Chair: Thank you very much for coming to give evidence to us this afternoon, Chancellor. Can I just begin by asking you to comment on the story in *The Times* that the Prime Minister prevented you from addressing social care in your Autumn Statement? You wanted to announce bigger increases in local authority precepts but were ordered to delay, because of fears the change would add to the burden on low-income families. Is this true?

Mr Philip Hammond: No, as so often these stories are not. We are absolutely aware of the cacophony of input from local authorities and from health trusts around the situation in the social care area. In fact, I believe there is a UQ being answered right now in the chamber on this.

Chair: There is, which is one of the reasons I will not prolong this exchange on it, but I wanted to give you an opportunity to comment on it. The short answer is it is not true.

Mr Philip Hammond: No, it is not true. Of course we have talked about the situation in social care, and we will continue to talk about it, including between me and the Prime Minister, the Health Secretary and the Communities Secretary and any perm—any two out of those four. It is an important area, and we will continue to discuss it. We will continue to look at the representations we are receiving.

Chair: You have also published the distributional analysis on a
continuous series, going back to the series as first introduced in 2010. We have been asking you for that for some time, and we are very grateful for it. That is a great help. It adds to transparency. It is a much more mature way of doing business. Your predecessor was very reluctant to provide us with this material. I am grateful too for what I took to be a commitment in the Autumn Statement that you would continue with this for the rest of the Parliament. Perhaps I should ask Clare Lombardelli what we should take from this analysis. From what I can tell, if we go to chart 1G, this shows an increase in income for the bottom half of the income scale as a result of the Autumn Statement. Is that right?

Clare Lombardelli: That is correct.

Q293 Chair: If we go over the page to 1H, this perhaps is the graph that your predecessor was somewhat reluctant to put on show, Chancellor. The bottom three deciles are all worse off, aren’t they? Poorer people at the bottom end of the income scale get hit, and all people are better off, except the top decile.

Clare Lombardelli: The people in receipt of benefits in those deciles, yes, they are.

Q294 Chair: So, that is correct. These groups are going to be worse off. That has got a number of causes. Correct me if I am wrong, but one of them is the higher taper rate in universal credit. This is the £12 billion of welfare cuts. There are other causes, but that is one of them.

Mr Philip Hammond: Generically, it is because we were elected on a manifesto that included the commitment to reducing welfare spend, particularly the spending of welfare on in-work benefits. That had got out of control—had tripled—over the previous 20-odd years. We were elected with a commitment to addressing that. Self-evidently, the preponderance of the people in receipt of in-work benefits will be in the lower income deciles. That is going to be the main driver for the effect that you are seeing there.

Q295 Chair: Right at the heart of this is the decision to go to universal credit, and the effects and the implications that has for the system as a whole. Is that not correct?

Mr Philip Hammond: I do not think so. At the heart of this is the decision to reduce spending on working age welfare. That is being done, through the mechanism of universal credit, but it could have been done through other mechanisms. The key issue here is that there has been a policy decision—trailed in a general election and committed to in a manifesto—to roll back some of the massive increase in working-age benefit spend that occurred over the previous 20-odd years. That accounts for what is happening at the bottom end. What is happening at the top end is a conscious decision to ask those with the highest incomes to contribute more, in order to support the adjustment that we are making.
Chair: I am sure we will come back to both these questions later on. There will be more opportunities if you want to come back. I have no doubt that others will want to raise these issues.

Mr Philip Hammond: I just wanted to make the point that I was pressed by this Committee to publish the distributional analysis in this form, and I am happy that we have been able to do so. But it is important to make this point: if we are going to have a mature debate, you obviously need information in a format that you can use, but I need a sensible response to what that information shows.

We have been elected on a manifesto commitment to increase the thresholds for income tax at the basic rate and for income tax at the higher rate. As that manifesto commitment is delivered, every single member of this Committee understands that that will have an impact on the distributional analysis. Clearly, it will benefit those who are not at the bottom of the income distribution. I hope that if we are going to publish these kinds of figures, we will not have a pantomime display of shock horror when the manifesto commitment that is well known and understood delivers the outcome that must also be well known and understood.

Chair: We will see whether we provide you with some panto. We have not got any plans this afternoon, but we all live in hope.

Mr Philip Hammond: It is the season, Mr Chairman.

Chair: It is, exactly, so, hey presto—we might be able to find something for you. There you are—there are people promising it already. I would just like to move on to the question of transitional arrangements for leaving the EU. Do you think they are going to be necessary?

Mr Philip Hammond: There is an emerging view among businesses, regulators and thoughtful politicians, as well as quite a universal view among civil servants on both sides of the English Channel, that having a longer period to manage the adjustment between where we are now, as full members of the European Union, and where we get to in the future as a result of the negotiations that we will be conducting would be generally helpful. It would tend towards a smoother transition and would run less risks of disruption, including, crucially, risks to financial stability. That must be a very real concern.

Chair: Can I take it that the answer is yes?

Mr Philip Hammond: That is another way of putting it, yes.

Chair: Yes. Okay. They are the sorts of replies that we like. We are agreed that we need transitional arrangements in place.

Mr Philip Hammond: Chairman, if I may, I do not think we should approach this on the basis that we need transitional arrangements. We can only get to a situation where we have a transition if there is a
genuine meeting of minds on both sides of this negotiation that they are beneficial.

**Chair:** We, the current members of the EU, need transitional arrangements.

**Mr Philip Hammond:** Yes, collectively. Collectively transitional arrangements would be beneficial to us.

Q298 **Chair:** Good. That is definite progress. You mentioned the word “disruption”. I have got in front of me one of a good number of briefings I have had from firms about the need for transitional arrangements. Some of them are marked “confidential”. I have got one here in front of me from a major financial institution, which says a disorderly process of transposition or relocation with insufficient time to adjust could risk “severe disruption to client services, causing financial instability and significant cost to the wider economy in Europe, as well as globally”. It goes on in the same vein for some time. In a nutshell, what they are talking about is a risk of severe instability. Are these representations being made to you?

**Mr Philip Hammond:** Yes, we are hearing particularly from the financial services sector of concerns in this area, which, as you say, fall into two categories. One is about disruption to patterns of business. Remember that the financial services sector in London supports, in many ways, the real economy across the European Union, businesses in the manufacturing and agricultural sectors, for example. Also, if changes in practice are carried out in haste, there is a danger that regulatory procedures will not be as robust as they should be and that a full understanding of what is being regulated will not necessarily be had by all regulators involved. This would run risks for stability of the financial system as a whole.

Q299 **Chair:** We just need to be clear then what is going to happen if we do not get this in place. Here I have another helpful guide from the same brief: “Firms may need to activate contingency plans, rather than waiting until the terms of the agreement are known,” leading to the financial instability that has just been discussed earlier in this same document. In other words, we need agreement on these transitional arrangements at the start, not at the finish. If we do not have it at the start, firms are going to take pre-emptive action, aren’t they?

**Mr Philip Hammond:** I would expect that this would be one of the process issues that we would want to discuss early on in the negotiations.

Q300 **Chair:** A key objective of the negotiations is to get some transitional arrangements in place, isn’t it?

**Mr Philip Hammond:** No. That makes it sound like part of our negotiating agenda. This is part of the process discussion that we will need to have at the beginning of the negotiations, where we explore with our European Union counterparts whether there is a shared
understanding of the benefit that there could be from a transitional arrangement.

**Chair:** You have been in the Foreign Office far too long: “explore whether there is a shared understanding”. What you are going to do is ask for something, and demonstrate to the other side they have got something to gain by giving it to you.

**Mr Philip Hammond:** Chairman, it has to be a shared understanding. Unless there is a view that it would be in our mutual interests to have a transitional period, individuals will look at whether a transition gives benefit or dis-benefit to one side or the other. There has to be a shared understanding that it is required.

**Q301 Chair:** I will not call you Foreign Secretary, but it did sound like a Foreign Secretary’s reply—not this one, mind you. I have just got one more point I want to ask about this subject. How long might this transitional arrangement need to last? Here I have had quite a bit of advice too. Perhaps I will read a bit of that: “Two years is unlikely to be sufficient to complete the changes that are needed, owing to the complexity of transition.” This is an interesting point, which I explored with a senior member of one of these banks: “This will be exacerbated by many firms activating their plans simultaneously.” Has this point been made to you?

**Mr Philip Hammond:** Yes, indeed. This is a question of cumulative capacity to make what might be significant changes. It applies across a very wide range. I would not like anybody to think this is just about financial services. For example, depending on what future customs arrangements are between the UK and the European Union, there could be quite significant physical infrastructure changes that need to be made at ports of entry and exit, not only in the UK but in continental Europe as well. There could be a need to train large numbers of people in anticipation of a much more intensive process at borders.

It is not just the business sector; it is also the government sector that has to think about how long it takes to make changes, hire people, train people and introduce IT changes. The further we go into this discussion, the more likely it is that we will mutually conclude that we need a longer period to deliver.

**Q302 Chair:** To cut a long story short, it sounds as if two years is the bare minimum. We are probably going to need more.

**Mr Philip Hammond:** You are right that business tends to come with a rather ambitious view of what a transitional period might look like. As in everything in the world, there are compromises between the political will to get things done and to move on, and the bureaucratic and/or business desire to have the longest period possible to make any change.

**Chair:** Let’s leave the discussion of that there for the time being. We might come back to it later in the hearing.
Q303 Helen Goodman: I would like to ask you a couple of questions about trade and customs. Just picking up on the point you were making, Chancellor, at the moment the running costs for HMRC are about £3 billion a year. We do not need to have any customs controls on the 44% of our exports going to and from Europe, but if we left the customs union we probably would. Have you estimated what the increase in HMRC’s running costs would be in that scenario?

Mr Philip Hammond: The Department is doing some work on this now. It is true that in certain conceivable outcomes there would be a very substantial increase in the number of customs submissions and customs inspections that would need to be carried out. We are talking about something like perhaps five times as many submissions and inspections being required on EU trade. That work is ongoing in the Treasury at the moment.

Q304 Helen Goodman: When do you think you will be able to give us an estimate?

