

Treasury Committee

Oral evidence: Spring Statement 2019, HC 2056

Wednesday 20 March 2019

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Members present: Nicky Morgan (Chair); Mr Steve Baker; Colin Clark; Mr Simon Clarke; Alison McGovern; Catherine McKinnell; Wes Streeting.

Questions 112 – 194

Witnesses

I: Dan York-Smith, Director, Strategy, Planning and Budget, HM Treasury; James Bowler CB, Director General, Public Spending, HM Treasury; Clare Lombardelli, Director General, Chief Economic Adviser, HM Treasury; Philip Duffy, Director, Enterprise and Growth, HM Treasury.

Examination of Witnesses

Witnesses: Dan York-Smith, James Bowler CB, Clare Lombardelli and Philip Duffy.

Q112 **Chair:** Good morning, all. Thank you very much indeed for being here for this second evidence session on last week's spring statement. I am just going to ask each of you to introduce yourselves. If you can give your responsibilities and your job titles in the Treasury, for the benefit of those watching, then we will get straight on.

Dan York-Smith: Dan York-Smith. I am the director of strategy, planning and budget, so I am responsible for the co-ordination of the spring statement.

Clare Lombardelli: Clare Lombardelli, chief economic adviser at the Treasury.

Philip Duffy: Phil Duffy, the director of the enterprise and growth unit.

James Bowler: James Bowler, director general of public spending.

Q113 **Chair:** Lovely. I wanted to start with fiscal policy and particularly in relation to a question that I raised with the Chancellor immediately after the spring statement last week, about the fiscal objective, which up until now has been to run a budget surplus into the mid-2020s. The Chancellor's response to me said, "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". I am not sure if perhaps Dan is best placed to answer this, but what role does that fiscal objective play for Treasury officials when preparing plans for the Budget?

Dan York-Smith: As part of the forecasting process with the OBR, we receive updates on what its forecast says about the fiscal mandate and the fiscal objective. That forecast does not run past 2023-24, so at the moment the middle of the next decade is beyond the forecast horizon, but we are of course looking at the level of public sector net borrowing in the final year of the forecast as part of putting together a package. Clearly, the spring statement was not a fiscal event, so there were not policies that were fiscal in nature. There were other policies announced but they were allocations of existing funding, reviews or consultations, so we were not attempting to alter the forecast through policy in this case. We look at it, but in this case we were not making policy to change the outcome fiscally.

Q114 **Chair:** Clare, let me ask you this. We know we have a Budget. We do not know whether, potentially, given political events, we might have a Budget sooner rather than later, but let us assume we are going to have an orderly Brexit and the Budget reappears in the autumn. When you are preparing tax and spending plans for Ministers, are officials bound to



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meet that fiscal objective or are you getting the message that there is some flexibility, as the Chancellor has implied in his answer to me?

Clare Lombardelli: The judgment is for Ministers as to which policies they want to take forward, but in thinking through policies we would always be thinking about what the implications would be for those targets and objectives, and informing Ministers of those so they can make choices.

Q115 **Chair:** You would inform them of the impact on that objective of what is being recommended.

Clare Lombardelli: Yes.

Q116 **Chair:** The Chancellor has said on a number of occasions that he is going to use the fiscal headroom to help smooth a disorderly Brexit. Going back to my question, are you preparing plans for another fiscal event in the next couple of weeks or months? Where is the Treasury now in planning for the next fiscal event?

Dan York-Smith: As the Chancellor said in his speech, his intention is, first, to stick to having a single fiscal event each year. He said he planned to launch a spending review process before the Summer Recess and then to conclude it in an autumn Budget. That is his plan. He also said that, of course, Government are preparing for all possible outcomes, and in a sense we are always working on policies that might be included in a future fiscal event whenever Ministers decide that fiscal event should take place.

Q117 **Chair:** So they can be accelerated if necessary.

Dan York-Smith: We will accelerate what work we need to, to produce the fiscal event when it is announced, but I suppose it is not like it is a process that starts and stops. The process of policy development is a continuous one, and whatever is ready at the point is something that Ministers can consider for inclusion.

Q118 **Chair:** Clare, you came before us when we did the economic analysis sessions, and we talked about the fact that Whitehall no longer has a short-term macro forecasting capability following the formation of the OBR. If that is the case, how is the Treasury going to prepare a fiscal response to a disorderly Brexit?

Clare Lombardelli: We do a lot of work, all the time, to monitor what is going on in the economy and try to read the data and information that is coming out. We are doing that now, as you would expect, and we will continue to do that through the coming period. Of course, at a time of heightened uncertainty we are focusing on that more than ever. In terms of preparation and forecasting, we would look to the OBR to do that, so in any situation in which we are doing a fiscal event the OBR will provide those forecasts, and that will be what we are thinking about.

The sorts of things you might consider would depend very much on the circumstances that you are in, and that is why it is important that we are



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always thinking about what is going on with the economy, what the latest data says, how reliable that data is, how it can be supplemented by other information sources and how reliable they are. We do an awful lot of monitoring on the economy to try to understand what is going on.

Q119 **Chair:** Presumably you are also in regular touch with Bank of England officials in co-ordinating potential monetary and fiscal stimulus or response to what might happen in the economy should we end up with a disorderly exit from the EU.

Clare Lombardelli: As you would expect, we talk to the Bank of England, particularly about understanding the economy. They have operational independence for monetary policy, so they would be thinking about that. We would be thinking about fiscal questions, but those channels are open and the authorities talk to each other as you would expect.

Q120 **Chair:** Does your analysis suggest that, given the fact that interest rates are already near zero, there is a greater potential for fiscal stimulus if needed?

Clare Lombardelli: It would be for the Bank to talk about what space there is for monetary policy. We would be thinking about fiscal policy in terms of what our fiscal objectives are and things like the deficit.

Q121 **Chair:** I am not sure who this next question is for. I want to talk about the share of tax revenues as a percentage of GDP, and I think this is something Steve was talking about in yesterday's session. The OBR projects that the share of tax revenues to GDP will rise to 34.6% this year and through most of the forecast period, a level that has been exceeded only once since 1950. Was the Treasury expecting it to rise to that level or did that figure come as a surprise?

Clare Lombardelli: It is not a particular surprise. The tax to GDP ratio across advanced economies has been generally increasing. The UK is not out of line on this. If you look at OECD countries, the last comparable data is 2017, and we were in the middle of the pack, slightly below the average. As I say, across advanced economies you have seen that increasing. That is not a huge surprise. You generally find that, as countries grow, they choose to spend a higher proportion of income through the Government. Robert talked about this yesterday. It is really a question of political economy in that sense, in terms of people's revealed preference. You are right; it is higher than it has been in the past, as it is in a lot of similar countries, so we were not particularly surprised by it.

Q122 **Chair:** I want to touch on something else, before I bring in Colin on a very different subject, in relation to Nissan and this issue of contingent liability, which I raised with the OBR yesterday. There is a perception that the assurances given to Nissan are not treated as a contingent liability, but the OBR said yesterday that, if it quacks like a contingent liability and looks like a contingent liability, it may very well be effectively a contingent liability and should be disclosed to Parliament. Why was there



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no disclosure in BEIS's annual report and accounts 2016-17 or to Parliament of a contingent liability arising from the financial package offered to Nissan?

Philip Duffy: This relates to the situation in late 2016, where the Business Secretary wrote to Nissan with a proposition, and it was not recorded as a CL at that time. We and the NAO have looked at this, and concluded that the judgment of the accounting officer of BEIS that this was not a CL was right. The rationale for that is that, contrary to what the EFO says, it was not the case at that moment that there was just one more decision before this payment was going to be made. Actually, there were quite a few uncertainties about whether this payment was going to be made. For example, at the time that we were discussing it, which was before the autumn of 2016, there had not yet been approval from the independent Industrial Development Advisory Board, the IDAB. It was not clear whether the Nissan management would accept the terms that the Business Secretary had offered. It was not clear whether they would be willing to make the investment that would be necessary for any such payment to be made.

I think that is the right judgment. Had it been a case of simply saying, 'There is one more decision here and then it will be paid', that would be different; that would fall within the CL guidance. It is for BEIS and its AO to make that judgment, and to deal with that in its accounts. We are confident it did that properly, and it did, at your request, get the NAO to look at that, which found the same. That would be our position on that question.

