudes to Brexit. I do not know if you have had a chance to see that.

Sir Charlie Bean: No, I have not read that particular report.

Q49 **Rushanara Ali:** Mr Chote, did you want to add anything to that?

Robert Chote: No.

Q50 **Rushanara Ali:** I know you touched on stockpiling earlier, but I just wanted to dig deeper into that. Is there any evidence of households stockpiling, or is it all just anecdotal? I think you mentioned earlier that there is some anecdotal.



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Sir Charlie Bean: It is largely anecdotal. When it is businesses, there is plenty of evidence from surveys and things like the Bank of England's agents, their senior decision-makers panel and so forth. As far as householders go, I am not aware of any hard evidence. It is all anecdotal.

Robert Chote: Even on the business side, it is more in the survey evidence than it is concretely in the official—

Sir Charlie Bean: The only thing I would say about that is that there was an upside surprise on stock-building, as far as we were concerned, in the back half of last year, which I would attribute in part to precautionary stock-building by businesses but the aggregate stock building numbers are very prone to revision. We may be having this conversation in six months and the numbers are completely changed.

Q51 **Rushanara Ali:** According to one report, three-quarters of warehouses are at full capacity.

Sir Charlie Bean: Yes, that is the sort of thing where there is some information. I believe Governor Carney referred to this when he was here.

Q52 **Rushanara Ali:** On consumers and stockpiling, there was one news report on 17 March that suggests that Brits have spent over £4.6 billion on Brexit stockpiling. There was another report, a news report again on 13 March, that Morrisons sees signs of Brexit stockpiling. There seem to be signs of people starting to do this. Obviously, it is going to be different for different households depending on what they can afford to stockpile. You are saying that it is anecdotal but there are reports emerging.

Sir Charlie Bean: That is anecdotal.

Q53 **Rushanara Ali:** Sure, but it is a significant number, if it is £4.6 billion. It would be interesting to hear your reflections on where you think things are going, particularly if we see a no-deal scenario, given the uncertainty and what is already beginning to emerge in terms of consumer behaviour.

Sir Charlie Bean: One of the key things is that if there is a lot of this behaviour, it also potentially worsens the shortages. It is like a bank run. It makes things worse because everybody is trying to stockpile the commodities because they think they might run out. That creates the shortages. That is one thing that you might legitimately start kicking in if people think there is a cliff edge just around the corner.

Q54 **Rushanara Ali:** There is even a report of a Health Minister talking about stockpiling body bags. That cannot be sending the message to consumers that they should not be stockpiling.

Sir Charlie Bean: As I understand it, Matt Hancock has been ensuring that we have plenty of supplies of key drugs and so forth.

Q55 **Rushanara Ali:** This is Stephen Hammond, a former member of the Treasury Committee.



Sir Charlie Bean: This is rational precautionary behaviour by individuals but when a lot of people are doing it, it can worsen the problems.

Q56 **Rushanara Ali:** You can see the contradiction here, can you not?

Sir Charlie Bean: I am not sure it is a contradiction; it is a tension. That is a better word.

Q57 **Rushanara Ali:** "A tension" is probably a better phrase. In terms of mixed messages and uncertainty, it is starting to feed into how consumers are responding because consumer confidence was a lot higher but is starting to become more complex in terms of responses, which is understandable.

Robert Chote: It is clearly an uncertain environment for anybody who switches on the news.

Q58 **Rushanara Ali:** Are any of you stockpiling yet?

Robert Chote: In terms of distinguishing what exactly is being done at a very micro level, the evidence base is not particularly robust for this. It is the sort of behaviour you would expect in a world in which people are uncertain, but saying quite how much impact somebody specific saying something specific has on this is probably stretching it a bit.

Q59 **Rushanara Ali:** I am going to move on to housing and house prices. You are forecasting that house prices will be broadly stagnant this year before rebounding from 2020. Is this just a blip, or a more fundamental correction in house prices?

Sir Charlie Bean: At the moment, we have taken the view that it is a period of temporary weakness, or, as you say, stagnation over the next few quarters. No, I would not call it rebounding but a recovery so that they grow in line with real incomes.

Robert Chote: There is a chart on page 51, chart 3.23, which shows it effectively, as you say, stalling for a bit but then going back. You will have lost a level but it will go back to the growth rates there. In the short term, that is reflecting, in particular, the way the survey evidence is pointing—RICS and consumer confidence.

Sir Charlie Bean: The near-term dip is driven by the evidence from things like the Royal Institute of Chartered Surveyors' expectation survey, availability of secured credit indicators and things like that. They condition our forecast over the next six months or so and then our macroeconomic model takes over.

The thing I would emphasise is the uncertainty around this. At the Bank of England, we spent a lot of time, while I was there, trying to figure out what was going to happen to house prices. They consistently surprised us on the upside. This may well be another of those instances. Equally, we know house prices on occasion can fall sharply. There may be a more enduring weakness. It is not obvious why you should see a more



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enduring weakness conditional on what we have in our central projection, which is reasonably steady growth after a slight hiatus.

Q60 **Rushanara Ali:** You are making an assumption on a smooth Brexit.

Sir Charlie Bean: Yes, absolutely. I am saying that conditional on that, it is rather difficult to see why you should have a very sharp slowdown in house prices, house prices falling or anything like that. If you go into a world that looks very different with quite a sharp contraction and a lot of cautiousness on the part of households and business, as we did after Lehman Brothers, you would expect to see a much sharper slowing in the housing market.