Mr Philip Hammond: I cannot give you an answer now, but it is an ongoing piece of work.

Q305 Helen Goodman: We might be talking about hundreds of millions of pounds.

Mr Philip Hammond: In the most extreme outcome, if you take the most extreme outcome to be constructing a border customs regime that is similar to the one we operate now for non-EU countries, it could certainly add hundreds of millions of pounds to the cost of operating the customs service. I should say that against that one would have to consider the revenue from customs duties that the Government would receive if it were levying customs duties at the border.

Q306 Helen Goodman: That is true. Just before I move on to that point, I was told earlier today that when we made a new trade arrangement with South Korea, it led to an eight-month wait for people to get the status of being authorised economic operators—people who can have a fast track through the customs. The process to get the clearance for that was eight months. Would you agree that it would be pretty catastrophic if, having negotiated new agreements with other people, there was then a long, bureaucratic wait like that for businesses in practice?

Mr Philip Hammond: In the case of the South Korea-EU trade agreement, I do not know whether the wait you referred to was caused by EU processes, or whether it was UK customs that would have been responsible for those processes, so I am afraid I cannot answer that question.

Q307 Helen Goodman: You gave the OBR some statements of government policy on the desired trade regime and system of migration control. However, in the end the OBR have assumed that trade intensity will fall as between before and after leaving the EU. Does it disappoint you that
they made that assessment?

Mr Philip Hammond: The OBR have made their own judgment, as they explained to you when they gave evidence to you a couple of weeks ago. They have made their own judgment over the forecast period. As I think Robert Chote made clear to you, that does not in any way reflect a judgment about what the final end state might be, just that over the period of the forecast they expect trade intensity to reduce.

Q308 Helen Goodman: I think it is for a full decade that the trade intensity is falling, which is quite a long time. Would you not agree that has quite a significant impact on the economy?

Mr Philip Hammond: I hesitate to contradict you, but I think the OBR only forecasts out to 2021-22. I do not think they go any further.

Q309 Helen Goodman: In what sense do you think Britain is becoming a global leader in free trade if our trade intensity is falling?

Mr Philip Hammond: The commitment that the Prime Minister has made is that the UK will remain a champion for the principle of open markets, free trade and tariff-free, quota-free access on a reciprocal basis to markets. In my view, that is a principle that has served the UK very well over many decades and will continue to serve us well in the future. We will continue to advocate that. What happens during the short-term process of exiting the EU, and potentially changing our patterns of trade, does not necessarily mean that, because we have a desire for freer and more open trade, the short-term deliverable will be more trade. It may take time during the transition process to see the benefits of that.

Q310 Helen Goodman: I want to ask you about another sector that is worried about the transition. That is the university sector. You have made two statements about science spending. Over the weekend, I was talking to somebody from Newcastle University who was thinking about putting bids in to Horizon 2020. If they write a bid in 2017 for a project that begins in 2018 but is not completed until 2023, they could not work out whether your guarantee would cover them. Would your guarantee cover them?

Mr Philip Hammond: Yes. If that project is endorsed by the relevant sponsoring Department here as being in line with Government policy and a value-for-money project and it is awarded EU funding, the Treasury will underwrite that commitment of EU funding for the duration of the project.

Q311 Helen Goodman: I noticed you said that it needed to be good value for money and in line with domestic strategic priorities in a statement on 3 October. When you are adding those extra criteria, are you not adding another bureaucratic process for the academics who are having to apply? They all complain about applying for Horizon 2020 money being a very bureaucratic system. You are saying, “In addition to your Horizon 2020 application, you have got to clear this.” I am not sure who you would clear it with. It might be the Department of Health or BIS or the
Department for Education. Is there a system set up for them to do that already?

Mr Philip Hammond: There is. They should be able to clear that with the relevant sponsoring Department. The point is this: we have been saying for many years, and it continues to be the case, that not all EU funding is well targeted or good value for money. Before I commit the UK taxpayer to spending what will be UK taxpayer funds after we leave the EU on supporting a programme, we need to make sure that that is a programme that is value for money and broadly aligned with UK government objectives. I do not think it is a very high threshold. I would hope that there are a relatively small number of projects that would not qualify, and that it will be quite simple for people who are intending to bid for projects to get them cleared or otherwise by the sponsoring Department.

Q312 Helen Goodman: Even the Foreign Secretary said on The Andrew Marr Show the other day that he thought that we should join the successor programme to Horizon 2020. Is that your aspiration as well?

Mr Philip Hammond: Very much so. I do not know why you say “even the Foreign Secretary”. The Foreign Secretary is a great enthusiast for pan-European co-operation from outside the European Union. Programmes like science, technology, R and D and academic exchange programmes are hugely beneficial to this country and hugely beneficial to countries across Europe. We would very much hope that we will be able to agree a format that allows us to continue to participate in those programmes.

Q313 Helen Goodman: I agree with you about that of course. It sounds as if you are not quite confident that you will succeed in securing that, which is why you feel you need to offer this guarantee that the UK Treasury will be providing the funds. Is that fair?

Mr Philip Hammond: No. I wonder what discussion we would be having here at this Committee if I had not offered that guarantee. The reason I have offered the guarantee is to avoid any uncertainty, to reassure people who are bidding for projects and, perhaps just as importantly, to reassure the potential collaborators in other European Union countries who they will be working with that, if they get the award, they can be confident that the project will proceed. Whether it is funded by some successor pan-European association, or whether it is funded directly by the UK Treasury, they will continue to get the funding. It is to remove uncertainty and any possible doubt.

Q314 Helen Goodman: You announced increases in R and D spending in the Autumn Statement of £400 million rising to £2 billion, which was very widely welcomed. Did you make some kind of assessment as to the extent to which that money will be used to replace the possible loss of EU money, and the extent to which it will be felt to be additional by the universities and other research organisations?
Mr Philip Hammond: This is additional money. It is intended that it will be used in support of the industrial strategy to support innovation and the application of science in particular. We have an excellent science base in the UK. Where we are perhaps less strong traditionally is in applying that science, and in the process of innovation from scientific discovery to commercial application. Innovate UK, the vehicle that has been created to support that process, will be a beneficiary of the announcement at the Autumn Statement.

Q315 Helen Goodman: That is a very reasonable response, Chancellor. Does that mean that, if people have to call on your guarantees for the European science spending, that would be a claim on the contingency reserve?

Mr Philip Hammond: I think we are talking about a period that, by definition, will be after we have left the EU. The basis on which we have underwritten the funding is this: if we are not in these programmes, we will, by definition, not be paying subscriptions to be in them to the European Union. We will have that cash that we would have paid in available to support the programmes in question. The OBR, as you know, made the assumption that there would be no windfall—that whatever money was not paid in EU subscriptions would be recycled into other forms of spending. That is a judgment they made. Certainly one of the calls on that money would be to support EU-committed spending in these areas.

Chair: Just on a point of clarification, the OBR has used assumptions about trade running out to 2025. I do not think it is a very big point, the difference between 22 and 25, but in this particular case that is how they did their calculations. We have not asked them why they went beyond 2022, but they did.

Q316 Mr Jacob Rees-Mogg: Chancellor, first of all, thank you for an Autumn Statement that seems to me to be positive about Brexit and enthusiastic. That is very good news and very encouraging as to where the Government are looking. Could you set out your broad views of free trade as a policy objective?

Mr Philip Hammond: Yes. I have always been of the view that, in the medium to long run, the more open markets and the freer trade, the more prosperity we will enjoy. If you are going into an open competition, you need to be match fit for that competition, and this was a principal theme of the Autumn Statement. We need to focus over the next few years on raising the UK economy’s game to ensure that, as these opportunities present themselves, we are able to ensure that we benefit from them.

Q317 Mr Jacob Rees-Mogg: If you put aside the need to use every negotiating tool that you have in the course of the negotiation, do you think that tariff-free access to the UK is beneficial even without reciprocity?
Mr Philip Hammond: I am afraid this is where you are testing the boundaries of the principle that we are not going to speculate on our negotiating position. That stretches firmly into the realms of negotiating position.

Q318 Mr Jacob Rees-Mogg: I am trying to keep you in the realm of broad principles, rather than specifics, as to what you, as Philip Hammond, ex being the Chancellor, think intellectually about free trade and what you have always thought about it.

Mr Philip Hammond: Unfortunately for you, I am here as the Chancellor to answer questions as the Chancellor. That firmly strays beyond the principle that we are not going to speculate on where our red lines might be or what our negotiating position might be.

Q319 Mr Jacob Rees-Mogg: Therefore, as less of speculation, the Government have been indicating that they will adopt all the current tariffs that they have agreed at the WTO at the point of re-accession individually. We obviously already have our membership as a founder member, but that is the tariff list that we will put forward. Would it be right to view that in the same category as the great repeal Bill—that at day zero, so to speak, everything will be as it is?

Mr Philip Hammond: Yes, it is a day-zero position and clearly, subject to any agreements we voluntarily enter into to constrain ourselves otherwise, we will be free to change those arrangements in accordance with the rules of the particular organisation, in this case the WTO.

Q320 Mr Jacob Rees-Mogg: Therefore it is no indication of a future policy intent to keep tariffs as they are. It is simply maintaining the status quo to provide stability at the point at which we leave.

Mr Philip Hammond: It is a starting point. Subject to any agreements that we make to the contrary, we would be free to change those tariffs in the future.

Q321 Mr Jacob Rees-Mogg: May I follow up on a point from Mrs Goodman on the number of people we might need to employ for the extra customs work? Is it fair to say that that would be an active decision of the Government to do this? It would require the Government to decide that it wanted to impose tariffs on the European Union.

Mr Philip Hammond: It is not a question of tariffs.

Mr Jacob Rees-Mogg: Or customs inspections.

Mr Philip Hammond: It is a question of customs procedure. We have to plan on a contingent basis for possible outcomes. If it became apparent during the early negotiations that a possible outcome was a customs regime that resembled the regime we currently have for non-EU trade, the implication of that would be that we would need to make considerable investment in HMRC fixed infrastructure, people and training, and IT systems.
Mr Jacob Rees-Mogg: But ought you not therefore consider the option of putting all non-EU trade on to an EU trade basis, and the cost savings you would have if you did that? These would be decisions of Her Majesty’s Government that it would be free to take, whereas currently under the EU it cannot lift any restrictions on non-EU trade.