Q123 **Chair:** In *Managing Public Money*, which is the Treasury's own guidance, it states that contingent liabilities above £300,000 should be disclosed to Parliament if confidential, and disclosed in letters to both the Public Accounts Committee and departmental committee, which they were, because I think that the Chairs of the relevant Select Committees were written to at that time. Your argument is still that there was no need for disclosure to Parliament because it does not fall within the strict definition of contingent liability.

Philip Duffy: We have to be clear on the roles here. The accounting officer of BEIS had the responsibility to look at that question and decide whether this was likely to emerge as a liability, and he made the judgment at that time, which the NAO has endorsed, that it was not yet likely enough to make that threshold. That is the important distinction and perhaps explains the difference as between us and the OBR on that question.

Q124 **Chair:** Are you happy to write to this Committee on the basis of capturing that answer, I suppose, which is why this not within the *Managing Public Money* definition?

Philip Duffy: Yes, I am very happy to write on that. I would also point out that that negotiation continued with Nissan all the way through to



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June 2018, so we were a long way away from a decision point in late 2016.

Q125 **Chair:** In the future, what disclosures will the Government be required to make when they make promises of state aid to companies?

Philip Duffy: In the future, the same policy will apply. If a promise has been made and it is likely to occur, the test in *MPM* about when it should be reported in the accounts will be the same. At the moment, when you think there is only one more decision or it is very likely to happen, generally speaking the AO would have to record that in the accounts as a CL.

Q126 **Colin Clark:** Going back to the real world for a moment and away from the Wizard of Oz, at the spring statement the Chancellor announced that the future homes standard will mandate the end of fossil fuel heating systems for all new houses from 2025. Which Government Department will lead on this work and what will the Treasury's involvement be?

Philip Duffy: This has been a longstanding idea that was supported by the Committee on Climate Change, the CCC, and it is an action that would be necessary to be consistent with the Government's statutory obligations under the Climate Change Act to deliver later periods of the carbon budgeting process. In carbon budgets 4 and 5 we currently have a significant gap. It is not a completely new proposition; it has been discussed for some time between the Departments.

The lead Department on this will be MHCLG. That is because the vehicle for doing this will be amendments to Part L of the building regulations. As you know, the building regulations are changed every five years. The reason for the timing is to allow some experimental or potential changes in 2020, and compulsory changes from 2025. We have discussed this extensively between the Treasury, MHCLG and BEIS, and we are happy that this can be delivered and is workable from an economic point of view.

Q127 **Colin Clark:** With regard to BEIS, does this not run contrary to the Government's policy that gas was an essential part of reducing greenhouse gases? Is this not a policy change for BEIS, which has repeatedly said that gas has half the greenhouse gases of coal, for example, in getting away from coal-powered stations? Is this not contrary to BEIS's policy?

Philip Duffy: No, I do not think so. When we talk about the importance of gas for the transition, we are talking about gas replacing coal in the energy-generation sector, and that remains our No. 1 policy. It is important to say that we do not have a clear view across Government, and neither do any other countries, about the right mix of technologies for the heat transition we need to make between now and 2050. Gas will remain a very important part of our energy mix.



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It is worth noting that, at this very announcement, the Chancellor also committed to increasing the proportions of so-called green gas, or bioethanol, in the gas grid, and we are consulting on that later this year. That is because both technologies may have a role. Whereas in domestic heat for new-build houses you may see air and ground heat pumps becoming more common, I do not think it is right to say that the gas supply is going to be ending any time soon. Even at the end of this period, gas will have a role, biogas in particular, and hydrogen, for particular specialised applications, like transport, for example. At the minute, the Government do not have a policy for picking winners in the technology mix for heat. We are still evolving our policymaking to try to make sure we comply with those statutory obligations.

Q128 Colin Clark: Have the Government made estimates of the increased costs for homeowners because of this ban? Have they estimated what the effect will be?

Philip Duffy: Yes. The cost comes from two sources. The first one is the constriction of the new house with the low-carbon heating system, and then we have the onward running costs. On the first of those, we are very taken with the observation that the cost of fitting new zero-carbon heating into a new-build house is around about £5,000. The cost of retrofitting this same technology to an existing house could be as high as £25,000 in the current market.

From a cost-benefit point of view, there is a logic to making sure that we are not increasing the level of retrofitting we have to do between now and 2050, and that clearly is going to increase the overall construction cost for that. The classic answer you get is that that is going to come from the land price. There is some evidence that the land prices would adjust to cover the additional cost to housebuilders of fitting the low-carbon technology at the point of construction.

There is then a second-order question of the running costs for consumers, in terms of household bills, of moving to low-carbon electricity. Because of levies and the other ways we structure the energy tax system, electricity is more expensive than gas, but it is very early days yet to work out what the cost pattern will be between now and 2050. I would also make the point that some level of transition in heat is not optional. If you agree with the Climate Change Act and you agree we are going to have to carbonise at least 80% of emissions, we are going to have to make some of these transitional changes.

Q129 Colin Clark: Is there planning for any spending to encourage insulation or is there any policy for changing the attitude towards building these zero-carbon houses?

Philip Duffy: The Government are already spending very heavily on renewable energy. We have the renewable heat incentive, for example.

Colin Clark: I mean the insulation of houses rather than the heating



sources.

Philip Duffy: The principle here of the Government's approach is that we want a market-driven answer rather than a state subsidy-supported answer. That does not mean we will not intervene in that market, for example, for vulnerable consumers, and we already do that in lots of ways, but the principle has to be that this transition will need to fall on users of energy to encourage that reduction. That is already the principle we have taken with electricity, of course, because the funding for the contracts for difference and the offshore wind transition comes off consumer bills; it comes through the levy control framework. I do not think at this time we are signalling that there will be significant new spending on that transition.

On the other hand, giving plenty of notice of this transition, signalling now what is going to happen in 2025, allows that supply chain—much of which, I should add, is UK-based; Mitsubishi in Livingston, Scotland, is a big supplier of heat pumps—to boost its capacity and start seeing some of the cost reductions we have seen in other technologies, like wind.

Q130 **Mr Baker:** I am so pleased you said you are going to look for a market-based solution, because I was beginning to wonder as we ran through that. Can you explain what it would mean to have a market-based solution to this set of problems?

Philip Duffy: There are a wide variety of ways one could deal with heat transition, but it is worth looking at how we dealt with electrical adjustment in power supply. We have used consumer levies, which have gone through various auctions to buy the cheapest possible power. That is how the offshore wind sector has been supported. We announced at this spring statement the consultation on the business energy efficiency scheme. That scheme is a levy that you must pay into, but you can get your money back if you agree to invest in lower-carbon technologies. It is something that we have done previously in—

Q131 **Mr Baker:** I am scarce on time and I am so sorry to cut you off. The point I was really just trying to land was that, as a Conservative with Conservatives in power, I very much hope we will let the market lead what we do.

Could you explain why we are having a three-year spending review when previously we have had five-year reviews?

James Bowler: We have not had a five-year spending review. There are five-year forecasts by the OBR. Before 2010, there were three-year reviews. Most recently in SR 15 it was a four-year review for resource spending. That took us up to, as was then, the end of the Parliament, so the three-year spending review that the Chancellor has announced is essentially a return to what we would normally do. However, will it be three years in every instance? Well, we have already announced a five-year resource settlement for the NHS, and I would expect the



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Chancellor to look in particular at capital spending as to whether he would want to go further and longer than that, as he has in the past.

I would put one plug in for our spending framework, as I do this. The UK is one of only five countries that do this multiyear allocation of budgets by Departments, and do it properly, and it is a really strong aspect of our budgeting structure and really important. I can even name the other four countries if you wish, but it is probably not worth your time now.

Mr Baker: Go on.

James Bowler: Finland, the Netherlands, Denmark and Israel.

Q132 **Mr Baker:** My brief reminds me what I thought I knew: that there were spending reviews in 2010 and 2015, so it feels like this is all tremendously complicated. The 2010 and 2015 reviews, if I understood you correctly, lasted for three or four years.

James Bowler: They went to the end of the Parliament, as was then. The 2010 review went for four years. There was then a one-year review in 2013 that went one year past the Parliament. Then the 2015 review, the last year of which is this coming year, 2019-20, was a four-year review.

Chair: If you remember, we were due to have a general election in 2020. We might still.

James Bowler: If you think spending reviews started in 1998, the first one was three years; 2004 was three years; and 2007 was three years. I guess the common point there is that the last year of that allocation is often the last year of the Parliament, which it would be in this case, where the last year would be 2022-23.

