HM Treasury

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Mel Stride MP
Chair of the Treasury Committee
House of Commons
London
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(*Via email*)

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Dear Mr. Stride

Thank you for your letter of 11 January.

TREASURY ECONOMIC ANALYSIS

Under the Industry Act 1975, the Treasury was responsible for preparing and publishing economic and fiscal forecasts twice a year. In 2010, the Government decided to transfer that responsibility to a new Office for Budget Responsibility (OBR), which was subsequently established in statute under the Budget Responsibility and National Audit Act 2011. Consequently, the Treasury no longer prepares economic forecasts. We do, though, retain a significant macroeconomic capacity, which we use for a variety of purposes: for example, policy advice to ministers, including for fiscal events; stylised projections to analyse different policy options (such as alternative paths for fiscal policy); and analytical work on particular policy themes or challenges. The purpose of all this work is to inform policy advice to ministers. We also maintain and develop (jointly with the OBR) a large-scale macroeconomic model, which the OBR uses for forecasting. This involves ensuring that the model reflects any changes to the structure, composition and classification of the ONS national accounts and other data sources, the re-estimation of the behavioural equations to take on the latest data or theory, and other work to develop the overall coherence and consistency of the model.

Since the onset of the pandemic, the Treasury has provided ministers with advice on the impact of Covid-19 on the economy and the public finances. To inform this we have brought together the economic data published by the Office for National Statistics, forecasts and projections prepared by the OBR, the Bank of England and others, academic literature and real-time information such as mobility data. In considering the impact on particular sectors or regions, we have considered the non-pharmaceutical restrictions (NPIs) in force or under consideration; the extent of Gross Value Added (GVA) accounted for by the sectors directly affected; the employment accounted for by those sectors; regional variations in NPIs, and the resultant impacts on factors such as supply chains and ability to travel to work; and the vulnerability of the labour market and firms, using the information provided by survey data. We have used a range of analytical tools to bring together this information and to assess the interaction between the different factors. This includes the work referred to in the SAGE minutes of 21 September. This analytical work has generated advice to ministers on the possible range of impacts, although inevitably those are subject to a high degree of uncertainty. It also informed the Government's publication, 'Analysis of the health, economic and social effects of COVID-19 and the approach to tiering', on 30 November.

As set out in that document, any attempt to estimate the specific economic impacts of precise changes to individual restrictions for a defined period of time would be subject to very wide uncertainty. Many factors will determine the short and long-term economic impacts of the restrictions, including the path of the virus in the UK; the effectiveness of and degree of compliance with the restrictions; the proportion of the country under certain restrictions, and how that proportion changes over time; the behaviour of consumers and businesses in response to the virus and restrictions, including the overall change in consumption and investment and businesses' ability to adapt, displacement to other sectors, and how changed activity in one sector affects another; the effectiveness of other measures, including community testing and vaccines, which in turn depends on vaccine roll-out, take-up and efficacy; and the path of the virus globally, including the possible development of new strains, and the approach to restrictions in other countries. Furthermore, to estimate the economic effects of changes in restrictions also requires knowledge of what would have happened to the path of the virus and the economy with different restrictions, or no restrictions. Unfortunately, the evolution of the virus and the restrictions required to mitigate it has changed over time, and given the complex interactions between the two, it is not possible to know with any degree of confidence what would otherwise have happened. Any assessment of a given change to restrictions is therefore unavoidably only partial in nature.

As a result the OBR, in their November Economic and Fiscal Outlook, drew attention to the very high degree of uncertainty attached to the projections in the scenarios they set out, noting that they "make no attempt to assign probabilities to any particular outcome" and that "ultimately these are judgement-based scenarios". Any forecaster would face the same challenges. At the best of times, and in the most stable economic conditions, forecasting is an uncertain business, using models that can only capture a small part of reality, and incorporate many judgements, assumptions and simplifications, giving results that are inevitably imprecise and uncertain. But in normal times, economic forecasting and analysis can at least assume a stable and predictable economic environment, and draw on well-established models, with long data sets and stable behavioural equations and coefficients to estimate the effects of a change in one variable on another. In the circumstances of an unprecedented pandemic, none of this applies. And while epi-macro models provide valuable insight into how changes in one variable can affect outcomes elsewhere in a highly complex system, they rely critically on assumptions on parameters – which, in the absence of previous experience or extensive data sets, can only be assumptions. For example, in current circumstances, a critical factor in determining the consequences of various policies on the path of the pandemic and the impact on the economy is the degree to which vaccines reduce transmission. As of today, there are only very limited reliable studies on this, so the modeller can only make assumptions, and different assumptions will generate very different results. We have studied the outputs of the academic literature on epi-macro modelling very closely and benefited here from the Treasury's observer status at SAGE, and discussions with both leading academics and the analytical network across government departments. While we have incorporated the insights into our analysis, we need to recognise that the results are exceptionally uncertain, and heavily driven by assumptions.

The Treasury will continue to incorporate economic analysis into policy advice to ministers, using all the information set out above, as well as previous experience at earlier stages in the pandemic. Some issues – such as the impact on vaccine roll-out on consumer behaviour and voluntary social distancing – have not yet been observed and so cannot be modelled with any degree of confidence. On others – such as the possible impact on different sectors as restrictions are reduced – we will be able to draw on previous experience, including the analysis published in the 30 November document. The Government is clear that the unabated spread of the virus would lead to unacceptable health and economic outcomes.

SELF-EMPLOYED INCOME SUPPORT SCHEME (SEISS)

Treasury Ministers always welcome constructive proposals from stakeholders, including those submitted by the Federation for Small Businesses on the SEISS. But, unfortunately, the proposal for a Directors Income Support Scheme (DISS) still gives rise to a significant risk of fraud.

The DISS seeks to address the issue that eligibility for the SEISS and the grant amount are based on an individual's earnings from self-employment, but that it is not possible under current reporting mechanisms for HMRC to distinguish between dividends paid in lieu of employment income and those paid as returns on investment in a company.

The DISS proposal is that the government would pay grants to companies based on corporation tax returns, supplemented with further information gathered from a self-certification by Directors or their accountants, and that the companies would then have the option to pass on the grant received to Directors.

The Government's assessment of the DISS is that the scheme as proposed is unworkable, because it is intrinsically reliant on self-certification by owner-managers of companies. The effect of this reliance on self-certification is potentially to open the scheme up to an unacceptable level of fraud and abuse, and perhaps even criminal activity. Ministers believe that the Government cannot expose the tax system to these risks.

The Government continues to work closely with stakeholder groups to explore the various proposals that have been put forward to address these issues.

You also asked about plans for the fourth grant of the SEISS. As you know, the Financial Secretary to the Treasury was subsequently asked about this when he appeared before the Committee on 25 January. As he said in a written answer on the same day, the Government will continue to look for ways to improve the Self-Employment Income Support Scheme (SEISS). It continues to consider the matter carefully and work closely with stakeholders to explore how best to support different groups. The Government will set out further details on the fourth SEISS grant in the Budget.

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