Mr Philip Hammond: What you are suggesting would imply a position that said at the point of exit from the European Union we would unilaterally remove all tariffs on imports from every country. I suspect that might make negotiating free-trade agreements rather difficult, since the reciprocal removal of tariffs is generally at the heart of them.

Mr Jacob Rees-Mogg: All I am saying is that this would be a choice for the Government to make, and if you are modelling one choice, you ought to model the other.

Mr Philip Hammond: It would be a choice for the Government to make, subject to any commitments that it had entered into as part of our EU exit negotiations, and subject to the rules of the WTO.

Mr Jacob Rees-Mogg: Are you expecting to make commitments other than transition arrangements in relation to the tariffs that we would have on countries outside the European Union?

Mr Philip Hammond: As you well know, I am not going to speculate on the negotiating process.

Mr Jacob Rees-Mogg: But is that even a possibility?

Mr Philip Hammond: As you know, we have not made any decision about the customs union: whether we would aspire to remain in some form of customs union arrangement or not. That is a decision yet to be made by the Government, let alone to be negotiated with the European Union. We are firmly in the realms of speculation there.

Mr Jacob Rees-Mogg: But our tariffs could continue to be set by the European Union on an external basis, an ex EU basis.

Mr Philip Hammond: If you are asking me if there was a theoretical construct under which that would be the case, yes there is. Whether it would be an attractive option is another question. We need to go into these negotiations with a complete understanding of the range of possible outcomes. Then we need to engage with our negotiating partners to understand their position and their aspirations as well, because the negotiation is a two-way process.

Mr Jacob Rees-Mogg: On the point of going into broader free-trade negotiations and not offering unilateral free trade, are you unsympathetic to the argument that unilateral free trade is in fact advantageous to the UK consumer?

Mr Philip Hammond: In the short term, it would clearly be advantageous to the UK consumer. It would reduce the cost of imported
goods. We have to look slightly more strategically, because the UK consumer is also probably a participant in the UK employment market. He will want to know that he has a job as well as that he can buy his imported goods slightly cheaper. We would need to think carefully about how any strategy of seeking to negotiate free-trade agreements with third-party countries would be affected by a policy of unilateral free access to our own market.

Q327 Mr Jacob Rees-Mogg: Is it not the record of protecting industries from tariffs that it not only increases costs but in the long-term you make you whole industry less competitive and your economy grows less successfully? It is not just a short-term benefit for consumers; it is a long-term benefit for the competitiveness of the whole economy.

Mr Philip Hammond: This is right in a perfect world where everybody does the same, but it is much more difficult in a world where we are seeking to negotiate, potentially, access to third-country markets and have very little to offer if we have already unilaterally opened our own markets.

Mr Jacob Rees-Mogg: I cannot tempt you to say, I do not suppose, that—

Mr Philip Hammond: No.

Mr Jacob Rees-Mogg: No. Alright.

Mr Philip Hammond: Even though it is Christmas.

Mr Jacob Rees-Mogg: Even though it is Christmas. May I just conclude with a non-declaration of interest? Some people have written to me, thinking the money you have provided for Wentworth Woodhouse is coming personally to the Rees-Mogg family, because my mother-in-law grew up there. I would just like to confirm that this is not the case.

Mr Philip Hammond: I should like to confirm for the record that I did not know that your mother-in-law grew up there.

Mr Jacob Rees-Mogg: I assumed you would not.

Q328 Chair: That is very good news. It is good to get families into the discussion at Christmas time. I would just like to go back to the question of the removal of all tariffs and the effects that it would have. Have the Government looked seriously at this proposal? Are the Government doing any work, for example, on what the effects would be on industries that are currently beneficiaries in some way to a common external tariff? By the look of it, Clare Lombardelli has passed you something that could be of help.

Mr Philip Hammond: I can tell you that we are doing some work looking at the impacts of different tariff scenarios on individual sectors of the economy. This is being done across Government, the DIT, Department for Exiting the European Union and the Treasury. Tariffs vary
enormously, and the exposure of sectors to tariffs vary enormously. While we clearly believe that, generally speaking, lower tariffs are better, because of the boost to productivity and the benefit to consumers, we do not favour unilateral liberalisation to zero, because of the point I have already made. That is giving away our bargaining chips before we get into the bargaining. Maintaining an optimal tariff does not necessarily mean having a zero tariff.

Chair: This sounds like a line to take.

Mr Philip Hammond: There are circumstances where a non-zero tariff can be welfare optimised.

Q329 Chair: I am really after not a line to take but just a point of fact. Are you doing work in the Treasury to examine what might be at stake for those industries that are currently, to a greater or lesser degree, beneficiaries of the tariff wall?

Mr Philip Hammond: Yes. It is not just in the Treasury. It is a cross-department piece of work. We are looking at the impact of tariffs and their potential removal or change on different industries and sectors.

Q330 Chair: The second very important question, which was not raised at all, is do you think that access to services and service trade should form part of the negotiations, if there are to be any—and you talked about reciprocity—with counterparties with respect to tariffs outside the EU? In other words, we have a great deal more at stake than just the question of the industries I have referred to, which may have a period in which to adjust.

Mr Philip Hammond: Precisely. Since our economy is 80% services based, and the questions around tariffs generally apply to trade in goods, in many cases if we were talking to third party countries, in order to secure an optimal deal for the UK we would need to be looking at free access through non-tariff barriers for our service industries, as a reciprocation for access to our markets for goods.

Q331 Chair: It is an extremely difficult task to accomplish. That is why to look at it just on the basis of trading goods does not tell us very much about what is in the UK’s interest.

Mr Philip Hammond: That is right. It is much more complex. But I just came back from South Africa last week. We already have a very strong financial services industries link between the UK and South Africa, for example. It is possible to do this, but it is more complex than simple agreements around trading goods.

Q332 Rachel Reeves: Chancellor, I want to speak a bit more about the issues of Brexit and the economy. First of all, you will be aware that our colleague, Kevin Brennan, and other parliamentarians are releasing a single before Christmas to raise money for the Jo Cox Foundation. I was wondering whether the Treasury would consider waiving VAT on that
single so that more money could be raised for the causes that Jo cared so much about.

Mr Philip Hammond: Of course the Government fully support the efforts of parliamentary colleagues and others to raise funds for the Jo Cox Foundation, and we have heard those representations. Members of the Committee will be aware that the Government do not have it in their power to waive VAT, because of European Union rules. But what I can do, and I will do, is announce that the Government will donate to the foundation an equivalent amount to the VAT paid on the sales of the forthcoming single, “You Can’t Always Get What You Want”.

Q333 Rachel Reeves: Thank you very much, Chancellor. I very much welcome that decision. Thank you to you and to your colleagues in Government for that decision. Moving on to the issues of the European Union and specifically immigration, last time you appeared before this Committee you said that the Government would not be seeking to restrict the inward migration of computer programmers, brain surgeons, bankers and senior managers. The Secretary of State for Exiting the European Union has since gone further, saying that he would seek to avoid labour shortages in key sectors. You mentioned a few occupations where you would not want to make restrictions. Was that exhaustive, or do you think that the Secretary of State for Exiting the European Union meant something wider when he said that he would seek to avoid labour shortages in key sectors?

Mr Philip Hammond: First of all, let me clarify what I said. I have said that we will have a system of migration control of some kind between the UK and the European Union. We have not determined what kind yet, but we will have a system of controlling migration. The point I was making was that, just because you have a system of controlling migration, that does not mean you have to use it to slam all doors shut. I cannot conceive of any circumstance in which we would want to impede or prevent the flow of highly skilled, highly paid people, first, because they are very important to our economy and, secondly, because I do not think it is highly paid, highly skilled people that cause concern among our own electors, who are concerned about this issue.

If others have made comments about labour supply into the economy more generally, of course it is the case that we want to support UK firms. We do not want to find UK firms suffering from a lack of labour supply, but we also have to recognise that once we get further down the skills curve we get into what is much more sensitive territory for our own electors, who are concerned about this issue.

Q334 Rachel Reeves: I am sympathetic to what you say, Chancellor. I am just keen to unpick it a little bit further. You mentioned two things in terms of areas in which you would not want to make restrictions. You talked about skill levels and particular types of jobs, but then you also said highly paid. In terms of non-EEA migrants, there are some rules around earnings. Are you more interested in the skillset? Obviously, you
are working this out. But you mentioned those two issues, the skillset and the pay. Do you think that one of them is more important? You mentioned public concern. Are you particularly interested in one or the other, or is it both?

Mr Philip Hammond: Generally speaking, one is a proxy for the other. It is not exhaustively true, but, generally speaking, people get paid more for highly skilled jobs. I am not an expert on the migration system, but I think I am correct in saying that in our non-EEA migration control system at the moment we have an earnings threshold, and that is taken as a proxy for skill. However, we do have an exception to that for people working in education and healthcare. There perhaps it is the case that sometimes quite high skills are not recognised with necessarily very high pay in those typically public sector roles. It is not always the case that high pay and high skills go together, but when we talk about high paid, high skilled, we are generally using high pay as a proxy for high skilled.

Q335 Rachel Reeves: Are you indicating that the Government might look to have a system for EEA and non-EEA nationals that is equivalent, so some sort of earnings threshold but with special rules for, for example, those sectors that you have already mentioned?

Mr Philip Hammond: No, I have not said that. What I have said is that we already have a non-EEA migration system in place. We will have some kind of control system for EEA migrants. I do not know what it will be yet. We have not concluded what we would like it to be and we have not started negotiating. What I have said is I cannot conceive of any circumstance in which we would use that system to choke off the supply of highly skilled, highly paid migrants.

Q336 Rachel Reeves: But you have made some analogy with the system for non-EEA.

Mr Philip Hammond: I am simply drawing attention to the fact that we already have a distinction between highly skilled migrants and not so highly skilled migrants.