Q133 **Mr Baker:** Are unprotected Departments likely to face real-terms cuts in their budgets over this spending review period?

James Bowler: The answer to that will be on the outcome of the spending review, which the Chancellor set out in the autumn. He has set an indicative plan for spending over the coming forecast period, which sees resource spending, which is often what people measure this on, rising 1.2% in real terms. If you then take the NHS settlement that we have done, that sees other spending outside the NHS rising in line with inflation. As it stands, if you want to prioritise within that and not just give everyone a flat real settlement, if someone gets above inflation—and there are a lot of commitments to do that, for example, in the ODA budget—the quid pro quo is that someone would get below inflation.

However, there is quite a lot of water to flow under the bridge here. The Chancellor's speech very much linked this to what would happen in the coming debate on exiting the European Union, but he talked about the headroom he might have to put more into spending, reduce debt or keep taxes low. You will find out at the end of the spending review. At the moment, that is the situation on our indicative plans.



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Q134 **Mr Baker:** You mentioned the NHS in passing. Is the five-year settlement going to be untouched by the spending review or will it be revisited?

James Bowler: The resource spending for the NHS over five years is fixed. It is now fixed in cash. We had an announcement in June last year, and then the final settlement, which is now fixed, was published in January alongside the 10-year plan for the NHS. However, not all of health spending is completed in the spending review. The capital spending for the NHS is yet to be fixed, and the rest of the Department of Health spending, which most notably includes public health, is yet to be fixed.

Q135 **Mr Baker:** You mentioned capital and resource there. To make sure this question is put to you accurately, because it is rather technical, I am going to have to read it. The Department of Health has been transferring significant funds from its capital budgets to its resource budgets for the last five years, I am informed, a practice that I understand is not permitted by the Treasury's own consolidated budgeting guidance. Why is the Treasury going against its own guidance by agreeing to investment, to capital spending, and understating day-to-day resource spending at the main estimate and spending review?

James Bowler: You are absolutely right. The guidance says you cannot just do this of your own accord; you have to get the agreement of the Treasury to do this. In those instances you quote, the Department of Health proposed and we agreed that that was the best use of resources in that time. It is my strong hope and plan—and it is part of the point of this five-year settlement with a 10-year plan—that it puts the NHS on to a strong and sustainable footing that will move away from the need for year-to-year additions of funding and year-to-year switches between capital and current spending. A key component of that will need to be strong capital investment into the NHS, and that will be one of the key ways to manage demand for the NHS, which is one of the keys to its sustainability. That has happened in the past; it is not what we are looking to do in the future. To answer your question on the consolidated guidance, the Department of Health has to come to us and ask whether it can do that and we agree it.

Mr Baker: If I have understood you correctly, you have agreed to it as a matter of force majeure, in a sense, in that it has been necessary to do it rather than desirable.

James Bowler: Yes. That is correct, where we are talking about a health budget of £120 billion-odd, and the switches are at the margin on that.

Q136 **Mr Baker:** I have to say I am slightly alarmed by the practice, because, for example, I observed in my own constituency of Wycombe that some of the capital spending we need is raised by voluntary donations. Of course, as a great believer in free society, I think there is a place for that, but it slightly alarms me that, in an environment where the spending is



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being moved around like this, the public are still raising money for capital equipment voluntarily. Is this a practice that the Government are trying to explicitly move away from so that capital can be planned for out of general taxation rather than the public's good will?

James Bowler: Absolutely. It is probably worth saying that our capital investment is at a 40-year high going forward. We have public sector net investment of over 2%, and through most of my Treasury career it was knocking around the 1% mark. There are huge increases in capital investment in public services, most particularly with a focus on economic infrastructure, transport, housing and other areas. Yes, that is absolutely the case, and capital investment is rising steeply in health as well.

As I say to you, part of the reason for choosing to do a five-year settlement in health—and there has been a review that reported on capital investment in health, which looked further than that too—is precisely to get away from that. You are settling a £120 billion-odd budget at the end of the year and you have to land that. It is the case that you cannot overspend; that is the way our accounting works. In landing that, there are switches at the margin, but I very much hope that is not affecting your constituents.

Q137 **Mr Baker:** What guidance has been sent out to Departments, telling them what to include in their spending review submissions?

James Bowler: They will get the formal guidance in the summer. The Chancellor announced his plan, which I should say he linked to getting a deal in the EU exit. That is to launch the guidance on the spending review before the summer and conclude it in the autumn. The way you run a spending review process, which lasts about three or four months in real time, is to say, "Look, this is what we need from you". Then you have a debate and discussion, and it concludes with an announcement to Parliament in the autumn.

Have we therefore done nothing on the sending review? I can absolutely assure you that that is not the case. The Chief Secretary is meeting all her colleagues and we are discussing the nature of that guidance. I would happily go through some of the priority areas for us with Departments, and in particular the finance function, where we will look to agree what we produce. The formal guidance goes out there, but there is a lot of preparation underway.

Q138 **Mr Baker:** In the interests of time, perhaps if you wanted to set out the priority areas, you might consider writing.

James Bowler: To set this out very quickly, much of what we are trying to do in this spending review is to learn the lessons of what has worked and has not worked so well in the past. Secondly, we are looking at where our framework sits internationally. My No. 1 priority in that framework sense is to try to move things more to an outcomes focus. You may want to talk about the Barber public value framework later, and I can bring that up. We think, if we look at ourselves internationally now,



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we have become pretty input-focused. There are quite a lot of people saying, "Spending must be this as a percentage of that", rather than what you are trying to get for the money you are spending. That would be a focus for me, and you saw the Chancellor talk in the Budget and the spring statement about looking to have more of an outcomes focus. That is point one.

For point two, I would focus on delivery, in particular perhaps in the last spending review, but also, as you will be aware, people have assumptions about benefits, costs and time. We have much more data now and a much more professional setup with the IPA that looks at the reality of realising those benefits, the extent to which we deliver particularly big projects on time and to budget. I would like a focus on that. That leads to a difficult question for Departments, which is the ever-present question of prioritisation because, if the reality is that this thing is going to cost more and take longer, that means they get to do less, which is a tricky issue. I would put that as No. 2.

The third area I would point to, which is a more perennial issue in spending reviews, is the cross-cutting set of issues. This is trying to break out from the dreaded Whitehall silos, their accounting officers and their "me too, this is what I get".

Chair: Good luck with that.

James Bowler: It will be our umpteenth attempt at it, but I would say that we are making progress and we will continue.

Mr Baker: I would love to draw you into a discussion on all those areas but—

Chair: We will revisit them.

Q139 **Mr Baker:** My last question is simply to ask you what the Chancellor means when he says there will be a zero-based review of the capital budget.

James Bowler: This is not a brand new thing. All spending reviews since 2010 had a zero-based review. What you do is say, "Departments and economists, for all the capital spending you are intending, please evidence it and show what returns you expect to get on it", so benefit-cost ratios, and those will be put in. For all the capital, they will have to evidence what their returns will be. Then a set of economists consider those and make recommendations on where we can get the biggest return to our investment, "investment", for once, being used correctly in this term. Ministers continue to take the final decisions.

Q140 **Mr Baker:** If I may, I will just make a point, which is that I hope, one day, we can return to the subject of benefit-cost ratios and how, within those benefit-cost ratios, prices are allocated to things that do not have a market value, which is something I saw. These are things that are not traded and, therefore, do not have a price, and yet they are priced into



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benefit-cost ratios.

James Bowler: So you are worried that they are priced in.

Mr Baker: They are priced in.

James Bowler: I could go each way on that one.

Q141 **Mr Baker:** They do not, in fact, have a price because they are not traded.

James Bowler: Let us return to it, but the Green Book is the world-leading set of how we set out our cost-benefit analysis.

Chair: There is a question for all of us—you may or may not welcome it—about the scrutiny of the CSR as it unfolds later on this year, but that is a matter for Parliament to reflect on.

Wes Streeting: I have a series of questions on no-deal tariffs.

Chair: We are going back to Brexit.

Q142 **Wes Streeting:** I am not sure who wants to volunteer. The Government have produced a tax information and impact note, as you will be aware, for no-deal tariffs, but one thing that was, interestingly, omitted was the Exchequer impact of the proposals. Is this because the Treasury does not know or because you do not want to tell us? Who would like to answer? Who is drawing the short straw, Clare or Dan?