Q61 **Alison McGovern:** I want to ask some questions about unemployment and wages. In response to questions from colleagues, you have already said on several occasions that in relation to the data there may be regional variations but that it is not really your role to consider that. I want to start there and probe that somewhat, because the implication of that is that any regional variation does not affect the aggregate and therefore we are not interested in disaggregated data because that has no impact on the national picture. Is that correct?

Sir Charlie Bean: As far as we are concerned, we would be interested in regional information if it helps us understand what is going on in the aggregate data. There may be times when understanding the regional pattern, particularly if you have some parts of the country that lead, such as London, is helpful. Housing, if I can go back to that, is a good example where there seems to be some evidence that movements in London house prices tend to lead the rest of the country. That might be an example where digging into the regional information might help you. However, we do not have an interest in the regional breakdown per se.

Q62 **Alison McGovern:** Can I just put it to you, though, that the public worry greatly about the lack of balance in the UK economy? There is a lot of anger at the moment about London racing ahead. On several occasions, this Committee has raised concerns about the impact of Brexit on regional imbalance and whether or not it is going to make it worse. As a profession, economists regularly come to this Committee and say, "We are uninterested in the regional disaggregate. We might be interested if there was any evidence that regional impacts had an influence on the aggregate figure but insofar as it does not, we are not interested". Do you not think the public will be frustrated at that?

Sir Charlie Bean: We are talking at cross-purposes here. First of all, in defence of my colleagues at LSE in the Centre for Economic Performance, they have an extreme interest in regional developments. The question is about what we are asked to do at the OBR, which is essentially looking at the public finances. We are not asked to analyse policies that are trying to influence regional distribution or things like that. These things are very important; they are just not our agenda.

Q63 **Alison McGovern:** Let me put the question in a different way, because I



do not think we are talking at cross-purposes. I have not explained my question well enough. When this Committee visited the Fed, we heard evidence that there were significant problems in the US labour market that were being caused by regional, concentrated high levels of unemployment, and that that was having an impact on the aggregate US economy. We know that in our own history, in the United Kingdom, significant pockets of unemployment in particular locations in the country have caused problems for the UK economy as a whole. What you are telling me at the moment is that you do not think that there is any evidence at the moment that the UK as a whole should be bothered about significant levels of inequality—

Sir Charlie Bean: I am not saying anything remotely like that. What I am saying is that for the purposes of understanding what is going on in the macroeconomy and our fiscal forecasting, our interest in regional developments is merely insofar as it gives us a handle on that. It does not say regional issues are not important in their own right, neither does it say there might not be occasions when understanding what is going on at the regional level might be important.

On the particular example you give, that pockets of high unemployment in particular regions might be helpful in understanding what is happening at the aggregate level, we are in an economy where unemployment is extremely low at the moment, historically.

Q64 **Alison McGovern:** Let me come to that. Your report says that the unemployment rate fell to 4% in quarter 4 2018 and that employment growth this year is forecast to be somewhat weaker in your October forecast. You go on to say, “We expect the employment rate to edge up to about 4.1%, returning to its equilibrium of 4% by the end of 2022”. That is fine but in the House of Commons, Members of Parliament from Birmingham pointed to unemployment rates in their constituency of closer to 10%. Are you seriously telling me, as a professional economist, that that level of variation in the employment rate between different parts of our country is inconsequential to our country’s economic prospects?

Sir Charlie Bean: No, I am not saying that at all.

Q65 **Alison McGovern:** Then why would you not consider it a matter for your report?

Sir Charlie Bean: There is inevitably regional variation in unemployment rates. There is variation in unemployment rates across ages too. They can be shifted by policy interventions and it is perfectly sensible for Governments to seek to do something about that. I am merely pointing out that for what we have to do, which is quite a narrow remit—and it was the same at the Bank of England where the interest was in the aggregate economy—our interest in what is going on at the regional level is only relevant insofar as it helps us understand what is happening in the aggregate. That is not saying that the regional things are not important.



Robert Chote: There are an awful lot of people doing very good work in this area.

Alison McGovern: I know. I am well aware of that, but I am asking you, as the body that is responsible for informing the House of Commons as to the economic future of our country and the consequences for public finances, what you think your responsibilities are. Let me put the question a different way.

Q66 **Chair:** Is this an issue with your mandate?

Sir Charlie Bean: Yes, if you like.

Robert Chote: Fundamentally, we have to produce the macroeconomic forecast that we need in order to forecast the variables in the public finances that you, Parliament, have told us that we have to produce. Charlie has written books and papers on the nature of unemployment. Mismatches within the economy and in the labour market are an important driver of the sorts of judgments you end up making on things like the aggregate equilibrium rate of unemployment.

Q67 **Alison McGovern:** If we accept that the only thing that should inform our decisions about the public finance is the aggregate as presented, there is a suppressed premise that people can just move, and that if we have an imbalance in different areas in the employment rate, if we want to take a read-through from a low employment rate into the consequences for the public finances, that assumes that people will just move to get a job. That is a public policy assumption that the public would be very concerned about.

Sir Charlie Bean: We certainly do not assume that. The whole justification for why the economy, when it is operating to capacity, will have some unemployment is precisely because it is not a frictionless labour market. People cannot move regionally, easily, from where they have lost a job to where they might get a new job. Equally, they may not be able to shift from the occupation that they previously had to a new occupation, because they may need to reskill. That is the whole reason why the equilibrium unemployment rate is what it is.

