

Lord Bridges of Headley
House of Lords

26 February 2024

Richard Hughes
Chair

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obr.uk

Dear Lord Bridges,

Additional information on debt sustainability

Thank you for your letter of February 12 asking for clarification on some issues relating to debt sustainability. I attach an initial response to all your questions.

We will be producing more material relating to these issues in our upcoming *Economic and fiscal outlook* that will accompany the Budget on March 6. I will share this material with you as soon as it is published.

Please let me know if the OBR might provide further assistance to your inquiry.

Sincerely,



Richard Hughes
Chair
Office for Budget Responsibility

1) The impact of immigration: Paragraph 4.48 and Table 4.3 of the Fiscal Risks and Sustainability Report 2023 indicates that net migration of 245,000 a year would reduce the national debt by 30 per cent by 2072-3. What impact will the ONS's new long-term projections of 315,000 per annum have on debt forecasts? And could you clarify by how much a lower net migration figure – say 100,000 a year – would reduce the national debt over the same period?

Our forthcoming *Economic and fiscal outlook*, to be published alongside the Spring Budget on 6 March, will include a full analysis of the economic and fiscal implications of the ONS's new population projections. It will also include alternative scenarios for future net migration levels. We will share this with you as soon as it is published.

2) The impact of the speed of the green transition on the national debt: you mentioned that work is ongoing on this issue, but it would be useful to see the impact of the various scenarios that have already been modelled, and the assumptions that underpin them.

Our 2021 *Fiscal risks report*¹ detailed a number of scenarios relating to the transition to Net Zero. This work combined:

- Estimates from the Climate Change Committee's *The sixth carbon budget*² for the direct whole economy costs of the transition
- Economic scenarios developed by the Bank of England³ that estimate the indirect effects on the economy
- OBR estimates for the share of the direct costs likely to be borne by government; the impact of the indirect costs on the fiscal position; the direct loss of tax revenues linked to fossil fuels and emissions; and possible revenue benefits from taxing carbon more systematically.

Among the scenarios looked at were an 'early action' scenario where global emissions are steadily reduced over the 30 years to 2050 and a 'late action' scenario where decisive steps are not taken until the 2030s so that subsequent actions need to be more aggressive to achieve net zero by 2050. Relative to early action the late action scenario assumes:

- Greater macroeconomic disruption from higher carbon prices needed to drive more rapid transition and scrapping more carbon-intensive capital before the end of its economic life that leads to a lower GDP.

¹ OBR, *Fiscal risks report*, Chapter 3: Climate Change, July 2021. See Chart 3.35 for a rundown of the different scenarios

² Climate Change Committee, *The Sixth Carbon Budget*, December 2020. For our report we used the 'Balanced Pathway' in year costs, as found in CCC report's accompanying dataset.

³ Bank of England, *2021 Biennial Exploratory Scenario (CBES)*, 2021. The CBES was built from the second phase of the Network for Greening the Financial Sector scenarios. Our work built upon the 'early action' and 'late action' scenarios.

- Nearly doubled public sector spending as we assume that both the whole economy costs are higher and that government bears a higher share of them.
- Higher receipts from carbon-intensive activities. For example, fuel duty remains higher for longer; and
- Revenues from carbon taxes are lower reflecting a missed decade in which taxes could be levied.

Late action therefore leads to higher deficits in a smaller economy. This roughly doubles the impact on debt relative to the early action scenario leaving debt 3 per cent of GDP higher.

3) The impact of the Government making full expensing permanent at the Autumn Statement 2023: what modelling has been done on the investment impact of this measure on debt, and for growth in the long term?

In Box 2.1 of our November 2023 EFO we estimated that over the long run the build-up of capital stocks from full expensing would rise to increase potential output by a little under 0.2 per cent. While the long-term direct revenue cost of the measure settled at 0.12 per cent of GDP in the long run. We have not worked through the consequences of the two changes on debt in the long-run but would expect it to be modest by comparison with the other drivers of debt dynamics over the next 50 years.

We have put an explanatory Article on our website entitled *The economic effects of full expensing* available at: [The economic effects of full expensing \(obr.uk\)](https://obr.uk)

4) The costs of the nuclear deterrent: could you clarify how the cost of the Dreadnought and Replacement Warhead programmes, including their in-service costs, are reflected in the long-term debt projections; and what assumptions have been made as to the in-service cost?

Our long-term debt projections do not build up defence spending costs bottom-up. Instead we assume that total defence spending remains at its medium-term level as a share of the economy. This is roughly equivalent to maintaining our NATO commitment to spend 2 per cent of GDP on defence.