Clare Lombardelli: I will give it a go. None of us on this panel is an expert on tariffs. To the question on the Exchequer impact, it will be for the OBR to work that through when this becomes something that it needs to think about. It is hard to know in the sense that predicting the short-run impacts of those tariffs with any certainty is quite difficult. This is fairly unprecedented territory, and so putting a number on that will be quite a challenge. Because the OBR's forecast this time is based on getting a deal, it did not have to do this as part of that process because, of course, these tariffs only apply in a no-deal world. Should that happen, there will then be a process in which the OBR, in discussion with us and in particular HMRC, will go through the process of looking at the costings of that, what the impact is likely to be and so forth, but it is unknown at this stage.

Q143 **Wes Streeting:** I am certainly not beating up officials for this, because it is certainly not your fault, but, to be clear, this could potentially hit reality next Friday, so this is not a distant point; this is imminent and worryingly possible. For all the reasons you outlined, which sounded perfectly reasonable from the point of view of people having to do the number-crunching, the TIIN has been issued without any Treasury numbers on the impact.

Clare Lombardelli: Yes, that is true. It is important to think about what the Government's policy aim here has been. It is to try to minimise the disruption from introducing a set of tariffs that have not been there in the



way in which we trade with the EU. In doing that, we have been thinking about a number of things, balancing the impact on producers, which will be hugely affected, and on supply chains and consumers. In a sense, that is a set of trade-offs, and so the way we have gone about trying to do this is to think in more detail about how you balance those and try to minimise the disruption by sector.

The thing that is also worth bearing in mind with this is that the whole policy would apply for 12 months, while a full consultation and review of a permanent approach is done. It is hard to give any sense of scale, but if you recall, when we published the long-term economic analysis in November, we did look at what the implication would be in a no-deal world. The main baseline assumption we used there was the MFN tariff schedule, but we did look at the sensitivity and, if you were to liberalise all those tariffs, what the long-term impact of that would be, and we came up with a number of 0.8 percentage points of GDP in 15 years.

I do not want to underplay the importance of this as an issue but, as you heard yesterday from Professor Bean, there will be a lot of other things going on in a no-deal world. You would potentially have quite big macroeconomic changes. You would also potentially have the exchange rate and other things having an impact, so it is quite hard to know. Other things like non-tariff barriers will also be having an impact.

Q144 Wes Streeting: I appreciate all of that. I just wanted clarity on the extent to which the Government are making decisions with their eyes open. For the reasons you have outlined, it is reasonable, from the point of view of officials and the difficulty in producing the numbers, but it is startling from a public policy point of view.

Moving on to some of the issues that I anticipated I would want to raise, to what extent is the proposal for zero-rate tariffs influenced by concerns that we would not be administratively ready and capable of collecting tariffs on imports from the EU?

Dan York-Smith: As Clare said, the main consideration has been about the balance between the impact on producers and consumers. It would be for HMRC to answer on its readiness, and I know that it has given lots of evidence, including to this Committee, on its operational readiness. Really, this has been about that balance between producers of goods in this country and what the tariffs mean for them, versus the consumer impact where there are imports of those goods.

Q145 Chair: In the advice to Ministers on this, would there have been advice included, presumably from HMRC, about readiness to collect those tariffs?

Dan York-Smith: I would have thought so but we will have to write to you about it.

Clare Lombardelli: I would add that, if you look at where the Government have chosen to diverge from liberalisation, it is not because of operational reasons.



Wes Streeting: They are policy decisions.

Clare Lombardelli: Yes, it is a policy choice, which suggests that those objectives around particularly sensitive sectors or where you potentially have unfair trading practices or preferential treatment for developing countries have driven the decision, more so than operational concerns.

Q146 **Wes Streeting:** We would appreciate a note on operational readiness, but that distinction you just made is helpful for us in understanding how Government are reaching decisions.

Clare, as you said, the proposal for no-deal tariffs is a temporary period for up to 12 months but, in the event of no deal, what would you expect to change in the next 12 months that would lead to the tariff position being revised?

Clare Lombardelli: One of the things we would want to do in that world is more consultation with the businesses affected, among other things. In that sort of world, you would have quite a lot of new information coming through quite quickly, and we would be learning about what the impacts are not just of tariffs but of economy changes going on. In a no-deal world, you would be monitoring, understanding and updating your understanding of the economy all the way through, including on the tariffs, so you would have information from that. We would also want to do more consultation with those affected, to try to understand it in more detail, in a way we have not been able to do ahead of this, which is why it has been for a temporary period. You take all that information together in making a decision about the long-term tariff policy that you would apply.

Q147 **Wes Streeting:** One thing you did not mention there in your answer—and I appreciate this is the responsibility of another Government Department but I am sure the Treasury will have sight of it—was the possibility of there being a whole range of trade deals in place over the course of that 12-month period. Are we not anticipating a full suite of trade deals at this stage?

Clare Lombardelli: Other people have discussed at this Committee at length the issues around the time it takes to do trade deals and otherwise. There is an interaction between your tariff policy and trade deals. I would observe that, of course, tariffs are a part of that, but what has a bigger economic impact are the non-tariff barriers. Irrespective of your tariff policy, you would be looking, in trade deals, to reduce the non-tariff barriers, because that, as we learned from the long-term analysis, has a bigger impact on the patterns of trade and its economic benefits. It is not just a tariff issue.

Q148 **Wes Streeting:** That relates slightly to my next question. The TIIN talks about the “positive macroeconomic benefits of eliminating all import tariffs, particularly in reducing consumer prices and boosting GDP”. Does this suggest that there may be a reluctance to re-impose tariffs later on and, if so, what does it say about the strength of our position in



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negotiating trade deals? It kind of says that we are not interested in re-imposing tariffs, does it not?

Clare Lombardelli: I do not think you can necessarily draw that conclusion. What do we know? We know that liberalising tariffs puts downward pressure on prices and increases GDP. The long-term analysis will tell you that. Given that, the Government have still chosen to impose some tariffs and to not liberalise all tariffs, so you can see there is a trade-off there and we would expect further consideration of that trade-off in determining your longer-term policy. I do not think that you can quite draw that conclusion.

Dan York-Smith: With respect to trade agreements, there are some countries with quite liberalised tariff regimes, like Singapore and Australia, that still conclude trade agreements with other countries. Making the point that Clare made, some of the non-tariff issues about trade facilitation are more important economically than the tariffs.

Philip Duffy: I have one thing to add. It is very important here to understand not just the tariff but also the strength of the trade-defence administration that you have. That is true in areas like steel, which we have had representations from business on. The question then is to assess how far DIT can get in the next year in building that capability and whether that can be used to provide protection to particularly strategic industries, where there may be a risk of dumping or other anti-competitive behaviour.

Q149 **Wes Streeting:** On the process of decision-making, comments in the *Sunday Times* on 3 March by the CFO of Brompton suggested that some traders were aware of the proposals for zero-tariffs way before the Government's announcement to Parliament on 13 March. In fact, Sky News reported on proposals for zero-tariffs the day before, on 12 March. What discussions have officials had with business or other parties about setting import duties at zero percent, and how did you decide who to talk to and how to manage that information flow?

Dan York-Smith: We might have to write to you because I do not feel any of us have an answer to that.

Wes Streeting: That would be appreciated.

James Bowler: We were not in discussion with the CFO of Brompton ourselves.

Q150 **Chair:** You are all Treasury officials of various longstanding experience and everything else. Would you agree that this is a fairly unique circumstance? Most advice that goes to Ministers has numbers in it somewhere, and an anticipation that, if you do this, this is likely be the impact. This is a unique circumstance whereby, Clare, as you said and as we know, there could not be lots of consultation with business before the announcement last week. It is quite unprecedented that these decisions are made without the input of lots of people impacted and without being



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able to put numbers on for Ministers.

Clare Lombardelli: It is unprecedented in the sense that leaving a customs union and a single market is fairly unprecedented. It would not be fair to those who have worked on this policy to suggest it was an evidence-free zone. It certainly was not. With the information that we had available, and the ability that we had or otherwise to talk to stakeholders, the best advice was given. I would emphasise again that it is a short-term policy with a view to reviewing that and looking at it before introducing something long term and permanent.

Wes Streeting: That is reasonable. To be perfectly honest, if we were discussing any other policy area and a bunch of senior officials turned up with a lack of evidence underpinning the numbers, the assumptions and the policy direction, we would normally be kicking you across the room with a verbal barrage of questioning.