In understanding where that number lies, which we currently have at 4%, it is about looking at these regional questions as to whether they have shifted. That is actually the key for us: whether regional mismatch or skill mismatch has changed. That is exactly when it will be insightful.

Q68 **Alison McGovern:** Let us move on. I think I have made my point. What do you think about the potential for structural unemployment? We have a low rate and also expectation of low rate of unemployment in the future. What do you think the prospects hold for the stickiness around skills and the mismatch of people's skills against opportunities if the political process that we are going through at the moment changes the mix of businesses we have in the country?



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Sir Charlie Bean: You would certainly expect Brexit to lead to some industrial restructuring. Some industries are going to benefit from it. Some are going to lose from it and need to contract. The resources need to shift from one to the other. That will lead to a period where the equilibrium rate of unemployment will be higher. Equally, you may need some changes in skills. The migration regime, how that operates, is also potentially relevant. If it leads to certain sorts of skills being in short supply, then that can have ramifications for the demand for other sorts of labour too. It is entirely plausible that the equilibrium rate of unemployment will move and quite possibly edge up for a while.

Q69 **Alison McGovern:** It might not if the trend for self-employment and underemployment continues. Your reports notes that it has moved relatively slowly from 12% of people being self-employed to 15%. We could see that trend continue, which might help keep the equilibrium rate of unemployment lower than it would otherwise be.

Sir Charlie Bean: It is possible that people who struggle to find a regular job set themselves up as self-employed agents. I have to say that we think probably the tax system may be more of a driver there than people responding to labour market pressures.

Q70 **Alison McGovern:** Do you have particular evidence that causes you to think that?

Sir Charlie Bean: From what we know about the rise in the share of self-employed, when it dates from and so forth. Academics have done some work on this. You may be more familiar with some of it.

Robert Chote: We did some work a couple of reports ago, looking at the tax consequences of different forms of arrangement. If people are companies, if they are self-employed or if they are employees, those can make a significant difference. We assume in our fiscal forecast that people respond to those. There is also a broader issue that there may be underlying changes in the nature of people's work that might want more people to move in that direction anyway.

Andy King: You can map the rise in the self-employed share quite neatly on to the rise in the number of owner-managers of companies. You can map the numbers together quite well. We did it in the fiscal risks report.

Q71 **Alison McGovern:** There is correlation at least. I just have three questions on wages. On the assumptions about growth in wages, you say that a modest increase in productivity will help wage growth through to 2023. How does that compare to wages growth that we saw pre the crash?

Sir Charlie Bean: It is still significantly weaker. Earnings growth was about 4.5% a year in the couple of decades leading up to the 2007-08 crisis. We are talking about earnings growth of 3%, edging up to 3.5% here, and inflation being roughly the same in the two periods. You are



talking about a percentage point a year weaker than pre-crisis. That reflects back that productivity growth is about a percentage point weaker.

Q72 Alison McGovern: Just turning to the area where productivity has been a real challenge, in the lower-earnings end of the income distribution, the one thing that the Chancellor did mention was the Government's ambition to get the minimum wage to 60% of median income. We know that there are more and more people who are proportionally in that lower end of the distribution, with 3 million people being paid within 50p of the legal minimum. In that group, we have twice as many women as men. Do you have any scepticism about what the impacts might be? We are all assuming that the labour market will respond in the way that it has and that there will be minimal impact on the labour markets from the Government's stated ambition. Would you agree with that?

Robert Chote: The Government hinted at this at the time of the Budget. There is a box in the last EFO that tries to look at some of the potential employment consequences. There are not many other countries that are trying minimum wages at that sort of level relative to the median. It would be interesting to see this review that the Chancellor has ordered, with an academic, to look at this to see what he can come up with there.

Sir Charlie Bean: That is with Arin Dube.

Robert Chote: There are not an enormous number of countries in that position to whom you could compare yourself. It is not a straightforward task, but I am sure he is a bright chap and I am sure he will have a good crack at it. You are right in the sense that more people are covered by this. I think we estimated last time that you would be moving to a situation whether about a quarter of the labour market would be directly affected.

Sir Charlie Bean: That rings a bell.

Robert Chote: Another quarter would be indirectly affected, because you would expect the ripple effects to rise up through the wage distribution.

Sir Charlie Bean: The crucial thing is it is relatively easy to work out what fraction of the population are directly affected, but the big unknowns in this are to what extent wages above the floor also rise to partly restore differentials and, secondly, what the employment response to that is. One of the key things has been when the minimum wage was first introduced that seemed to have relatively limited employment responses. That was basically because this was concentrated in industries where employers had quite a lot of monopsony power. They were a dominant employer in the locality. They ended up absorbing most of the cost.

As you go further up the pay distribution, that assumption might be less plausible. It seems to be reasonable, both because you are affecting a bigger proportion of the workforce and because the employment



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elasticities might be bigger, that a given percentage point increase in the minimum wage is likely to have more of an adverse effect on employment now than it did when it was introduced at relatively low levels. Exactly how much of an effect that has is precisely what Professor Dube will be probing into, using what he knows particularly about the way the US in different regions has responded to minimum wages there, but also other countries.

Q73 Mr Baker: Good morning. Turning to the much neglected topic of the public finances, you have dutifully forecast that the Chancellor is more likely than not to fail to meet his fiscal target of a surplus in the mid-twenties. In response to the Chair, the Chancellor said in the House, "The deficit will be 0.5% of GDP, but whether we choose to get the deficit down to zero or choose to do other things is a choice". Do you think the Chancellor has the same understanding of his fiscal objectives as you have.