Q337 Rachel Reeves: Absolutely. That was why I was exploring whether that was the route you wanted to go down. If you look at the figures from the ONS Labour Force Survey for where migrants are employed, there are a large proportion in, for example, construction. 9.1% of the people employed in construction are EU nationals, and 10.2% of the people working in manufacturing. While I recognise some of these areas that you have spoken about—computer programmers, brain surgeons etc.—it would seem that there are some sectors in the economy that particularly rely on the skills that migrants bring. When the Secretary of State for Exiting the European Union talks about labour shortages in key sectors, do you think it is also worth looking at where migrants are currently employed to think about where the skills are most needed?

Mr Philip Hammond: They are two separate questions. Some of these people will of course be highly skilled in agriculture, in manufacturing, in
construction. Some of the jobs will be highly skilled and highly paid. Separately, it is definitely worth looking at how exposed different sectors are to access to migrant labour flows. It is not just different by sectors; it is different by regions. If you disaggregate that construction figure between the construction industry in the North East and the construction industry in London, you will see dramatically different levels of penetration of EU migrant workers in that workforce.

Q338 Rachel Reeves: Yes. Certainly there is a sectoral issue and a regional issue. I guess having a migration policy though that had rules for where you are going to work and in what sector would be very difficult to administer. Do you worry about that?

Mr Philip Hammond: I have not suggested that as a proposal. There are countries that operate migration systems that are based around a specific employer with a specific job offer. I do not think it is impossible conceptually to respond to those kinds of different challenges across the economy. We really have reached no conclusion on this at all at this stage. We need to engage with our European Union counterparts first. Work on this area will be ongoing, in parallel with the discussions we are having in Europe.

Q339 Rachel Reeves: You are right, Chancellor, and so are the Government, to talk about labour shortages in different sectors of the economy and having an immigration system that helps address those labour shortages where they exist. To what extent does that rub up against the Government’s objective of having less than 100,000 net migration per year?

Mr Philip Hammond: That is a long-term objective, as the Prime Minister has made clear. The way we will deliver it is through a combination of upskilling in our own population to fill gaps, where the reason we cannot fill them is that the relevant skills do not exist here in sufficient numbers, and investment of capital, for example in the agricultural and horticultural sectors. In those sectors there are steps of automation that can be taken by investing capital but are not taken when access to low-cost labour is available. There are two routes over the medium to longer term to achieve that objective.

Q340 Rachel Reeves: I just want to understand exactly what you are saying, Chancellor. Over this forecast horizon, are the Government more concerned about meeting the labour shortages in key sectors, rather than meeting what you referred to as the long-run objective of reducing net migration to less than 100,000 a year.

Mr Philip Hammond: Both have to go hand in hand. We have to work with industry, with business, to ensure that we can make steady progress towards achieving that long-run objective, by supporting industry to find efficiencies, productivity enhancements and opportunities for upskilling the domestic labour force in a way that will allow us to reduce the current dependency on low-cost migrant labour.
Q341  **Rachel Reeves:** Over the period of the forecast horizon that the OBR set out, net migration continues to run at not much less than 300,000 per year for the rest of this forecast period. Is that a reasonable assumption? Is that consistent with government policy?

**Mr Philip Hammond:** I believe the OBR have used the ONS forecast for migration, and the ONS forecast is what it is. It is an ONS forecast.

Q342  **Rachel Reeves:** Do the Government think that the ONS forecast is a reasonable one? It is not the same as the government objective of reducing it to less than 100,000. Is that just saying that, over the forecast horizon, the Government are not going to meet that long-term objective of getting it to less than 100,000?

**Mr Philip Hammond:** The Government’s priority is to make continued progress against the long-term objective, and to do so in a way that works with the grain of what business and industry needs to see, rather than cuts across it.

Q343  **Rachel Reeves:** Over the OBR’s forecast horizon, net migration is not on a downward trajectory. Is that reasonable?

**Mr Philip Hammond:** I think that is what the OBR shows, or a small decline over the forecast horizon. The OBR’s assumption, if I remember, was that exiting the European Union will reduce the amount of EU migration, as well as the amount of EU trade. However, that is not the same as saying that they are projecting that migration will fall below the Government’s target.

Q344  **Rachel Reeves:** But it is perfectly reasonable for the OBR and the ONS to assume that the Government’s ambition of getting net migration to below 100,000 will not be achieved during this forecast horizon.

**Mr Philip Hammond:** The Government’s ambition is a medium-term ambition, as we have made clear.

**Rachel Reeves:** It is beyond five years.

**Mr Philip Hammond:** It is a medium-term ambition.

**Chair:** Which means beyond five years.

**Mr Philip Hammond:** It means it is a medium-term ambition.

Q345  **Rachel Reeves:** What is medium term, Chancellor, for those of us who are less clear? I am not sure what medium term is.

**Mr Philip Hammond:** When does the autumn start and finish?

**Rachel Reeves:** When is the budget?

**Mr Philip Hammond:** It is a medium-term ambition. We need to make steady progress towards delivering it, but I am not going to put a precise timeframe on it. That is not my specific remit.
Rachel Reeves: What do you mean? You are the Chancellor. What is the medium term in your view? You say it is the Government's ambition in the medium term, but if we do not know what the medium term is, we do not know what the ambition is.

Mr Philip Hammond: The key thing is that we see steady progress being made towards achieving this ambition, so we are moving in the right direction. For the record, I also think that, for most people in this country, that will be the important thing—that we are heading in the right direction.

Rachel Reeves: But the OBR does not think you are moving in the right direction. It is not on a downward trajectory.

Mr Philip Hammond: People will see the direction of travel heading in a downward trend.

Rachel Reeves: The OBR does not think it will be, but maybe it will.

Mr Philip Hammond: I think the OBR does. The OBR’s migration scenarios, quoting the ONS principal migration projection 2015, showed that migration falls from 232,000 in 2016-17 to 226,000 in 2017-18, 206,000 in 2018-19, 196,000 in 2019-20 and 185,000 in 2020-21.

Rachel Reeves: If you halve that, you might meet your medium-term target.

Mr Philip Hammond: I think, Ms Reeves, that most people would call that steady progress.

Rachel Reeves: It will take eight years beyond those five years then to meet the Government’s medium-term target. We can assume that medium term is 13 years if you carry on making that fantastic rate of progress, Chancellor.

Mr Philip Hammond: We can certainly assume that you have an impressive mental arithmetic capability.

Chair: What a diplomat. Do you think students should be excluded from the Government’s immigration objective?

Mr Philip Hammond: I think we did this one last time.

Rachel Reeves: We just did not get an answer.

Chair: We have had a go at medium term. Perhaps you might want to have another go at this one.

Mr Philip Hammond: That is not the Government’s policy. The Government’s policy is that students are included in the overall target.

Chair: Yes, I know what the Government’s policy is. I am asking you whether you think it might be a good idea to change it.
Mr Philip Hammond: I speak on behalf of the Government. The Government’s policy is that students are included in the overall immigration target.

Chair: Is it a good idea to put students in the immigration objective?

Mr Philip Hammond: That is where we are. There is a very real concern that if we were to look at different options for measuring migration, people would feel that perhaps the Government were seeking to manipulate the outcome, that the Government were changing the rules, moving the goalposts. That is a very strong argument against any change. I have no doubt that people could make strong arguments for change, but the concern that people would feel any change was a manipulation is a very important one we have to take into account.

George Kerevan: Good afternoon, Chancellor. As a result of the Autumn Statement, insurance premium tax will have effectively doubled in 20 months. It is a highly regressive form of taxation. Is the increase of that tax simply because you needed the revenue, or was there some specific reason to light on IPT?

Mr Philip Hammond: I was very clear in the Autumn Statement. Perhaps I was not clear enough. I said explicitly because we need to raise revenue to fund the commitments that I will be making today, because we have made a decision that non-capital spending commitments would all be fully funded, I needed to raise insurance premium tax further. I accept that that imposes a burden on insurers. Whether they choose to pass that burden on to their customers will be a marketplace decision for them. It probably is worth noting that the impact on household budgets is very small, because the proportion of household budgets spent on insurance is very small, and is smaller at the lower end of the income distribution than at the higher end, for obvious reasons.

George Kerevan: I think the insurance bodies have said that, for instance, on motor premiums it is £10 and more.

Mr Philip Hammond: Yes, £10 per year on the average motor premium.

George Kerevan: In the Autumn Statement you seemed to try to justify randomly raising this tax because it is the one you can raise, if I have interpreted you correctly, with reference to VAT. You seem to suggest that the 12% tax measures quite well compared with a 20% rate of VAT on other kinds of products and services.

Mr Philip Hammond: I simply pointed out that insurance premiums are not subject to value added tax, and people should bear that in mind, as they should when looking at APD on air travel. That also is not subject to value added tax. It is something that people ought to bear in mind when looking at the tax position of a given product area in the round.

George Kerevan: But in fact this is a sales tax.
Mr Philip Hammond: No, it is not a sales tax. It is a tax imposed on the providers of insurance.

George Kerevan: It is effectively. It effectively amounts to the same thing.

Mr Philip Hammond: It is no more a sales tax than corporation tax on a manufacturer is a sales tax on his product.

Q355 George Kerevan: The revenue consequences are equivalent if it had been a sales tax. Whereas if it was VAT, the VAT would be levied not on sales but on the difference between what the consumer pays on their premium and what is paid out. Even if you charged 20% on that, the net return to the Treasury would be less than you are going to get with the 12% that you are posing on the insurance premiums themselves.

Mr Philip Hammond: I understand the difference between a specific tax and a value-added-tax type structure. I am not sure that I agree with the calculation of what a value added tax on insurance premiums would look like. It is notorious that it would be very difficult to construct one, but there are a number of elements in the business model of an insurer that would need to be taken into account. It goes a little bit wider than just premium income versus claims paid out. There is also the timing differential between receipt of premiums and payment of claims, which of course is not an insignificant part of the insurer’s business model.

Q356 George Kerevan: The OBR, in its assessment of the impact of the measure, noted that there was the possibility of tax-planning activity by insurance companies, which, if the rate went too high, would lead to diminishing returns to the Treasury. What do you think would be covered by the notion of tax-planning activity by insurance companies?