Chair: That is metaphorical.

Q151 **Wes Streeting:** Yes, metaphorically. Normally, this is where the Treasury Committee and other Select Committees would be going ballistic. The reason I am not is that everything you have said about the difficulties facing civil servants is entirely reasonable but I just think, as professionals, there is no way that you would ever countenance policy decisions or recommendations going to Ministers in any other area of public policy in this kind of shape. That is a fair assumption, is it not? Taking into account what Clare said, this is completely unprecedented, but it is not good.

James Bowler: I would make the two points that Clare has made here. First, you are not talking to the people who made that policy with the Department that has been set up to take those decisions. Secondly, this is a temporary regime in unprecedented circumstances, but I would not like you to think that you have the whole picture on everything that went into this policy from us four.

Chair: I expect there will be a series of letters swapped with Mr Scholar on this.

Q152 **Wes Streeting:** Yes. Anyway, I am not interested in having a go at officials. I do have one final question, though. Why are some of the tariff rates denominated in euros?

Dan York-Smith: This is to do with the fact that we have a current set of tariff schedules at the WTO, which are denominated in euros. They mark the upper bound of the tariffs that we will charge, and we are rolling them over. It is for the simplicity of administration, in that we already have some tariff schedules denominated in euros, and those represent quite a small number of types of good. It is largely in the agricultural sector, where there are tariffs by weight. One of the other big tariffs is on cars, and that is a percentage, so it tends to be in the agricultural sector, where they are by weight. It is because we already



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have a schedule denominated in euros at the WTO, which we are rolling over.

Q153 **Wes Streeting:** So you are not hedging against a fall in sterling.

Dan York-Smith: We do not comment on market exchange rates.

Q154 **Wes Streeting:** Thank you for your answers, and best of luck in the coming weeks. We appreciate the work you do.

Q155 **Alison McGovern:** We certainly do appreciate your efforts at the moment. To turn to forecasting briefly, the *Economic and Fiscal Outlook* notes, "As usual, the BRC requested changes to almost all the draft costings prepared by Departments". Could we have some comments on where we think Departments are at in terms of capacity? Are they understaffed? I am sure that the staff we have are brilliant, but do we lack resource? Might our Government economists be distracted at the moment or is this a long-running problem in terms of people's ability to manage a big and complicated workload?

Dan York-Smith: I will answer that one. I would not recognise this as being a problem per se, in the sense that, since the OBR has existed, it has certified costings of policy measures, and it is always an iterative process. Largely, it is driven by the fact that a lot of costings are based on modelling and assumptions, and those assumptions are really critical to the final outcome in terms of the cost. Because the Budget Responsibility Committee is making the judgments about the forecasts as a whole, it often has quite strong views about those assumptions. It is not unusual for every costing to have actions provided by the BRC for the analysts producing the costing.

I do not think it is the case that there are not enough analysts or that they do not have the skills or the capabilities; it is merely that the forecast process itself is iterative, where judgments are made and then judgments are changed, and that happens on pretty much every costing at pretty much every fiscal event.

Q156 **Alison McGovern:** It is a process of constant improvement; that is what you are saying.

James Bowler: This is a strength of our system. This is the system working. Arguably, before the existence of the OBR, the officials' view of the impact of the policy would just go into the thing, but now it is challenged by a set of independent views, which we would see as a strength.

Q157 **Alison McGovern:** Supposing that the independent economists have a different view from the Treasury view, which they may or may not, I just wanted to ask about forecasting in the current circumstances. Given what you have just said about the iterations and that this is, essentially, a process of learning about the economy as we go, is it even possible to forecast at the moment, given the level of uncertainty in the British



economy?

Clare Lombardelli: Let me talk about that. Yes, it is always possible to produce forecasts. As you know, we do not; the OBR does. This is a time of heightened uncertainty. It is not the only time and, if you think about economic history in the UK, there have been quite a few periods when things have been very uncertain, and predicting the way in which parts of the economy interact with each other and the relationships there has been difficult. Professor Bean talked a bit about this yesterday, and he has much more experience and has done this for some length of time.

It is definitely the case that, when uncertainty is high, you can have, in a sense, less confidence about the point estimates, which is why you look at things like ranges. The Bank of England published some interesting stuff in the *Inflation Report* about the impact of uncertainty and what that means for how reliable certain variables are. It is definitely an uncertain time to be doing forecasting. That said, there is value in having those forecasts because, in producing them, the point estimate may or may not be right. Looking at the detail of how those are put together and the relationships that people may or may not see can you give some information about what is going on, so it is definitely worth doing. It is uncertain. It is always uncertain. At the moment, you could say it particularly is, but there have been lots of periods in the post-war period where there has been uncertainty.

Q158 **Alison McGovern:** Minimal information is better than no information.

Clare Lombardelli: Yes. I would not describe it as minimal information. I would say that there is information there. A lot of people are thinking very hard about understanding this. The OBR has produced quite a large document that talks about the forecast. They are not the only people in this business. Other people are forecasting the UK economy at the moment, so there is information there. It is worth having it but, as with all forecasting, it is worth understanding what it can and cannot tell you.

Q159 **Alison McGovern:** In its revisiting of the Budget 2018 package, specifically the universal credit measures, the OBR says, "DWP analysts were not aware of the Budget income tax personal allowance measures". Is that something that would be common? Is that a structural problem or a cock-up?

Dan York-Smith: I can take that. Generally, benefit costings are particularly complicated because they are often multibillion-pound, demand-driven policies where the interactions between different benefits, the behavioural response of claimants and so on are required to produce a good costing. It is true that, in this case, the DWP analysts producing the costing did not have the information about the policy change on the personal allowance. They did, in their costings, include the interactions with the tax system, because that is an important part of coming up with the costing. In this case, they did not have it on the personal allowance change.



Having said that, the revision that the OBR had to make, given the scale of universal credit expenditure, is relatively modest, and it has not spelled out how much of that was due to this particular interaction as opposed to other changes it asked to be made to the costing.

Q160 Alison McGovern: Let me ask the question from a slightly different point of view, because I totally accept what you say about the importance to the accounting figures. In terms of the interaction of the policy, the incentive impact for citizens is also important. In theory, if you had an interaction of a personal tax allowance policy with the benefits system that went under-forecast or un-forecast, or whatever, that could have quite a consequence for people's experience of the benefits system. Has that been put right for the future? Whether the number is quite right is one thing, but I am more worried about whether people have the right incentives.

Dan York-Smith: There were a number of comments from the OBR about its forecasting process at the Budget, of which this was one. We have been through a process with the OBR to try to rectify those, and the OBR acknowledged, in its *Economic and Fiscal Outlook*, that we had made a lot of progress and the process had worked much better this time. We are trying to get it right and ensure that we do not have things that are not correctly forecast or costings that are not correct in the future.

Q161 Alison McGovern: So you think that there has been a procedural alteration that means that that particular problem would not arise in the future.

Dan York-Smith: One of the challenge of the Budget was that there were so many policy measures and it was so large, so I would not want to say that, absolutely, we are going to get it right every time in the future if we have a similarly large set of policies. It was certainly one of the things on which we have talked to the OBR about how we get it right, and it is our intention to rectify it in the future.

James Bowler: To pick up the core of your point, this is a forecasting issue about how accurate the forecasts are for that bit of spending. It should not impact at all on your constituents' experience of the actual policy.

Q162 Alison McGovern: That is not quite right, because the decision that might be taken about the policy might be dependent on what we thought the incentives were.

James Bowler: That is very unlikely to be the case but, in this case, it was that income tax was lower than they thought it was going to be.

Q163 Alison McGovern: In relation to this case, it is unlikely, but you can see why you would worry about the consequence. If you have DWP measures interacting with HMRC measures, it is very important that that is understood in a seamless way because, frankly, the public experience the money in their pay packet in a fairly seamless way.



Q164 **Chair:** It goes back to the point you made about cross-cutting earlier on. It is an issue across Government about getting people to talk to each other. The issue about this is what the appropriate moment is and who is best placed to bring it together.

Dan York-Smith: I should say, to reassure the Committee, that the team responsible for welfare policy in the Treasury—which would be scrutinising DWP measures—sits next to the team that does personal tax policy, and they very much are talking. In this case, when designing a policy, the interactions with the personal allowance were definitely taken into account; it is just unfortunate that they were not in the costing for the public finances.