Robert Chote: The fiscal objective is well set out. Exactly the date at which it is applied we have taken to be 2025-26 on the grounds that that was the point in the Parliament at the time that the target was set in the first place. We cannot say explicitly whether the Government is on course to achieve that, because it is two years beyond the end of the forecast horizon. What we would note is that there is still a deficit at the end of the forecast horizon. In the years following that, you would expect there to be more upwards pressure on public spending from an ageing population than has been the case recently. That is the basis upon which we say it is not clear yet that one is on course to achieve that.

What the Chancellor is talking about here is the constellation of choices that he is going to have to make, come an autumn fiscal event, about what set of fiscal rules he wishes to operate by over the medium term and how that is going to guide the set of spending choices he would make over that. He is basically saying he has a choice about whether to stick with that sort of objective, whether to stick with that sort of time horizon for it and what to do about the shorter-term targets that he has as well.

Q74 Mr Baker: It sounds like you are not quite ready to say that he is failing to meet his objectives.

Robert Chote: As I say, we put the red cross on the website that it is not yet clear that he is on course to achieve it on current policy. The question here is whether we find out more about policy over the remainder of this period to the mid-twenties and whether the target stays the same.

Q75 Mr Baker: In our report on the Budget, we said of the Chancellor that he appears to be disregarding the fiscal objective. We went on to say, "It is now clear that the fiscal objective now has no credibility". Would you agree with us that the objective has no credibility and that the Chancellor is disregarding it?



Robert Chote: What I assume you were referring to in the report in that case was in the last fiscal event there was a big underlying forecast improvement that on its own would have got you to the point at which we would have said, "Yes, you were on course to achieve that target but the money was spent". Actually, the money had been spent the previous June or July on the NHS announcement, so it is unclear to what degree it was a response to the forecast change. In that level, the Chancellor had an opportunity to move on to that sort of trajectory and did not take it, but given that the Prime Minister made a big health spending announcement some months previously, that is not quite at the same level.

He would say, "We now have, on the basis of the performance of past forecasts, a roughly 40% chance of balancing the Budget as early as 2023-24." That is by no means out of reach in that sense. There is then the related issue about the spending pressures in the following two years. That would be an issue for future spending reviews. Do you feel the need to spend more, as a higher share of GDP, on health or social care or whatever it might be, to address those sorts of issues?

Q76 **Mr Baker:** Was the Committee right to say that we should replace the objective?

Robert Chote: Parliament was, I am sure, right to say that the OBR should not express a view of what the appropriate time period should be.

Q77 **Mr Baker:** I will move on then, because we need to turn to the forecast of tax revenues, and income tax in particular. To what extent is the forecast growth in tax revenues being driven by increased inequality in pre-tax earnings? I particularly am struck by a chart that you possibly will not have. It is a chart from the IFS, which has a striking increase for the highest earners. In your own report, you point out that just 31,000 taxpayers now account for 7.9% of PAYE income tax and NI receipts. To what extent is your very important forecast of higher tax receipts driven by this income inequality?

Robert Chote: Let me say something briefly, and I will allow Andy to pick up particulars. There is information there that you are referring to from Real Time Information, which is a useful source of new data from HMRC. You are right in the sense that we have income tax higher throughout the forecasts. That is the largest single moving part. You have had, since the last forecast that we produced, revenues coming in particularly strongly in January, the major month for income tax revenues.

That partly reflects the fact that you have earnings growth being relatively strong and, as Andy will come to in a minute, there is evidence that you are seeing particularly rapid growth at the high end of the employee earnings distribution, so people who are therefore paying a relatively high average tax rate. That provides you with a stronger basis. There is also self-assessment income that has come in more strongly



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across the board. Some of that is obviously on the income tax side, but it is telling you about what happened in 2017-18. That distributional point is important. I will ask Andy to say a little more.

Andy King: The IFS charts draw on ONS survey data, which is an annual survey. Unfortunately, they take that data point in April, so it is often distorted by anything to do with the tax system. At the top end, it looks quite similar to what HMRC's information from the PAYE system looks like. At the bottom end, it does not, which is to do with the change in the timing of when the national living wage moves. On the HMRC numbers, it has got a smile. The bottom end is doing well and the top end is doing well. For tax, what really matters is what happens at the top end. We looked at a few tax systems in our risks report. Now the proportion of receipts from the top end is quite high, that makes it quite difficult to forecast, because you are basically looking at a very small population with quite a lot of power over what they pay themselves.

In this instance, what we have done in the forecast is we have seen what is happening in the data to this point, and because of Real Time Information this point is reasonably close; it used to be somewhat more lagged. We have reflected that in the forecast, but we do not assume that continues over the next five years. It locks in a more tax-rich distribution that generates fiscal drag. We do not assume that good news compounds further in future years.

Q78 **Mr Baker:** Thank you for that quite, if I may say so, technical explanation, but do you not think it is quite extraordinary that 31,000 people are paying 7.9% of PAYE income tax? Is it not extraordinary that we are so vulnerable to such a small population and the tax they pay?

Andy King: As I said, it was an issue that we looked at in our fiscal risks report. This concentration amongst small numbers is the same as with stamp duty in the property market, where a small number of transactions in Kensington account for a large proportion of receipts each year.

Q79 **Mr Baker:** With that in mind, to what do you attribute this extraordinary phenomenon? What is driving this increase at the highest end?