Mr Philip Hammond: I cannot speculate on that, but I agree with the principle that the higher the rate of tax, the more likely it is that the taxpayer will seek to engage in tax-planning activity.

Q357 George Kerevan: Before I move on, finally, would you contemplate in future budgets extending the scope of the tax to cover other forms of insurance—reinsurance, for instance?

Mr Philip Hammond: As you are aware, chancellors contemplate extending the scope, size and amount of all taxes at every fiscal event. The fact that they choose often not to do so probably points to many of the exclusions being there for very good reasons.

Q358 George Kerevan: Can I move, briefly, on to a different subject, which is your debt target? One of your three new rules is to reduce net debt below 90% of GDP by 2021. Why 90%?

Mr Philip Hammond: Sorry—the debt rule is to have debt falling as a percentage of GDP by the end of the Parliament. We expect—the OBR expects—debt to peak at 90.2% of GDP. I know everybody in the Committee knows this, but it is worth recording again that this large
increase in debt as a percentage of GDP is driven, in part, by the action that the Bank of England took in August, the creation of the Term Funding Scheme, which was designed to ensure that the benefits of lower interest rates were passed on to consumers and business borrowers. That shows up on the public sector net debt figure, but it is a short-term facility and it will have started to unwind by the end of the forecast period. I have published the figures for the underlying PSND excluding Bank of England activity, which, from memory, peaks at around 83% of GDP.

Q359 George Kerevan: Given the rather benign way in which the markets reacted to your Autumn Statement and the increased borrowing figure, and given that the US President-elect, far from trying to reduce the US deficit, is proposing a trillion-dollar fiscal injection, I just wonder why you feel you need to cling to the notion that net debt should be falling in this very specific period.

Mr Philip Hammond: We are not the United States. Unfortunately, we do not print the world’s reserve currency. We have a very large debt as a percentage of GDP and, to be honest, we are exposed. If there was a crisis, God forbid something on the scale of 2008, now, at a time when we are already in the 80-something per cent of debt to GDP ratio, our scope to be able to respond to that would be limited in a way that makes me feel uncomfortable. I would like to see our debt to GDP ratio declining steadily to a level that, once again, gives us the headroom to be able to respond were there to be any unforeseen crisis, which could be fiscal, financial or otherwise.

Q360 George Kerevan: Accepting your point about the United States having a reserve currency, it is nevertheless the case that we, through the Bank of England’s special measures, have effectively monetised a third of the national debt. Japan has done the same thing over the last 30 years. Japanese net debt is something over 200% of GDP, which seems to be an awful lot of headroom. Again, what is the efficacy of choosing a specific year, 2121, to say, in that specific year, net debt is going to fall? Surely that is a hostage to fortune.

Mr Philip Hammond: On Japan, of course, if we could persuade Mr and Mrs Smith to save like Mr and Mrs Watanabe and finance our debt, we might be looking at a different scenario, but we are not. I set a target of debt falling as a percentage of GDP by the end of the Parliament in order to provide some clarity—a framework within which people are able to judge the policy decisions that we take. I also think the fact I have set that target of the end of the Parliament—the OBR itself says that we will meet that target two years early—sends a signal that we have fiscal firepower in our locker if it is needed. We have set fiscal rules that allow us to respond, if necessary, to any slowdown in the economy, any external shock, in a way that will allow us to support the economy. That is the message I am trying to send.
If I can just take that one step further, I do not see the setting of a “debt falling as a percentage of GDP by the end of the Parliament” rule as a restrictive announcement. I see it as an announcement that signals that we have, in fact, got some firepower available to us if we need to respond to unforeseen events.

Q361 George Kerevan: I appreciate that, but you are then liable to the counter argument that you have deliberately chosen a year in which you know that you can, with a good following wind, reduce the level of debt. You have chosen a target that you know you can achieve in order to convince the markets that you have got headroom. It just seems to me that you are committing the same kind of mistake of previous chancellors by having a very specific rule and then making it so easy to achieve that the markets begin to doubt that you are serious.

Mr Philip Hammond: Let it be on the record that Mr Kerevan says it will be so easy to achieve and let’s see what happens in due course. It is certainly the case that the OBR, on its current forecast, sees that objective of debt falling as a percentage of GDP being achieved two years early, but that is on the basis of the OBR’s current forecast. What market participants want to know is whether we are setting ourselves a rule that says if, at a future fiscal event, the OBR has to revise its forecast downward, we are left with the choice of being unable to respond in a sensible way or breaking our fiscal rules. I hope the message is that, within modest reason, if there were a downgrade, we would be able to respond to that, which is to do so without breaking our fiscal rules.

Q362 Chris Philp: I would like to probe the opposite case to the one that George Kerevan was advancing. George was suggesting there is scope to spend more or take longer to clear the deficit; I would like to explore the opposite case—namely that we should be moving faster to clear the deficit, not least because we said we would in 2020, and if we do not do it until 2025, that is 15 years. Is there a danger that, if we take too long over this—this being getting the deficit to zero—the public might get tired of hearing the rhetoric on it, lose patience and the argument for fiscal responsibility might get lost in the public arena?

Mr Philip Hammond: Clearly, I have made the judgment that postponing into the next Parliament the point when we reach fiscal balance, but continuing to make clear that we will reach fiscal balance, is the right compromise here. Many representations have been made that we should abandon the idea of overall fiscal balance altogether. I do not share that view and neither does the Prime Minister.

Q363 Chris Philp: Certainly neither do I. Clearly, you have made a different judgment, but is there not an argument that says, “Get the pain out of the way more quickly, restore fiscal balance; it may involve some painful short-term decisions, but it puts us in a better place longer term,” particularly to respond to the shocks you mentioned a moment ago. I think we have about 1% of GDP wiggle room. That might not be enough if there is an adverse event in the future.
Mr Philip Hammond: 1.2% of GDP, I think or hope; that was my calculation. We are in a different situation because of the decision to leave the European Union and the fact that we will be negotiating over a period of two years or so our exit, with the outcome not certain until probably quite far on in that process. That introduces new uncertainties into the calculation. We know that there has been a response from business, which has been to slow down investment. We have to be able to respond to that. I think my predecessors’ policy was the right policy for the circumstances that prevailed when he made it. Those circumstances have changed in terms of the greater uncertainty created and the much higher borrowing that is now projected over the current forecast period. Self-evidently, I think the decision I have made is the right decision, otherwise I would not have made it.

Chris Philp: Clearly. Thank you for that. Clearly, the Government has decided to stick to a number of previously announced fiscal policy areas, both in terms of taxation, for example, increasing the thresholds, as you mentioned earlier, but also sticking to the various ring-fenced spending budgets. Given the altered circumstances that you just referred to, would there be a case in the course of this Parliament for looking again at some ring-fences? For example, the European Union average spending on overseas aid 0.45% of GDP, in France and Germany it is 0.3%, in the US it is 0.2%, and the OECD average is 0.28%. Were we, for example, to get to 0.7%, say, over a 10-year period rather than meet it now, that would give us significantly more fiscal latitude, depending on whether you froze it in cash terms for a period or even took it down to the EU average and then drifted back up over 10 years. Is that the sort of flexibility you think we should be open to considering in the coming couple of years?

Mr Philip Hammond: The Government’s policy is, as laid down in statute, to deliver 0.7% of GNI as official development assistance, and our intention is to continue to do so. We were elected on a manifesto that made that commitment and, as I set out at Autumn Statement, despite the difficulties we intend to deliver on the manifesto commitments.

Chris Philp: There is no review of that intended in the course of this current Parliament.

Mr Philip Hammond: No. What I said at the Autumn Statement is that, later on in the Parliament, we will have a spending review. That is the right time to look in the round at all the commitments that have been made for this Parliament—tax commitments, spending commitments, ring-fences and so on. The Opposition has chosen already to start making commitments about which ones will be continued, I suspect on a rather ill-advised and ad hoc basis. These things need to be looked at in the round in a formal process, because there are decisions around priorities, around looking at the original objectives when these policies were originally introduced and the extent to which they have been delivered or not, and looking at the consequential effects of these
policies. We will have to have that debate, and the right time and place to do it is the spending review later in this Parliament.

Q366 Chris Philp: Which year is the spending review intended for?

Mr Philip Hammond: It has not been determined yet, but it will be later in the Parliament.

Q367 Chris Philp: We discussed at the beginning with the Chairman transitional arrangements, by which I presume you and the Chairman mean temporary arrangements that prevail between us leaving the European Union and negotiating some permanent ongoing set of arrangements. Is that what you understand by transitional arrangements?

Mr Philip Hammond: Transitional arrangements could cover a variety of outcomes. It could be the case that during the two-year Article 50 period a set of agreements was reached with a clear and firm end state but with the parties agreeing that there is a need for a period of adjustment, perhaps introducing the changes to get from status quo to the end state in a series of steps or an extended period before those changes were introduced.

It could also be the case that at the end of the Article 50 negotiation period no conclusion has yet been reached about the final end state of future arrangements between the UK and the EU, and there might be an agreement that said, “We have not yet concluded our discussions about the final end state. In the meantime, once the UK leaves the EU, a transitional arrangement will be put in place for a period of time, finite, to give us a little more time to conclude what the end state should be.”

Q368 Chris Philp: Would you agree that it would be preferable if we managed to get in perpetuity certainty rather than the second of those scenarios you outlined? First, that would contain obviously inherent uncertainty, because the perpetuity end state would be unknown, and secondly we may have less negotiating leverage should that be kicked into the future.

Mr Philip Hammond: In principle, certainty is always preferable to uncertainty, but if it is certainty of something very unfavourable, that is not quite so good. We all know what the one certainty we all face is.

Q369 Chris Philp: There are two, aren’t there? Taxes as well.

Mr Philip Hammond: I have some power over them. I do not have any power over the other one.

Q370 Chris Philp: On the assumption you are opposed to abolishing taxes, I am pretty sure taxes are as certain as the other one. In terms of our negotiating counterparty, I know that notionally we are supposed to deal with the European Commission and Mr Barnier. My impression, and I would be interested to hear if you agree, is that they are a little more interested in defending the European Union as a political institution rather than the economic wellbeing of citizens in the EU, whereas EU national
governments might be a little more concerned about the jobs of German auto workers or French wine manufacturers than defending the European political construct. Is that an analysis that you share and, if it is, how should that inform the way that we practically handle the process of negotiation?