Q165 **Alison McGovern:** If you were watching the session yesterday, you may have heard my exchange with Professor Bean on regional disparities. I do not know if any of you has any comments on how we might improve analysis of those disparities. The sense that we have had from the Bank of England in recent sessions, and again yesterday, was that those charged at the most senior levels in the world of economics are a bit uninterested in regional disparities, insofar as they do not affect the aggregate, but that is really not the public's view. Do you have any comments on where that should go?

Clare Lombardelli: I will comment on this briefly. I do not think it is a fair criticism of economics to say that it is not interested in regional disparities in terms of the macro variables, where we know that there is a relationship in certain areas between the distribution and the levels of certain variables, so that is definitely something that people think about. There is a lot of academic and other work on that area.

I would also point out that the majority of the questions around distributional analysis are questions of microeconomics, and there is a huge amount of work done by economists, including the Government Economic Service, the majority of whom are looking at microeconomic issues. I take your point that, in this Committee, quite often it is not talked about, but that is because you are not seeing the Ministry of Housing, Communities and Local Government as much. It will have lots of analysts thinking about, looking at and analysing that. Those sorts of issues are being looked at by the economics profession across the board. It just may not be coming in front of you quite as often as the macro forecasting.

Q166 **Alison McGovern:** Is your argument, therefore, that we do have a structural issue within economics, by saying, "The Government Economics Service has lots of people in MHCLG"—or whatever it is called now—"doing microeconomics, but here in the Treasury we do macro, so that is not really an issue for us"? I completely understand that, in the world of economics, the regional disparities that this Committee has asked about on many occasions are a well-researched matter. My question is this: are we going to see the Treasury, alongside others like the Bank and the OBR, take full account of the regional impacts of



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Government policy, given that that is what the public care about, rather than just saying, "Other people do that; we do the aggregate here"?

Clare Lombardelli: To be clear, the Treasury does look at this, think about it, care about it and consider it in its policy advice and analysis. I am not saying to you that the Treasury does not care; I am saying to you that most of the discussion in macroeconomics tends to focus on it less than some of the discussions around microeconomics, but it is a very important discussion and it is something that the Treasury looks at, thinks about and analyses. There are lots of economists across Government and elsewhere who could come and talk to you at length about regional analysis and its impact.

Philip Duffy: Quite a lot of the people who worry about this work in my unit. The key point here is that the industrial strategy is used as our overarching structure for thinking about this, and place is one of the pillars of that industrial strategy. That is having a real effect on how the Treasury is taking spending decisions in what it does. A good example of that would be research and development. We previously had an entirely spatially neutral approach to that, so the money essentially went to London and the south-east. There was no consideration of the regional economic impacts of that spending decision. That has now changed.

Another example would be transport spending. There is a very lively debate about that and the impacts on—

Q167 **Alison McGovern:** Sorry to interrupt you but that is not the question that I was asking. I know the Government do lots of other things that are economic decisions that are not what we are talking about. My question is this: do you think, given what you just said, Clare, perhaps the micro economy and the macro economy might be connected?

Clare Lombardelli: I absolutely think the micro economy and the macro economy are connected, and the work that we do and the way in which we go about it recognises that.

Q168 **Wes Streeting:** Is the OBR remit at the right place on this?

Clare Lombardelli: The OBR remit is to look at the fiscal aggregates, assess us against those, and produce a forecast. It is a judgment for them, and it is right that it is their independent judgment as experts, as to the extent to which they think about these issues, and they do. For example, in talking about unemployment, they make estimates around things like structural unemployment and frictional unemployment that will pick up issues where you might have regional dislocations, as was talked about yesterday. It is right that it is their judgment that does that. The benefit of having an independent OBR is that it can look at the best analysis.

Q169 **Wes Streeting:** I appreciate that, but we ask them and they say, "Our remit says this, and the remit is set by Treasury". I agree with literally everything Ali said, and I think this is an area where the Treasury needs



to do a bit more thinking to reassure us that this is in the right place.

Q170 Chair: Philip, you were in the process of talking about transport. That will be of interest to people watching this. I take Alison's point that it is a slightly different issue and I think we will want to explore further with Ministers and others the micro economy focus, in the same way that we have about the gender focus, for example, and impacts. There is a perception that infrastructure spending all still goes to London and the south-east. Could you talk us through briefly what you were going to say about transport spending?

Philip Duffy: First, we are acutely aware that, if you believe in the vision of well-connected urban areas in the north of England, you will have to improve the transport spending and delivery across that area. We have seen significant problems in transport delivery, including with the Northern Rail franchise.

I start by pointing out that the Treasury is not unaware of that. We are fully aware of that and we understand the experiences of travellers every day across Greater Manchester, Leeds, Sheffield, Hull and Liverpool. The next question, if you think about the spending we have made—and we said at the spring statement that we are looking forward to hearing about the outline business case for the Northern Powerhouse Rail scheme, which we expect to receive by the end of this year or early next year—is making sure that, in the big decisions we take on spending in the next period, we are aligning spending with that priority of improving connectivity across the north.

At the minute, spending is, depending on how you cut it, roughly fair per capita across most of the English regions—this is transport spending in England only—but it is heavily skewed by these very large projects, particularly High Speed 2, which is a very large part of our spending over the next piece.

My point, really, quite simply, is that that is an area of great concern to the Chancellor, which he is focusing on quite fairly. We are seeing improvements already. We now have the electrification of Preston-Manchester open, which is really good. The Pacer trains are due to be phased out by the end of 2020, which is also good progress, so we are making some progress across transport outside London and the south-east. There are also issues about trans-Pennine road connectivity, which we are quite focused on. The Chancellor was signalling in the spring statement the importance of that agenda as we go into the SR, and it is no more than that, really.

Chair: I would just say that there is a bit between the south-east and the north, called the Midlands, which I would champion very much.

Philip Duffy: There is.

Chair: You whizz through it on the train. It is very important.



Wes Streeting: Also, the infrastructure pressures on London are immense, so just bear that in mind.

- Q171 **Catherine McKinnell:** I was delighted to hear in the spending review that there was a focus on some of the rail challenges, because one of the things I have consistently raised—and I very much agree with what Ali is saying—is the risk, if these very large infrastructure projects, like HS2, are not accompanied by the smaller infrastructure investment that needs to feed into that to be able to connect to it, and, for example, the line north of York to get HS2 up to Newcastle and beyond, that you make parts of the country further away, relatively speaking, than others. Even though you have spent billions of pounds of investment in infrastructure that is supposed to make the country more connected, it can result in the opposite effect. That is one of the things I have been very concerned about in terms of HS2 and the East Coast Main Line. The lack of infrastructure investment on that line may mean that we do not get the benefit of HS2, but it has a negative effect. That is a concern.

Philip Duffy: Can I make a brief comment?

Chair: Very briefly, because we will come back to infrastructure.

Philip Duffy: We have the NIC advising us on what to build and what the priorities are, which is a Treasury-sponsored body. We set the NIC a fiscal remit of 1% to 1.2% of GDP for economic infrastructure that would, in theory, run on for some period. I do ask people to be patient about the scale of the challenge here because High Speed 2 is a very large, very long-term project and very challenging to deliver, so it is important that we, frankly, finish the work we started to make sure that we are delivering what we promised.

Lastly, the NIC has said that there needs to be more investment over time into city regional and local travel, and less into very large projects. We agree with that diagnosis but we are very committed on the large projects for the next few years. The Transforming Cities Fund was the start of that process but that is an area we are quite keen to explore in the zero-based review at the spending review.

- Q172 **Catherine McKinnell:** I am still on infrastructure. I wanted to also ask about the comprehensive national infrastructure strategy, which the Chancellor reiterated the Government are committed to publishing, along with financial commitments that are related to it. Is it safe to assume that this is a fairly advanced project and are you able to say when it will be published? To what extent is it hampered by a focus on Brexit or contingent upon a withdrawal agreement being arrived at?

Philip Duffy: This document would, essentially, be our formal response to the NIC's five-yearly national infrastructure assessment, which we have now received. Parts of that are going to be quite straightforward for Government to accept; other parts are more challenging. We are currently working across all Government Departments that deal with



infrastructure to make sure we are exploring and making progress on that.

The timetable for publication is listed as autumn. It could be alongside the SR outcome; it could be at the autumn Budget. We do not have a clear view on what date that should be. There is a logic to that: partly, this is a good framework for the outcome of the zero-based review that James has discussed; secondly, we launched at the spring statement this infrastructure finance review, which is looking at a wide variety of questions about the source of money for this, not just public money, I should stress, but also the future of private investment in those areas, and regulation. The three—the spending review, what we are going to build and the funding—fit quite clearly together as a package in those areas.