Andy King: Over the past year, I could not say what is driving the recent change. My expertise is not in the distribution of income, but my understanding is that this has basically been trending to a more equal distribution over recent years. This is turning back to something that we saw pre-crisis, where the top of the distribution is doing better than the average.

Sir Charlie Bean: Can I just interject here? It is worth saying that there is an international aspect to this. In a lot of countries, although there is not a lot of action going on in the bulk of the wage distribution, there has been a big increase in equality at the very top in the last two years, which may be to do with superstars being able to claim more of their



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income and so forth. It is an area that has quite a lot of debate, but it is an international phenomenon. It is certainly very apparent in the US.

Q80 Mr Baker: I am glad you raised the international phenomenon, because it seems to me just about everywhere we are still running what the Governor once told the Committee is extraordinary, if not emergency, monetary policy. Do you think that could have anything to do with income growth at the top end?

Sir Charlie Bean: It is not obvious why it should be connected with monetary policy, because remember we are talking about PAYE taxes here. We are not talking about asset income. If it was asset-related, there might be some connection with monetary policy.

Q81 Mr Baker: I am sorry to interrupt, but Andy, moments ago, was saying that some of this very small population have a great deal of power over what they pay themselves. If one were to be handling, for example in the City of London, assets whose prices were shooting up due to monetary policy, and one had a lot of power over what one paid oneself, would that not explain the connection?

Sir Charlie Bean: You are right there. There may be an indirect element, but you would probably expect to see that also in unusually high bonuses. I am not sure that bonuses recently have been especially unusual.

Q82 Mr Baker: I had better move on from an old sore of mine. I really wanted to talk a bit about the fiscal sustainability report. I know you have one coming up. The purpose of my last question is just to encourage you, in your next report, to try to address the question of whether we are really facing up to the choices that we have. In the last report, you said that debt would go up to 283% of GDP in the next 50 years. You have said policy would have to change to ensure that the deficit was financeable. It is quite a breezy way of skipping lightly past the enormous problem we have in funding our spending.

Just to turn on to the share of tax revenues in GDP, you forecast it will rise to 34.6% this year and through most of the forecast period. This is a level that has only been exceeded once since 1950. What has changed in the tax base in the last decade to drive up tax revenues to these levels? Is it sustainable?

Robert Chote: On the question of whether it is sustainable, obviously there is a set of political choices here and there are plenty of countries that have higher and lower tax levels than this. Political scientists would say that if you look at the revealed preference of the UK population and the political choices that they make and that you end up making on their behalf, you do not nudge it much. There is nothing to stop it going higher than that if you were to set policy accordingly. It is not as though there is a technical Laffer curve that you are hitting at that point, although some people would argue that there is a political one. It is very hard to get it above that sort of level.



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Q83 Mr Baker: Can you explain what you mean by there not being a technical Laffer curve on this? Obviously, people watching this may or may not know what the Laffer curve is.

Robert Chote: It is used in the sort of analysis that we would do of individual taxes. For example, we used it, and it had been used previously, looking at what happens when you raise the marginal rate of income tax on very high earners. There is a point at which, if you raise it sufficiently high, as you well know, you end up with receipts actually falling.

Q84 Mr Baker: That goes to Andy's point about people's control over what they pay themselves.

Robert Chote: Yes, there is an intertemporal part of that as well, as to when you choose to take money. There are plenty of technical studies looking at those sorts of questions, on the nature of taxable income elasticity for particular taxes at particular points in those tax schedules. There is that.

In terms of the aggregate tax to GDP ratio, it is harder to make a similarly robust sort of analysis. Some people would say, "Look, in practice it has never managed to get above this sort of level. Is that telling you something about the political economy choices that are being made?" As I say, there are other economies that sustain tax to GDP ratios significantly higher or significantly lower than that. In terms of the evidence about whether there is a robust relationship, over time and across countries, between the tax to GDP ratio and growth performance, it is not a robust relationship.

Q85 Mr Baker: With that in mind, what do you think is the upper bound that the UK could sustain, in terms of tax as a proportion of GDP?

Robert Chote: As I say, that is a political choice as much as an economic one. There is clearly evidence in other countries that you could go higher if you wanted to and if there was the political will to do so.

Mr Baker: I will just allow you to duck that question.

Chair: Yes, that was very well avoided.

Q86 Charlie Elphicke: Good morning. Do you think it is a sign of the times that this Committee has been going nearly two hours and I am now going to be asking about the spending review? Does that not underline the problems that we have with the Brexit obliteration effect?

Robert Chote: Brexit has sucked a lot of air out of a lot of rooms, many of them that you have been living with more than we have. Clearly, on the spending review, the medium-term set of choices that has to be made will be a key part of the next fiscal event, presuming that something does not intervene in the meantime.

Q87 Charlie Elphicke: Looking at what the Chancellor said the other day, how much does the Government plan to spend in 2019-20? What will the



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total spending be in aggregate?

Robert Chote: £840 billion and of that, departmental spending will be £312 billion on resource and £60 billion on capital.

Q88 **Charlie Elphicke:** So the cash out of the door is £840 billion next year.

Robert Chote: Overall, yes.

Q89 **Charlie Elphicke:** I know you guys have looked at ring-fencing. Ring-fencing of the health service inevitably means that there is less elsewhere. That is a political choice. To what extent have you analysed how the £20 billion extra money earmarked for the NHS will be spent, how efficiently it will be spent and whether we will get value for money for that.