**Mr Philip Hammond:** The European treaties give to the Commission the responsibility for conducting this negotiation, but of course within the structure of the European Union the member states, through the European Council, will expect to have considerable influence over how the Commission exercises those responsibilities. Of course, the European Parliament will also have a role to play, so we should understand this as being a competence that, in practice, all parts of the EU structure will have a role in.

Q371 **Chris Philp:** Presumably, therefore, you would agree that we should be engaging with all parts of that structure, not simply the European Commission channel.

**Mr Philip Hammond:** Of course we should maintain dialogue, relationships, as we do with all the member states. We have bilateral relations with all the member states as well as relations with the EU collectively.

Q372 **Chris Philp:** Finally, we spoke some time ago about stamp duty collection on high-value—meaning more than £5 million—residential and commercial properties, where it seemed, to me, that stamp duty was being uncollected to an extent not explicable just by stamp duty relief. I realise this is a slightly technical question. Do you have any follow-up thoughts on that or should I write to you separately?

**Mr Philip Hammond:** You did write to me prior to the Autumn Statement, if I am not mistaken. It was you who sent me some specific numbers.

Q373 **Chris Philp:** Yes. It was a presentation rather than a letter.

**Mr Philip Hammond:** It was a presentation of a gap that you perceived in the collection of high-value property SDLT. I have asked HMRC to do an analysis of that. I will write to you in due course and tell you what HMRC concludes.

**Chris Philp:** That is very kind, thank you, Chancellor.

Q374 **Kit Malthouse:** Chancellor, did you intend the Autumn Statement to be stimulating in an economic sense?

**Mr Philip Hammond:** Do you mean in a fiscal sense stimulating?

**Kit Malthouse:** Yes.

**Mr Philip Hammond:** It is modestly stimulating, in that it delivers an additional £23 billion worth of capital spending over the forecast period, financed by borrowing. I judge that will have a very modest degree of
demand stimulus, coupled with what we hope will be a contribution to improving the productivity in the supply-side of the UK economy by focusing that investment very deliberately in the areas that we judge—and I think the OBR and IFS, in their comments to you, supported this—will have the best chance of contributing to raising the productivity performance of the UK economy. It is primarily seen as a supply-side initiative, but it will have a modest demand-side impact.

Q375 **Kit Malthouse:** It is an investment in productivity, essentially, rather than a demand stimulus.

**Mr Philip Hammond:** It is an each-way bet. To be honest, at the time of the Autumn Statement the UK economy, in terms of the data available, is not displaying any sign of needing a fiscal stimulus. It is going to be the fastest growing economy among the large advanced economies this year, but the OBR is warning of a slowdown in the year ahead and a gentle recovery in the year after that. A very modest stimulus over the next two or three years is not money that is simply fiscal stimulus money; it is money that is carefully targeted to serve a purpose in improving the long-term performance of the economy. If it provides a little bit of fiscal stimulus along the way, so much the better.

Q376 **Kit Malthouse:** Just on timing, the OBR, as you say, are forecasting essentially a seven-quarter dip in GDP, which bottoms out in about a year’s time. They are saying that the fourth quarter this year is likely to be lower than the third quarter, and then the next two quarters after that will bottom out. Given that the money that you have indicated, the £20-odd billion, is to be delivered over the next five years, are we to take from that that you are more optimistic about that dip than the OBR or that, given the suddenness of it, you did not think that there was much that could be done to even it out?

**Mr Philip Hammond:** Let me say three things. First, if my approach had been “I must deliver a fiscal stimulus”, I would not have done it through capital spending, because capital spending projects take longer to deliver, even though, in this case, we have deliberately targeted smaller scale projects that are, dare I say, shovel-ready, but are much nearer to being shovel-ready than much larger projects would typically be. Our objective was to deliver an enhancement to productivity, and if it comes in the next two or three years, that is fine.

Secondly, I think you heard from the OBR that their principal two concerns in making their forecast of slower growth next year are: the impact of inflation on consumers—inflation that is driven mainly by the depreciation of sterling—and a slowing of business investment. I cannot do much about the former, but to the extent that the slowing of business investment is a reflection of business expectations and confidence, the announcement of a large, multi-year investment programme in productivity-raising infrastructure could reasonably be expected to have a positive impact on business sentiment over the medium term. I hope that businesses will look at this announcement and think, “This is going
to make my business a bit more productive. If we are going to get road improvements, rail improvements, more housing built in high-demand areas, this is positive for the UK economy and it makes me feel that little bit more positive about investment in the UK economy.” Therefore, we will, perhaps, stimulate a rise in expectations among the business community, which will help to ameliorate the decline in business investment that the OBR is forecasting.

Q377 **Kit Malthouse:** In terms of the seven-quarter dip that I referred to, just to be clear, your view is that the measures you have taken now and, possibly, may also take in the Budget, which will only be in three and a half to four months’ time, might help to iron out that 18-month—

**Mr Philip Hammond:** The OBR were explicit that at the trough the measures that I announced add about 0.1% of GDP to their forecast, so of that 1.4% in the trough, I think they are saying that 0.1% is due to the National Productivity Investment Fund.

Q378 **Kit Malthouse:** They are; that is right. I was asking if you are more optimistic than that.

**Mr Philip Hammond:** I accept the OBR’s judgment. As I have said several times, I am much more interested in what the long-term impact of this will be, and the OBR has not taken a view on that. They have taken a wait-and-see view, but I think both they and the IFS confirmed to you that it would be reasonable to expect that investment in this kind of infrastructure would have a positive impact, and it is not insignificant, as Paul Johnson said to you. It is a significant uplift in public sector net investment and very specifically targeted in a subsection of public sector investment: that which is most directly economically stimulative.

Q379 **Kit Malthouse:** I am sure that is very welcome. On the other side, one of the things that you did not address in the Autumn Statement, I do not think, but that you have expressed concern about is the level of business investment and the business investment slowdown. Do you think part of the solution to addressing the longer term economic trends would be to somehow stimulate that private sector investment alongside the public sector money that you are putting in?

**Mr Philip Hammond:** Absolutely. There are four basic elements to the productivity challenge in the UK: too little capital invested in our businesses; too little public sector infrastructure; inadequate skills; and a very poor regional distribution in our economy—a very significant regional imbalance in our economy. Addressing all four of those things is the key to raising the UK’s overall productivity and thus increasing living standards in the UK in future generations.

What I am going to do about it was implicit in your question. I did say at the Autumn Statement that the Treasury would undertake a review of our tax arrangements to support private sector investment, particularly private sector R and D investment, and we would do that on a Budget
timescale, so we are undertaking that work now and I will say more about that in the Budget.

Q380 **Kit Malthouse:** Fantastic. Finally, on this section, I wanted to ask you about the speed of deployment of public sector capital. Pretty much consistently over the last few years getting the money out of the door has underperformed the forecasts and it has been quite difficult. You have talked about the £20-odd billion being targeted on these shovel-ready projects, but there is still an overhang of the existing capital programme, which is behind the curve. Are you doing anything to try to accelerate all of that as well?

**Mr Philip Hammond:** You are right there has been, overall, a consistent tendency to underspend on capital budgets, because projects take longer than people project they will take to deliver. The OBR has treated my programme, as I think it is quite right for it to do so, on the basis of historical evidence. They have spread the jam according to their historical evidence of government performance, rather than looking with granularity at the programme that we have said we would finance.

In the early years, we have been quite specific. We are looking at specific projects that we hope and expect, in the face of the historical evidence to the contrary, we will be able to deliver quite quickly, because they are relatively small, specifically identified projects. Further out, the money is not allocated with the same degree of granularity and I accept that the historic experience is poor and we are trying to improve it. We have the Major Projects Authority involved in these things; we have the National Infrastructure Commission as well. We hope to see a consistently improving performance across the piece.

Q381 **Kit Malthouse:** I just wanted to turn quickly to a different issue you mentioned earlier, about Mr and Mrs Watanabe. Are you concerned about the savings ratio in the UK and our comparatively low level of savings in the long term and will it be a priority for you politically? Obviously, the Government has thrown quite a lot at it over the last few years—all governments—in trying to stimulate savings, it seems to little effect. Do you diagnose a particular problem there and, if so, what do you think the solution is?

**Mr Philip Hammond:** We have some structural issues around saving in the UK, which are, some of them, specific to the UK: the structure of pension saving, the extraordinary role that housing wealth plays in the overall calculation of UK households. All of those are factors and some of them may be distortive. In fact, I would go further and say that I am certain that some of them are distortive of behaviour. On a rather longer time horizon, we do need to look at the interaction between, at the level of the household, the desire to save and the desire to save in the most effective way—for many people, historically that has been through housing—and the needs of the economy around accessing pools of saving. That is a productivity challenge for us.
Q382 Wes Streeting: First, Chancellor, thank you for taking on board the representations made by the Committee here and on the floor of the House regarding the distributional analysis. We were not able to persuade your predecessor, so it is only right to acknowledge and thank you for responding in the way that you have.

Mr Philip Hammond: I would just make a small point. The ability to present this as an analysis by deciles is partly as a result of new and more granular data that is now available that was not available a year or so ago. There is a supply-side effect here that has made it possible for me to provide useful stuff.

Q383 Wes Streeting: We will tell George you stuck up for him. I am hoping to be lucky a second time. One of the issues I have been campaigning on with Martin Lewis from MoneySavingExpert is another decision that was taken by your predecessor, which was a small, from a Treasury savings point of view, but significant decision to make retroactive changes to student loan repayment conditions, in particular freezing the threshold at which graduates would begin to repay from next year, when it was due to rise in line with average earnings. There are a number of principal concerns we have about this, not least confidence in future promises made, as well as the previous promises made. In the spirit of Christmas, I wonder if you might agree to give up 30 minutes of your time to meet with me and Martin to talk through some of our concerns and whether we might persuade you to revisit that decision ahead of the Budget, before the decision kicks into practice.