Catherine McKinnell: There is a bit of a timing urgency to this. For example, spring 2019: I would say we are pretty much at spring.

Chair: We had the spring statement.

Catherine McKinnell: Exactly.

Wes Streeting: It is the last day of winter.

Catherine McKinnell: There are daffodils.

Chair: Or the first day of spring.

Q173 **Catherine McKinnell:** We are supposed to have a full fibre connectivity plan, and I am not sure we have that yet.

Philip Duffy: No, I do not think that is quite right. We published, last July, the *Future Telecoms Infrastructure Review*. It was a DCMS publication but Treasury was heavily involved with that. That had three large elements to it. The first was this work to look at the geographies around the country and stipulate, for the first time, regional regulatory and competition policies that would boost the delivery of full fibre to all properties to our timetable of 2033, which is our target date. That work is underway, and Ofcom is currently consulting on that. It is for Ofcom to work out which places fall into which geographies.

The second pillar of that work was the so-called barrier-busting work. This is things like wayleaves, ways you access properties and how you build out new developments. We are making good progress on a series of regulatory changes on that.

The third element of our work on this is what we call the outside-in, or last 10%, issues. This is about an element of public spending that helps more rural areas access full fibre, so they are not left behind. At the spring statement, we announced nine areas that have received money from our funding to assist that, and a set of projects that help public bodies in more rural areas to access fibre for other purposes.



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No one here would claim that we are where we want to be on fibre access at 6% access. That is not good enough. It is a key priority of the Chancellor.

Q174 **Catherine McKinnell:** Do we have a full plan?

Philip Duffy: We do. The *FTIR* was very comprehensive.

Q175 **Catherine McKinnell:** Is it published?

Philip Duffy: The *FTIR* was published last July.

Q176 **Catherine McKinnell:** All those plans are fully published for how it is going to be delivered by 2033.

Philip Duffy: The detailed geography of which towns fall into which competitive and regulatory zone is a matter for Ofcom. It is consulting on that. It needs to do further market analysis to get that list out, and that is what is going on right now.

Q177 **Catherine McKinnell:** In terms of how that process goes, that really matters as well, because we have seen no end of documented issues—I have, in my local area—about Openreach and the challenges we have had. What is happening to make sure we do not end up with some of the same challenges going forward, and that this is deliverable and will be delivered by 2033?

Philip Duffy: At the heart of the *FTIR*, for most large population centres, we would expect a market competition-driven approach to getting faster rollout. We are seeing that with the wide variety of so-called altnets or new entrants to the fibre market, which are making an impact. We are also seeing it in London, where Vodafone is investing very heavily in fibre, so we are seeing some changes in the large urban areas. For areas that are more lightly populated or more remote, we will need a different approach because it is not obvious that the level of capital investment required to deliver full fibre in all those areas can be justified at a multiple to provide a highly competitive market.

Ofcom is now looking at the areas in which you might award a tender for the market rather than competing in the market, and the areas in which, if we are going to get fibre and those benefits, we will have to use some public investment. That is the mix.

Q178 **Catherine McKinnell:** Can I just caution that I do not think we are there at all even in urban areas? I spoke to a local businessperson just on Friday, who was lamenting how they had bought a brand new house that does not have fibre. They want to work from home and they cannot. These are brand new developments that are going on now in urban areas like Newcastle, which do not have connectivity to fibre. This is a really urgent problem. I know you are trying to sound positive and upbeat that this is all deliverable, but the reality on the ground and the experience of people is that this is not going very well.



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Philip Duffy: I would like to comment on the scale of mobilisation required to deliver this by 2033. We would need 12,000 houses to be connected to full fibre every working day between now and then. No one in the Treasury underestimates what a significant challenge that is going to be for the country as a whole in terms of staffing and resources. It will, as the *FTIR* said, cost around £30 billion, which will be consumer-funded, overwhelmingly, but that is a big piece of investment. Right now, it is about competition policy, law, access and building standards. You will notice that, when we made the announcement on zero-carbon heat, we talked about future-fit homes, and that is partly about making sure they have the right wayleaves to fit fibre, rather than retrofitting into new houses in the way that your constituent mentioned. I would not want you to leave this meeting thinking we were complacent about that and things were all good, because we are not.

Q179 **Catherine McKinnell:** Good. I just want to ask as well about the European Investment Bank. It is currently supporting new UK infrastructure. You would assume that that would end on 29 March. Presumably, that is dependent upon whether there is an extension to Article 50, which clearly is up for debate. The Government have said very little so far about the future relationship but they have expressed their commitment to continue to work in a collaborative way. What is happening? What can we expect to see?

Philip Duffy: If the withdrawal agreement is agreed, there is no implementation period for EIB membership. We leave the day that we leave. There is no more membership for the UK of the EIB. We are a third country. That does not preclude a future relationship with the EIB, and the Chancellor has said repeatedly we will seek such a relationship. The EIB has lending programmes and memberships with a number of third countries, so that is not unprecedented, but they are, to be honest, at much lower lending volumes than we have seen over recent years, where it was lending £6 million to £8 billion a year to the UK market.

In the run-up to the publication of the infrastructure finance review, we have done a lot of analysis –

Q180 **Catherine McKinnell:** Sorry, is that not quite a significant proportion of UK infrastructure spending, around a third?

Philip Duffy: The important point about EIB lending is how much is additional and could not be obtained by other means. EIB lending is currently slightly cheaper, in general, than going to the market. The question the Treasury would ask is how much of this money is essential. There are a number of areas where EIB lending has been extremely important in the UK sector. To name three, there has been very large-scale lending, such as syndicated loans for Thames Tideway Tunnel in London, which had EIB backing; it has been very important in emergent technologies, particularly in offshore wind, and we would be worried about the future technology investment flow for things like heat, which we have been discussing in this conversation; and the third is



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countercyclical lending during a downturn. We are not in that state currently but we are aware of the role the EIB has played over time in those areas.

That is the rationale for issuing the infrastructure finance review. In the review, we comment that the NIC has suggested we have some form of new institution. We have not taken a view on that currently but we have looked, in the IFR, at all the ways in which the EIB has been additional in its lending for infrastructure in recent years, and all the ways and the tools we have to replace some of that lending or that capacity in the infrastructure market. It is not just about having a bank; there can be other routes, like guarantees, for example.

Q181 Catherine McKinnell: We are currently 10 days away from losing access to that funding and we still do not know how we are going to replace it.

Philip Duffy: I do not think that is a wholly fair characterisation of it because, for example, the Treasury have an extensive infrastructure guarantee scheme. We have been involved in about £4 billion of projects so far on that, including some quite important ones up and down the country, so we already have tools to help projects that might be in difficulty. We are monitoring very closely the state of the infrastructure market. It is quite healthy in the UK currently because we have a lot of mature, well-regulated assets that people wish to invest in across that period, so I do not think that is quite the case.

We made a small announcement in the spring statement confirming what we said at the autumn Budget about a further £200 million investment into the British Business Bank. It is not in infrastructure but is focused on lending to start-ups and the work of the subsidiary to the EIB, the EIF, which we will also be leaving on that area. That pretty much matches the activity in early-stage VC, which is our most valuable income stream from the EIF.

Q182 Catherine McKinnell: Now for something completely different: apprenticeships and the National Audit Office report in March for 2017-18. Levy-paying employers are only using 9% of the funds at the moment, so we are clearly looking at a potential significant underspend, which may also affect the Government's 3 million target by 2020. To what extent do you assess that the changes planned by Government are going to go against addressing these significant issues? Do you have an analysis of how much levy is likely to go unspent? What is the Treasury going to do with this unspent money, given that the policy seems to be not to allow any extension of time for employers to use that funding for their apprenticeship purposes?

Philip Duffy: We share the concerns businesses have raised with us about the difficulty in spending the levy. We share them not only from the point of view that it is a pot of money that should be spent, but also from a productivity and economic point of view. In particular, we are very seized of the importance of making sure that our internationally, globally



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competitive primes are able to spend money in their supply chain to raise performance across firms that are smaller and not quite so elite.

We made two changes, which we had already announced in principle at the autumn Budget but we had not made a date for. They will now begin as soon as next month. They are to allow levy payers, those who have a pay bill of more than £3 million, to spend up to 25% of their levy on their supply chain, up from 10%. We expect that that will cost around £450 million against a total levy of about £2.4 billion, so it is quite a significant increase in the outflow of money from that levy pot.