Robert Chote: That is outside of our remit. Our job is to do the forecasts. Therefore, we have to reach a judgment, when the Government set aggregate spending limits, on how much will actually be spent, not how well it will be spent and exactly what levels. That is for the NAO.

Q90 **Charlie Elphicke:** You look at the aggregates, not the granular. Do you get any sense of Government behaviour in spending reviews? Every three years they come along and do it in a mad panic. Do you get any sense that they do zero-sum budget setting and say, "Why are we doing this activity?" Do they all too often, in the end, just end up with a bit of salami-slicing because it is easier?

Robert Chote: Inevitably, those sorts of reviews have some combination of the two. The idea that you start with the assumption that we start with nothing and build it up from the bottom is clearly not plausible, but obviously spending reviews provide you with a better opportunity than in the day-to-day management of the public services to say, "Is this something we ought to be doing at all or differently?" It is also an opportunity to look at those areas where you can see pressures rising and reach judgments on, "We are going to have to, over time, spend more in this area, but not on the rest of them."

Q91 **Charlie Elphicke:** We have a three-year spending review system. Do you think it would actually be more efficient, from the point of view of Government finances, if they were done on a rolling basis, rather than just every three years? That would lead to greater Government efficiency, particularly in terms of spending and Parliament being able to challenge Ministers.

Robert Chote: There is a question, from your point of view, about which would be better for Parliament, in terms of it wishing to scrutinise the amount of money being spent and saying, "Is that being spent well and where people said it was supposed to be spent?"

In terms of the management of the public finances, what we are effectively doing is asking the Government to give us the concrete



aggregate spending plans where they have them and indicative ones thereafter. We reach a judgment on the degree to which we think those aggregate limits will be overspent or underspent. In practice, they are always underspent.

There is bottom-up information that you can bring to play in looking at that. If you are looking at what is going on in the current year, there is a different set of information we are looking at. If you look in future years, for example if the Government announce they are going to put in a big chunk of extra money in year 3, the sorts of judgments we will make are, "Is it plausible to expect the amount of spending to go up by as much as this implies between year 2 and year 3?" That is particularly a question of getting the capital spending out of the door.

We will ask, "Does the time profile look plausible, given what the Government have managed to deliver in terms of outcome in the past?" That is a key question for us in coming up with a forecast. It is a different question from, "Would Parliament have a better handle on feeling confident money was going to be well spent in year 2 if you had a three-year review, approached it annually or did it over a longer horizon?"

Q92 Charlie Elphicke: What you are doing is more of a desktop analysis rather than what you might do with a heavy-duty quantity surveying job on a building site.

Robert Chote: This is partly a reflection of the historical fact that Governments have tended to underspend aggregate limits by a few billion in almost every year that they have sent them out. That is not to say that those limits do not change. The NHS is a good example of a squeaky wheel that often gets greased in terms of more money being put in in that area. As I say, when we are looking within year, for example in the sort of forecast time horizon we have here, we will ask whether there is particular evidence of pressures in areas of Government activity that mean that we should change our view about the near-term overspend or underspend. Over the longer term, it is a more rough and ready process and we look at what has happened in the past.

Charlie Elphicke: We have a system where we do the spending reviews looking forward, with you doing a desktop study of, "That seems about right", and the Government just pottering along, doing what it likes with not very much challenge. Then afterwards, we then have a backwards look and that is when we do the granular system of looking at how the spending went, with the NAO coming along to carry out a ritual humiliation of whichever hapless official made a mess of building an airport in the south Atlantic. Then we will snigger about it, humiliate the poor official and say, "Is it not ridiculous that we have an airport where no planes can land?" rather than having a system of challenging ahead, to ask the officials and the Ministers whether they have actually thought about these things before they start down that road.



Robert Chote: Yes, I see that. I remember when I was at the IFS before doing this job, where obviously it was more oriented in that direction, noting it was rather strange to consider the profile in the national consciousness that a Budget gets as a parliamentary and political event versus the spending review. That is not helped, often, by the fact that spending reviews and departmental settlements are dribbled out over time, rather than confronting the whole thing there. It did strike me as somewhat odd that we have the wonderful pantomime that we are used to with boxes, et cetera, while in many ways the much more consequential medium-term judgments about what the size and function of the state is, which Parliament focuses on every three or four years, did not quite the same degree of attention.

- Q93 **Charlie Elphicke:** Let us go to a parallel universe where you have a Parliament that does have a focus on spending and a focus on efficiency before the messes and the cock-ups happen, and was able then to save just 1% of the entire public spending in each year. How much would that then save in 2019-20?

Robert Chote: If you were to save 1% of resource and capital, resource was £300 billion and capital was £60 billion, so your answer is £3.6 billion. The questions you would then be asking are, "What are the quality and quantity of services that you are getting out of this? Are those objectives well set? Are you squeezing the money out as best you can?"

- Q94 **Charlie Elphicke:** You could then have a phased shift in terms of productivity, governmental culture, cross-learning and how Government should be using technology more efficiently, and you could start to have the discussion about whether we are operating Government in the right way and whether we could reform it better to make it work more efficiently for the modern age. You might get even more savings.

Robert Chote: There is often quite a lot of language on that every time we have had a spending review for decades going back: "This is an opportunity. We are thinking more about cross-cutting issues", et cetera. It is easy to mock and say that did not work to your satisfaction entirely in the past, but there is no reason not to keep focused on what is the best way to deliver this in the future.