Mr Philip Hammond: I would have to be frank with you and say I do not see scope for reversing that decision. It is an important part of our overall fiscal consolidation and, of course, it is also about preparing the student loan book, ultimately, for sale as an asset sale. I believe that student loans represent a very favourable arrangement—a very favourable structure for financing students through higher education—but of course I am always happy to meet with colleagues in the run-up to the Budget. I would be very pleased to hear the arguments, but I would not want that to be interpreted as any indication that there is likely to be any change in this area. I would be happy to meet with you in the New Year.

Q384 Wes Streeting: I am grateful. I will bank the meeting and move on to the other issues that I want to talk about, which are primarily around health and social care. In reply to the Chairman at the beginning of the meeting, you mentioned that the decision not to address health and social care funding in the Autumn Statement was not as a result of a block from No. 10. Nonetheless, the Local Government Association has called on the Government to end what it describes as the worst funding crisis social care has ever faced. The Chief Inspector of Adult Social Care has warned the system is approaching a tipping point and that, unless we get to grips with some of these problems, we will get to an absolute crisis. 250 residential care homes have closed since March, 5,000 beds have been lost in the last 18 months and the Chief Executive of Care England has warned that hundreds of providers face financial ruin, with
40% of care services deemed to be no longer viable in the medium term. The Chair of the Health Select Committee has also warned of a critical shortage of care staff and resulting increase in costs. This morning, the former Conservative health secretary, Stephen Dorrell, who now chairs the NHS Confederation, has warned that cash shortages threaten the stability not just of local government but of the National Health Service. Taking all of that into account, why did you not address these issues in the Autumn Statement and what do you propose to do now to address the very real funding crisis affecting the NHS and our social care system?

Mr Philip Hammond: First, you mentioned in your opening the NHS and social care. The NHS’ funding requirement has, of course, been addressed by the Government across the whole of this Parliament, meeting in full and, indeed, exceeding the funding request from the NHS itself in support of their transformation plans. This will enable—and it was front-end loaded specifically for this purpose—the NHS to make the changes that are needed to drive efficiency savings within the service that can then be reinvested to get us to the point, which we all want to get to, of an NHS that is efficient and sustainable.

The second thing I need to say, and I am sorry if this comes as a shock to the system, is we all have to get used a world in which chancellors do not necessarily do everything. My colleagues in the Department of Health and my colleagues in the Department for Communities and Local Government are the people responsible for addressing the issues that are being raised here. They are talking to NHS trusts, they are talking to local authorities and, as I said earlier, we are very much aware of the issues that are being raised.

We recognise that the substantial increase in funding that social care will receive over this Parliament is back-end loaded, and we recognise that local authorities are challenged to deal with that pattern or profile. It is the case that local authorities, in aggregate, have been adding significantly to reserves; £9 billion since the beginning of the last Parliament is the figure that springs into my mind—someone will correct me if that is wrong. Local authorities will have to look at how they manage the situation to get from here to the very substantial increase in funding that will be available to them later in the Parliament.

It is also clear, and it is clear from looking across the UK at areas where social care is working well and areas where it is facing much bigger challenges, money alone is not the issue. It is about effective co-operation and collaboration between the NHS and social services. The key to this is getting the very best practice that we have seen in some areas rolled out much more widely across England to deliver the kind of high-quality social services we want to see.

Q385 Wes Streeting: I am grateful for that answer and particularly the acknowledgement about the back-loading of the additional funding earmarked for social care. I should probably declare that I am still an elected member in the London Borough of Redbridge, albeit an unpaid
member, but that does have a bearing on my perspective. I just want to clarify one thing around councils and their reserves. My council, the London Borough of Redbridge, has dipped into reserves and, in fact, in the next couple of years their budget outlook will put some money back in. That is important, because there will be parts of the capital programme, for example, where there is a logic, not to mention prudence, in making sure that councils do not go to the wall because they have spent everything in the kitty. I think that is wise and I just wanted to get that on the record.

In terms of the description you have made of NHS funding, I accept that the Government is meeting its commitment in terms of funding for NHS England, but when you look at the package of funding for health as a whole, the picture is a lot less clear. You will be familiar because of the interactions you have had with its Chair that the Health Select Committee disputes the £10 billion figure that is regularly cited as the Government meeting its commitment. The reason they do that is because when you take into account the fact that the £10 billion figure is expressed in 2020-21 prices rather than today’s prices, and you take into account the reductions in funding for public health grants and the reductions in training through Health Education England, they put the figure at close to £6 billion over the course of this Parliament, not £10 billion. That was supported by the IFS when they gave evidence in response to a question from Rachel Reeves. In fact, Carl Emmerson said the figure may be even smaller than that.

We need to acknowledge that, whilst the Government may be meeting its funding requirements for NHS England, it is effectively robbing Peter to pay Paul. Surely, you must accept, in terms of planning and the work that Departments are doing, there will be a knock-on impact on budgets. If, for example, public health funding reduces and there is a greater reliance on urgent care or social care, the costs go up. Similarly, if you are not addressing the social care funding crisis, there will be bed blockages in the NHS and cost pressures will arise there. Can you see the importance, therefore, of looking at spending on health and social care as a whole, and is that how you will undertake to address your decisions around funding on health and social care in forthcoming budgets?

**Mr Philip Hammond:** On the question of the NHS Five Year Forward View plan and the Government’s funding commitment to it, you mentioned two areas where the Select Committee disputes the figure, the first being the fact that the Government’s figure uses 2021 prices rather than 2015-16 prices. That is correct; that is true. We believe that our approach is the correct, statistically defensible approach to this, and we will have that argument with the Select Committee or anybody else.

On the second point you raised, frankly the Select Committee has moved the goalposts. The Government’s commitment and the ask was to fund the NHS, and we have made that funding commitment to the NHS. It is true that the Department of Health in other areas will be making
efficiency savings. It is the NHS that is protected and the NHS that has the benefit of this funding commitment from the Government.

On your question about joined-up service—I think I have already made this clear—we think that co-ordination between the NHS and local authority social services is absolutely crucial, and we think that in areas of the country where best practice is in evidence, it is having a real and visible impact. I am trying to remember the exemplar areas, but one of them is in the North East; I am sure somebody will prompt me in a minute. There are some examples of very good practice. We are trying to work with the NHS and local authorities to make sure that that good practice is widely disseminated.

We should not just drop in to the easy assumption that all pressure on the NHS is generated by challenges in social care. I am, equally, not advancing the opposite hypothesis that problems in social care do not have any impact on the NHS—clearly they do—but the NHS analysis does not suggest that challenges in social care are the biggest cause of, for example, the higher attendance in A&E, which is the driver of many of the challenges the NHS is facing.

Q386 **Wes Streeting:** No, but we certainly have a perfect storm where very serious concerns are being raised about both NHS funding and social care, and from a wide range of participants in the debate. It is not just politicians giving you a hard time because we are the Opposition and that is what we like to do; senior figures who are responsible for delivering these services are using language that an opposition might do on days of our greatest hyperbole. These are serious people making quite serious statements and with a good evidence base behind it. I understand the point the Government is making about efficiencies, but if I give my own London borough as an example, we have one of the lowest spends per head on adult social care in London, which is £405 per head as against the London average of £445 per head. Our public health grant is about half of that against the London average, and because we are working closely and ahead of the game in integrating social care between us and the NHS, we have achieved good ratings in terms of the adult social care outcomes framework and public health outcomes framework. Clearly, we are delivering efficiencies, we are a low-cost service, we are working in partnership and we are doing so with less funding than many other London boroughs, but the outlook for a borough like mine is incredibly challenging, not least because the Better Care Fund does not kick in until the end of the decade. When you look at the broader health and social care economy in Redbridge, it is a very challenging picture. I am wondering when you will be able to provide reassurance to London boroughs like mine, where people are generally worried about our ability to meet the social care needs of some of our elderly and disabled residents who need access to that support.
Mr Philip Hammond: First, I am delighted to let the record show that it was you and not me who contrasted the hyperbole of opposition with the statements of serious people.

Wes Streeting: Unfortunately for you, there is a synergy between them and that is your problem.

Mr Philip Hammond: It is perhaps also worth noting that it was those serious people in serious positions in the NHS who set out the NHS Five Year Forward View and asked for the funding for it, which they have received. We do not, for a moment, doubt or dispute that there are areas within social services that are facing challenges, some authorities more than others, in bridging between the situation we are in now and the situation we will be in after precepts have been used to raise funding locally and the Better Care Fund has kicked in, and we will work with authorities. I am afraid this is not always going to be a question of the Treasury working with those authorities. In the model that we are trying to operate, it will be the line Departments that take the frontline responsibility for this. We will talk to those Departments about their budgets, as we have done, and make the commitments that we have made, and then it is for the Secretary of State for CLG and the Secretary of State for Health to work out how best to work with local authorities and health delivery organisations to ensure the best possible outcomes.

Q387 Stephen Hammond: In your Autumn Statement, you set out that one of the central challenges to the economy was the productivity challenge. Part of your response is clearly the National Productivity Investment Fund, and you set out in that the fact that we need targeted and sustained investment and specific projects will be decided on in due course. At the end of 2021, 49% of the fund will have gone on housing, 18% on transport, 4% on digital communications. Can you lay out why you got to that mix on two bases: first, there is an awful lot of private sector funds for housing anyway and, secondly, a lot of the money that is going on transport, digital communications and, in particular, research and development is back-end loaded and, therefore, probably will not see any impact on productivity in this Parliament?

Mr Philip Hammond: It is important to draw attention to the fact that a sizeable part of the funding that is labelled as housing funding is infrastructure enablement to housing, something that we have perhaps not focused on as much as we should have done in the past. We know we have a problem in the higher price pressure point parts of the UK housing market in bringing forward perhaps difficult-to-develop sites: brownfield sites, sites remote from infrastructure or, to use an example with which I am very familiar from my days in MoD, ex-MoD sites, which are often capable of making a significant contribution to housing but are often slightly remote from existing infrastructure—old RAF airfields and so on.