The other measure we have done is to cut the cost of training if you are a non-levy payer, where you can access some finance from the levy pot, from 10% to 5%. That will cost a further £240 million from that pot. So we are making changes to make sure this money is spent in the way it was intended.

On your question about the delay and the delivery timetable, I would just say that we are still committed to delivering the 3 million apprenticeships we announced in 2015. We are also committed to making sure they are high quality and that those going on apprenticeships are getting the very best quality of training, since this remains a high-esteem and economically valid route for education.

Q183 Catherine McKinnell: On the flipside of this, there is also the NAO's projected risk of overspend in terms of the departmental budget for DfE on apprenticeships. It has been allocated for budgeting terms as part of the departmental expenditure limit rather than annually managed expenditure. Given it is a demand-led cost, this has been questioned. There appears to be a mismatch between the spending of the levy fund by businesses and the Government's own funding of its apprenticeship programme through the DfE. There seems to be an overspend and an underspend, and I just wonder what your plans are in terms of the mismatch, or if you have any.

James Bowler: When it comes to Departments wanting to move things from DEL to AME, that is me. It is in DfE's DEL, and DfE is raising this issue with us. I guess there are two things to say. We try to keep things, including demand-led items, in departmental expenditure, because that is a better sense of a strong budgeting grip on spending, and we will continue to try to do that, but we are in discussions. I do not have an announcement to make about the issue you raise of the pressures on DfE's budget, given that, and we will have to look at that in the round.

Q184 Catherine McKinnell: I guess the concern is whether it is sustainable. Is this going to undermine apprenticeships in any way? That is the big concern.

James Bowler: No, it will not undermine apprenticeships but it will lead to some interesting conversations between the Treasury and DfE about their budgets.



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Chair: Only one of many interesting conversations you are going to have over the next few months, I am sure.

James Bowler: There are lots of interesting conversations.

Mr Clarke: That was a masterpiece of Civil Service speak.

Chair: That is a compliment, Simon.

Q185 **Mr Clarke:** Our work here is done. On plastic bags and plastic packaging, which has been a signal policy success over the course of the last several years, in terms of the impact of the 5p and then the 10p rate, the next move is towards the April 2022 30% recycled content tax. Why was a tax chosen as the mechanism to implement this very laudable objective as opposed to, say, an outright ban, a levy or some other tool of policy?

Dan York-Smith: I will take that one. The analogy I would draw is with the soft drinks industry levy, in that the plastic packaging tax is, effectively, about reformulation. Instead of getting people to reduce the sugar content of their drinks, we want them to increase the recycled content of their packaging to stop new plastics entering the plastic supply chain. It is just one of a number of measures and one that is currently subject to consultation. We await what businesses and others say about the measure and its likely impact but it is one of a number of things, along with what Defra is doing on producer responsibility, which is about, once it has been produced, getting people to recycle it. It is part of a suite of measures. It is about changing the economics of recycled content in the packaging that is produced, which then enters the supermarkets and the goods that people purchase.

Q186 **Mr Clarke:** Are there any examples around the world at present of countries that have a tax of this nature? How has it fared there?

Dan York-Smith: I am afraid I do not know the answer to that.

Chair: If you could write, that would be great.

Mr Clarke: That is the key point here. In many ways, the UK is right to try to be a world leader, even if we are acting in isolation on this issue at this time, but nonetheless one would assume that any consultation would be better informed were we to understand that.

Dan York-Smith: Generally, in terms of this international competitiveness angle, plastic packaging makes up quite a small proportion of the cost of the good you purchase that is in the plastic packaging. That is something we will also consider as part of the consultation but it is quite a small part of it. We are not alone, in general, in the concern about single-use plastics in particular, so that is part of a wider global change towards reducing single-use, non-recyclable plastic.

Q187 **Mr Clarke:** I was at a wonderful talk last week with Attenborough on this very subject, saying that, when his generation was being reared on the merits of plastics, the whole selling point at the time was that these things are indestructible, which now, 60 years on, feels a little short



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sighted, so more strength to your elbow. In terms of the 30% threshold, from a policy perspective, anything that sets hard cliff edges, as we know, whether that is a C/D-grade borderline at GCSE right through to this, runs the risk of being gamed. Are we to read from this that, if you had something that was on a 31:69 ratio of non-recycled material, you would be exempt from this tax?

Dan York-Smith: Again, it is one of the things which I am sure people will respond to in the consultation. At the moment, we think 30% strikes the right balance of providing a clear economic incentive for people to use more recycled content in the production of their packaging, while, at the same time, not representing an unreasonable increase from where we are now. It is the kind of thing that I could imagine a future Chancellor would want to keep under review, just as we did, to draw the analogy again, with the sugar tax. The thresholds for the different bands and the coverage of the levy could be reviewed in the future.

Q188 **Mr Clarke:** You could have a differential rate of the levy, depending on your recycled content, could you not? That may start to become more complex to administer, but nonetheless you could conceivably say that there is a lower rate for stuff with a recycled content of 30% to 45%, say, and so on.

Dan York-Smith: You are right about the complexity angle. This is a new tax that HMRC will have to deliver. The more specific you are, and the more different rates and thresholds there are in a tax, the more complicated it is to administer. Indeed, the cliff-edge effects that you talked about could become more pronounced if you had multiple different rates. Again, let us see what people say in response to the consultation.

Q189 **Mr Clarke:** Is there a broad expectation that this cost would be defrayed by business or passed on to the consumer at this point?

Dan York-Smith: As I say, we are still at the point of consultation. It is part of a much wider change and it is not the only thing that is happening on plastic packaging. The producer responsibility scheme, which is about forcing greater recycling of the content, once it has been passed to consumers, will also affect the market in plastic packaging. Hopefully with these things, if you give enough notice, producers are able to adjust their behaviour.

Q190 **Mr Clarke:** Before it even comes to the consumer.

Dan York-Smith: Before it passes to the consumer, yes.

Q191 **Mr Clarke:** On greening the gas grid, you have a sense of the conservative tension on this issue, which is to say that everyone agrees about the end goal, but it is about whether you are doing in a market-sensitive way. What mechanisms are being considered to incentivise a proportion of green gas in the gas grid?

Philip Duffy: We are consulting on it. The approach taken to electricity is that we mandate operators to purchase a proportion of their energy from



renewable sources. That has costs, which are borne by the consumer, so it is, effectively, a form of consumer subsidy of a particular technology mix. We have used the phrase “green gas” and I should be clear that there are different forms of green gas from different sorts of feedstock and different sources. The Government do not have a particular prejudice about one form or another at this time, and we would want to work to make sure we are protecting a range of potential new technologies that we may need in the future.

Q192 Mr Clarke: The lesson on energy generation has been the spectacular success of contracts for difference. Steve mentioned earlier a market-sensitive route to delivering outcomes, and that is, to my mind, probably the most underappreciated policy success in allowing the market to steer policy-driven outcomes. Maybe we can do something that mirrors that.

In terms of how the Treasury is trying to address climate change more widely at this point, are there any further issues you want to highlight?

Philip Duffy: No. We are acutely aware both of our statutory obligations and of the need to balance the interests of energy users, both industries and consumers, some of whom are vulnerable, with the need to ensure this transition supports an industrial strategy where there is an important role for energy transition in that mix. That is something we are very alive to. We feel that, with the success you describe on CfDs and the levy control framework, the next stop will have to be heat.

I would caution that, before we got to CfDs, attempts were made to try different technologies at an earlier stage of development, and that is where we are with green gas, giving that market a chance to see if it can develop.

Q193 Mr Clarke: In essence, this is almost an R&D phase.

Philip Duffy: It is seeing how technologies will adapt and whether they can be scaled.

Q194 Mr Clarke: With a view to then perhaps a more market-led rollout at a slightly later phase, potentially.

Philip Duffy: Quite possibly.

Mr Clarke: That is really helpful. Thank you very much.

Chair: Can I thank you all very much indeed for being here? We appreciate that Westminster and Whitehall are going through unprecedented times. It is extraordinary that the spring statement really was a bit of a footnote last Wednesday, as opposed to what it would normally have been. We appreciate that it takes an enormous amount of preparation within the Department and across Government, but also preparation to be here before the Committee, so your time is very much appreciated. Thank you to you all.