There is a long debate about what is the optimal degree of target-setting in this sort of environment. As you know, we have gone up and down the hills on that in terms of whether you want a few broad things or whether you actually want an awful lot of micromanaging targets to drive out the sort of improvements you are looking for. People then say, "No, that is counter-productive. Let us move it back". That has been a change of fashion over successive spending reviews.

- Q95 **Charlie Elphicke:** These are targets that Government tend to set for themselves. What if they were more held to account and challenged from outside, and therefore Ministers are pressed to answer questions, think about things and challenge their civil service as well? Indeed, what if we



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established, like they have in America, a Congressional Budget Office? Could such strengthening of scrutiny and information have real effects? What effects do you think those could be?

Robert Chote: This is taking me quite a way out of the current day job. Some people have said that one challenge is that not all departmental select committees are as effective in scrutinising the spending and departmental report information that they get at that micro level, beyond, as you say, the ritual humiliation of somebody over some individual project. This is the one select committee I can say this at. The IfG has done some work in that sort of area, which gets you beyond simply putting it all into the lap of the Public Accounts Committee and the NAO, and actually getting the network of select committees to function more in that sort of way.

Q96 **Chair:** There is a debate here with the Liaison Committee about exactly how the CSR is to be scrutinised, recognising exactly that, in terms of the effectiveness of departmental select committees in scrutinising budgets.

Robert Chote: Yes, and there will be common issues. I do not know to what degree there is a sharing of expertise and best practice across select committees about how they deal with spending departments' financial returns and performance returns. Presumably there must be some scope for that.

Chair: Some more than others. Thank you.

Q97 **John Mann:** When are you going to do your next report?

Robert Chote: When the Government tell us that they are going to have a fiscal event and requests one from us.

Q98 **John Mann:** In terms of your personnel planning and your research work, what is your contingency for that happening suddenly?

Robert Chote: The central assumption is that you end up with something in the autumn. In the event that we have something earlier than that, which has happened in the past, for example with post-election Budgets, then we have to look at that, look at the other publications that we are scheduled to produce and see whether we need to move them in order to create space to do that.

Q99 **John Mann:** In the scenario of an emergency Budget after a no-deal Brexit, let us say next month, what criteria will you use to actually determine your report compared to what you have actually put in forecasting now?

Robert Chote: We would look at the sorts of issues that we flagged in the paper we did on how we would approach the Brexit task, back at the end of last year. In terms of the no-deal implications specifically, you are obviously looking at the short-term macroeconomic impacts that are anticipated. Key judgments there would include how deep any negative impact would be and, crucially, how persistent it would be, because that



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would have a lot of implications for the medium-term health of the public finances. It was quite striking, when the Bank of England produced its stress tests, that whatever view was taken of the depth of any immediate downturn, it was felt it would be relatively persistent.

The other thing, if you were going through this forecast, as Andy says, is we would be learning about market reaction and consumer and business behaviour and performance.

Q100 John Mann: Why is it not in this report? The law says we are leaving the European Union on 29 March and there is no deal, so why is this not in this report? That is what the law says.

Robert Chote: As I say, the assumptions we have used are on the basis that when we close the forecast we have to come up with some basis that is consistent with the interpretation of current Government policy and across the range of some non-disruptive outcomes in the appropriate central expectations.

Q101 John Mann: The law says we are leaving on 29 March.

Robert Chote: That is explicit in the forecast. We assume that we do. There is a transition period thereafter on the basis of the way in which policy was set out.

Q102 John Mann: You are making a series of political assumptions in your judgment.

Robert Chote: We are trying to see our way through the fog.

Chair: Good luck with that. We are still trying.

Robert Chote: I hesitate to put any blame here, but we work with the material we are given.

Q103 John Mann: There is always a danger that people's own politics can come into play with this. The IFS stated on Wednesday that the Forgotten Towns Fund was not new money. The Government say that £1.5 billion of the £1.6 billion is new money and £100 million is from within existing departmental allocations within MHCLG. Is this new money or not?

Robert Chote: In the spending review period, it comes out of existing allocations. Beyond the spending review, if effectively you are earmarking some money from a pool, most of the rest of which has not been allocated anyway, in that sense it is money newly allocated in this area. It is money that is coming out of an as yet unallocated pool elsewhere. Is that a correct interpretation?

Andy King: Yes.

John Mann: I will raise that with the Chancellor.

Q104 Wes Streeting: These are hopefully a few straightforward questions before we finish up. Not least, we have already opened a can of worms



with our report on student loans, which leads me into the questions I now want to put to you.

Robert Chote: I do not think there are any straightforward questions on student loans, but please try.

Q105 **Wes Streeting:** I notice it got a whole annex, but there we are. Can you briefly set out how you expect the ONS's proposed part-grant, part-loan approach to student loans accounting to affect the Government's fiscal position?

Robert Chote: As you are aware, the current approach driven by international public sector accounting standards is that student loans are treated like any conventional loan. The accounting system was not designed for a policy environment in which you expect a very large chunk of the principal and the associated interest not to be repaid. That creates a set of fiscal illusions, which we have laid out in detail. In particular, your income looks higher than it should be and your spending looks lower than it should be, because a lot of these effects are not manifesting themselves until late in the life of the loan, rather than upfront.