Here, we have made a conscious decision to do two things: to commit a specific fund, which local authorities will be able to bid for, towards
providing the infrastructure that will open up and enable development of land that otherwise could not be developed. We have also made a commitment to ensuring that in our routine processes of allocating transport infrastructure, the positive impact on potential housing development is fully taken into account in the cost-benefit analysis the Department for Transport does.

Q388 Stephen Hammond: That is all eminently sensible, but would it not have been even more sensible on that basis to have put the bulk of that fund that unlocks the transport in the same years in which you are trying to see the biggest boost to affordable housing? The big boost to the money you are allocating for infrastructure is at the end of the period.

Mr Philip Hammond: You are right. There is housing funding earlier on for housing associations and registered social landlords to provide additional units across all tenures, and we have also relaxed controls that restricted flexibility across tenures. In designing the profile of the funding there were a number of considerations to be taken into account, not least of which was the availability of cash to fund these. We had a profile that we wanted to follow and we have set out across the different allocations in the way that we think will be most effective. I am happy to write to the Committee with more detail of why we did it the way we did, if that would be helpful.

Q389 Stephen Hammond: That would be helpful; I would appreciate that. The second criterion, of course, was that you looked for specific projects that are “value-for-money investments”, according to the phrase in the Treasury book. When I questioned the OBR on this, Mr Chote was somewhat dismissive about this; he said it would have some impact on productivity growth. Obviously, having read the book carefully, I saw you were going to fund projects that had a clear and strong contribution to economic growth, but when I asked Sir Stephen Nickell, the OBR were very dismissive about whether or not this fund would have any impact on economic growth. Is that your view?

Mr Philip Hammond: I do not think the OBR were very dismissive. Obviously, I have discussed this with the OBR. The OBR are open-minded about the longer term impact on productivity. You asked both the OBR and IFS about their views on this, and I thought that their responses were broadly supportive. All other things being equal, if you invest an extra £23 billion in housing in high-pressure areas, network infrastructure and R and D, you would expect that to have a positive, not negative, impact on productivity.

Q390 Stephen Hammond: All of them said a positive impact on productivity, but the OBR, to be fair, said they would not make “any explicit adjustments to the trend productivity”. Also, when I questioned Stephen Nickell on its contribution to economic growth, he said it is "very small". 
**Mr Philip Hammond:** The issue here is about the contribution to productivity. The OBR’s approach is: “We will wait and see what it delivers. We will not forecast it. We will take it into account once it has been delivered.” It is for us to demonstrate, with the interventions we make, the impact.

Q391 **Stephen Hammond:** You did mention that part of the allocation process would be determined by cash flow availability for the NPIF. Can you give the Committee a breakdown of how it is being funded, in terms of borrowing and taxation?

**Mr Philip Hammond:** The NPIF is being funded wholly by borrowing. That was the explicit decision we made—that we would borrow £23 billion and use it for targeted capital investment in those specified areas. Every other announcement made at the Autumn Statement and every other spending announcement was fully funded.

Q392 **Stephen Hammond:** I have a number of other questions to ask you, but I am being prompted by the Chairman to be brief so he can bring my colleague in before the bell. You said that the UK economy lagged 30% behind the US and Germany, and 20% behind France. Are you happy that there is a consistency in both output measurement, measurement of a services economy versus a manufacturing economy, and of hours worked and, indeed, the part the labour market, where, potentially, because we have a lower rate of unemployment, we have traded that off for productivity gains that we might have had if we had it the other way around?

**Mr Philip Hammond:** First, there is a lot of debate about methodologies around this, and you will be able to interrogate expert witnesses about this. It is a valuable debate going on, and I would not want to camp on the 30% or 20% figures, but in broad orders of magnitude they explain a difference in earnings and incomes between economies that are otherwise broadly similar. We have a real problem and we should not shy away from that just because there may be, at the margin, some issues about precise measurement.

Q393 **Mr Steve Baker:** Chancellor, your evidence this afternoon has excited quite a lot of energetic press attention. I hope you will not mind that I fiddled with my phone to explain that the pitchforks are not, in fact, coming out. The Prime Minister set out some tests in her Sunday speech at conference about the ECJ and about migration and so on. Are you expecting the Prime Minister’s tests to be met as we leave the European Union?

**Mr Philip Hammond:** The Prime Minister set out what our stance would be as we go into this negotiating period. We have been pressed to say more. She has given a clear position in headline terms.

Q394 **Mr Steve Baker:** I am sorry to interrupt, Chancellor; it is just we are so short of time. I am really not trying to lead you. Could you just confirm that we are expecting to meet what the Prime Minister set out on that
Sunday?

**Mr Philip Hammond:** Self-evidently, we are going into the negotiations with a negotiating ask and we expect to be successful.

Q395 **Mr Steve Baker:** There seems to be an enormous amount of confusion between transitional arrangements and a withdrawal agreement. The way I would understand how the Prime Minister’s tests will be met is a withdrawal agreement that would meet those tests and deliver free trade in goods and services, based on mutual recognition, deemed equivalence, other measures. That could be judged to be a transition into a broad and deep free-trade agreement later. Is that the formal process as you understand it to be before us and would you, like me, expect the Prime Minister’s tests to be met at the end of the withdrawal agreement?

**Mr Philip Hammond:** We will have to engage at the beginning of the negotiation with our negotiating interlocutors about the structure. There are some on the European Union side who would think of the withdrawal agreement as being about those aspects of unravelling our existing relationship and what future arrangements we had as being contained in a separate but parallel agreement. I do think that is just semantic, because I think the expectation is that one may be completed more quickly than the other. This is an area that we will want to discuss, I would imagine, early on in the negotiating process with our partners, about how the process will operate.

Q396 **Mr Steve Baker:** Would you agree with me that we should not allow these uncertainties about process to lead to unnecessary and avoidable disagreements about where we are going to land?

**Mr Philip Hammond:** We should certainly try not to allow uncertainties about process to continue. The sooner we can clarify how the process will work, the quicker we are able to remove some uncertainty from that process—and that is good for everybody.

Q397 **Mr Steve Baker:** The subject I really wanted to touch on, if we can, before the division is off-payroll working rules and what is commonly known as IR35 for the public sector. In the OBR’s outlook, they have said that the rise in incorporation will reduce revenue by a billion in 2016-17, but your public sector measures for off-payroll working only increase revenue by £25 million. How widespread is this problem? Is there more that you could do to increase that tax take from the public sector?

**Mr Philip Hammond:** I think we are talking about two different things. The figure you quoted from the OBR was the cost of incorporations rather than specifically the cost of people working for the public sector working through this particular mechanism. One is a subset of the other, I think.

Q398 **Mr Steve Baker:** The point I am really driving at is it seems to be a very small subset. Is there not more that could be done to eliminate this problem in the public sector and drive that figure up a little higher?
Mr Philip Hammond: Where we are is that, in the public sector, the onus is being placed on the employer—the person who is making the payment—to ensure that the arrangement is fully compliant. I am not sure what more we can do beyond that, other than—and I made it clear in the Autumn Statement that we will go in this direction—look more broadly at the world of work and how it is changing and how that affects the tax base. This is work that broadly sits in parallel with the work that the Prime Minister has asked Matthew Taylor to do: to look at the changes in the world of work and how they impact on employment rights and workers’ rights. That is one piece of work over here, but we also have to think about the impact on our tax base of these changes.

Q399 Mr Steve Baker: I cannot help wondering if applying the new rules to the BBC will substantially drive up the tax take from closing down these arrangements.

Mr Philip Hammond: We will have to see.

Q400 Mr Steve Baker: Chancellor, are the Government losing money twice through these measures, once when the employee becomes an agency worker and ups their pay and, secondly, when they pay less income tax because they have incorporated?

Mr Philip Hammond: This is primarily an issue of national insurance contribution. There may be an income tax effect as well through incorporation, but the initial impact will be loss of national insurance contributions.

Q401 Mr Steve Baker: On this point, people tend to take dividends; of course, on national insurance, but they tend to take dividends rather than pay income tax. Do you think there is a case to be made that people should pay the same rate of tax both on income and on dividend income?

Mr Philip Hammond: There is an argument for looking at the way in which the same work being carried out by different people will incur different levels of tax depending on the structures that they have put in place. Clearly, where risk is being taken and capital is being employed, the remuneration to risk-taking and capital is, rightly, different from the remuneration to the provision of labour. But where there is no risk-taking or there is no capital employed—it is merely a hollow structure—there is a question of fairness that needs to be addressed. We need to look at that, and this is a long-term piece of work, but we need to make sure we have a system that, as the world of work changes, can cope with these different structures in a way that is fair to everybody. It is clearly the case that some people have more opportunity for selecting which type of structure to use than others do, depending on what sector they are working in.

Q402 Mr Steve Baker: Since we are talking about the long term, I would raise the report of the 2020 Tax Commission on the single income tax. I know the Office of Tax Simplification is aware of this. I just wonder if you would undertake to ask them to look closely at it and see whether, in the
long term, we might radically simplify the tax system.

Mr Philip Hammond: I know, Mr Baker, that you are in favour of radically doing things wherever possible, and I am very happy to talk to the Office of Tax Simplification and make sure that I am up to date with their latest thinking.

Q403 Mr Steve Baker: Finally, on this set of measures, both ACCA and the ICAEW have both scored it poorly on their various measures. The Institute has six measures, four of which are in the red, one amber, one green and, overall, has scored off-payroll working rules as red. Will you look again at what is being done in light of the feedback you have had from the institutions and check whether these things could be done better against their scorecard measures?

Mr Philip Hammond: Of course, we keep all of these things under continuous review. Particularly where we are talking about the public sector as an employer, of course we have perhaps even more scope for ensuring that we move more quickly if we find that there is more that needs to be done.

Mr Steve Baker: Chancellor, thank you very much. I notice the Minister is still in full flow and I wonder whether the Chairman might like my colleague to return to his questions.

Chair: Did I cut you off, Stephen? No, he is happy. I think we are all happy. Thank you very much, Chancellor, for coming to see us. It has been an interesting, informative and, at times, entertaining session, which they have not always been when Chancellors of the Exchequer have been before this Committee. We look forward to seeing you again, probably before too long and certainly after the Budget.