The approach that the ONS is taking is to say, "There are genuine loans that are going to be repaid, so let us treat them as loans. There are ones that are not, so effectively you should treat those more as spending". As the annex lays out, in terms of the consequences of that for public sector net borrowing, we do not know precisely how the ONS would do this but on the information that we have at the moment, it would add about £10 billion to net borrowing in the near term, next year, and rise to about £15 billion later on. It would not affect net debt, because net debt is a cash concept. It would affect net financial liabilities.

In terms of the impact that most people would notice in public finance management terms, it means that the correct measure of the deficit if you treat student loans more sensibly is about £10 billion to £13 billion higher than it currently appears to be.

Q106 **Wes Streeting:** Can I just probe you further on that last point? You revised your estimate of the impact of this new treatment on the deficit in 2023-24, down from £17 billion to £14 billion. What drove the change in numbers?

Robert Chote: The ONS or the DfE, in terms of actually cranking the handle on this sort of thing, has obviously been doing a lot of modelling work in order to get there and using the same modelling technology that it has available to it for the forecast that we are doing. One of the differences is that when we had a stab at this back last year, we were looking at a particular cohort of loans and reaching a judgment on that, whereas the DfE approach will be more granular in looking at individual loans. That is an important part of it.

Andy King: The other thing we did in the working paper was more of an illustrative methodology, where we looked at the proportion that was



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unlikely to be repaid and applied that across all years. The ONS has spent some months thinking about this and has come up with a way of doing it that leaves you with a zero balance in 30 years' time and works backwards through time. That means that slightly more of the effect is in the 30-year horizon and slightly less in the five-year horizon. That brought the numbers down.

Q107 Wes Streeting: That is really helpful to know. I am curious to know how you think this new approach could alter the incentives for Government to sell off parts of the student loan book, as has been the case on a number of occasions. Has it become more or less desirable, or is there no change?

Robert Chote: To the degree to which there is an incentive to do it in order to get net debt to come down, this does not affect the treatment of net debt. At that level, there is not an immediate effect there. On the other hand, net debt is now falling and so the temptation to go out and find something that ensures that it is less acute than it used to be.

Q108 Wes Streeting: Finally, the economic and fiscal outlook notes that there are too many uncertainties over the implementation of this new methodology for you to move your central forecast on to the new basis at this time. You have alluded to this partly already, but could one of you just outline clearly what those uncertainties are?

Robert Chote: The key one that is an issue for anybody looking at and trying to understand what is going on in the public finances is that, when you change the underlying assumptions that reflect essentially how you expect a particular cohort of student loans to perform in terms of what will be repaid when and the economic assumptions that also have to underpin that, changes in those could have a significant impact not only on the forecast but also on your outturn estimates of past borrowing.

If you have a cohort of loans that was made 20 years ago and you change some of the underlying assumptions that determine how that would be treated, it is going to affect the 20 years of outturn data, as well as the implications for the future. One of the challenges the ONS has is to decide how to do that. When you have those sorts of changes, are you happy to have quite big revisions to past data? Do you want to smooth it out into the future instead? Do you want to have lumpy effects in one particular period? This matters for policy changes as well as those sorts of assumptions. Andy, do you want to add anything?

Andy King: The policy change point is an important one. If you think, just a couple of years back, the repayment threshold was increased. It is not clear how that will feed into the data. In DfE's accounts, that pushed up the RAB charge a lot, because far less was expected to be repaid. Would that have a spikey effect in public sector net borrowing or not? That is relevant because the Augar review is ongoing, so if the ONS makes this change without knowing how it would implement the effects of any policy change that comes hard on its heels—



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Q109 **Wes Streeting:** What are you anticipating from the Augar review in terms of some of your considerations?

Andy King: Any change to any aspect of the system will flow through on both methodologies. We do not anticipate policy though.

Wes Streeting: I thought I would give it a go.

Chair: Like everyone else has this morning.

Q110 **Wes Streeting:** Absolutely. You have been here before, obviously. In terms of the work plan for this, you cannot really plan at the moment, can you? It was the Chancellor that said in the spring statement that the Augar review will be published shortly, and we know that means in Government terms: sometime in the next decade. He did at least say that the Government would respond later in the year. He did not say which year, but I assume he means this year. It is quite difficult for you and the ONS, in those circumstances, to do any meaningful work around assumptions, projections or forecasting without anticipating or knowing if any public policy changes arise out of the Augar review.

Robert Chote: The ONS timetable is relatively clear. It wants to have some indicative numbers of its own on the effect that this is likely to have on the data. Its aim is to produce that in June or thereabouts, and then it wants to reflect whatever the new treatment is in the public sector finances data from September onwards. As you say, with policy response it is not the Augar review per se. We have to wait until there is a concrete, firm policy decision.

Wes Streeting: Good luck with that.

Robert Chote: As you know, you have Augar in May. I do not know what firmness of proposals there will be. I do not know how firm the response will be, whether it will be in a form that allows you to implement it in the forecast straight away or whether it is out for consultation, and there is the question of quite how elastic the timetable is. Who knows what else you will have on your plate over the coming months?

Wes Streeting: If you do find out, let us know and we promise not to tell anyone.

Q111 **Chair:** Just very briefly, Andy you mentioned the RAB charge. Just for clarification, do you use the DfE's RAB charge or do you calculate your own?

Andy King: We do not use it. They all come out of the same model. Indeed, when the ONS goes to this methodology, everyone will be using DfE's model. It can churn out different numbers.

Chair: Thank you very much indeed for your time this morning. I have a suspicion we may be seeing you again sooner than you might like. We have found this morning very interesting, so thank you very much for your time.