



HOUSE OF LORDS

Unrevised transcript of evidence taken before

The Select Committee on Public Service and Demographic Change

Inquiry on

PUBLIC SERVICE AND DEMOGRAPHIC CHANGE

Evidence Session No. 5

Heard in Public

Questions 104-158

TUESDAY 23 OCTOBER 2012

10.00 am

Witnesses: Tom Josephs, Kayte Lawton, Dr Martin Weale and Professor James Sefton

USE OF THE TRANSCRIPT

1. This is an uncorrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.
2. Any public use of, or reference to, the contents should make clear that neither Members nor witnesses have had the opportunity to correct the record. If in doubt as to the propriety of using the transcript, please contact the Clerk of the Committee.
3. Members and witnesses are asked to send corrections to the Clerk of the Committee within 7 days of receipt.

Members present

Lord Filkin (Chairman)
Lord Bichard
Baroness Blackstone
Baroness Finlay of Llandaff
Baroness Morgan of Huyton
Baroness Shephard of Northwold
Lord Tope
Baroness Tyler of Enfield

Examination of Witnesses

Tom Josephs, Head of Staff, Office for Budget Responsibility, **Kayte Lawton**, Senior Research Fellow, Institute for Public Policy Research, **Dr Martin Weale**, External Member of the Bank of England Monetary Policy Committee and part-time professor at Queen Mary University of London, and **Professor James Sefton**, Professor of Economics, Imperial College London.

Q104 The Chairman: Good morning and a warm welcome to you and thank you very much for coming to help us with our inquiry. I am not going to go around our table. You see who we are and you might even have heard of one or two of us as well. We are sighted on who you are. So I will not, unless you particularly want to, ask you to introduce yourselves; but do so, if you feel that is useful, when you first speak.

As you know, it is being recorded. There will be a Hansard of it and so it is all on the record; not that that would change what you were going say, I am sure. We have quite a lot to cover and we had thought it might take about a couple of hours or so. If your diaries can allow that, that is what we provisionally thought and planned as our process. Clearly, if it needs longer, that would be good.

Welcome. Let me start off with the first question. In terms of how you respond, and clearly you will not necessarily want to run along the row because that would be a bit clunky, I am

probably going to throw the question out and then leave you to see who grabs it first of all and then others can see if they wish to respond to that. It will probably be slightly different for Tom Josephs, because in a sense, Tom Josephs, we will be questioning OBR methodology and process. So you are almost going to be the respondent to some of the issues, I suspect, whereas others are going to be setting up. You may want to come in as a commentary at certain points, putting the record straight as you would see it or giving a gloss to what has been said. Does that work all right for you as a process that effectively I ask it to you and one of you respond and then another will come in if they disagree or feel they want to make the same important point? You do not all have to say an answer to every question unless you feel moved to. Does that sound over-engineered or can you cope with that? I am sure you can cope with that. Good.

Let me start off, then, with the first one, which is essentially about the OBR's forecast of fiscal sustainability. Does it accurately show the impact of an ageing population over the next 10 or 20 years and are there any significant problems with the assumptions that the OBR is statutorily obliged to work with with its methodology? Who would like to have a go?

Professor Sefton: My name is James Sefton. With Martin, we updated the generational accounts for the UK as of 2008 for the ONS. What I did yesterday was I compared the forecast that we did during that exercise with the OBR forecast published in July of this year to see where the differences were and to see whether I could eke out something from that. That is what I did.

The agreement is very, very high between our forecast and theirs, so there are no major differences. However, there were one or two that I want to highlight. Our revenue projections are very, very similar. Our projections of individual in-kind government expenditure—that is education, health, welfare transfers and such like. We also have very similar numbers to the OBR on those.

The major difference was in terms of collective expenditure. It was very hard to drill down into the numbers at that point, but what I noticed when we were doing the forecast is that government gross fixed capital formation expenditure—investment expenditure—is projected to fall quite dramatically down to 2015 and 2016. They are cutting it back very much in the spending reviews. The OBR has assumed that that low-level expenditure will carry on from there onwards, so as a fixed proportion of GDP that will remain exceptionally low going forward. That caused a major discrepancy.

In terms of what we are talking about, the intergenerational transfers—that is what we are focusing on today—within the OBR there is an assumption that investment has been cut quite dramatically, it will remain low and, therefore, we are effectively under-investing in UK plc in the future. Again, it will be the younger generations that will probably pay the price for that. That was in terms of the actual numbers. That is where I saw the big discrepancy.

In terms of the assumptions, when we worked on it over many years, labour participation was a key variable, particularly labour participation of the 50 to 65 year-olds. Again, the demographic is changing. Obviously, there is a lot of uncertainty around those numbers. I saw that they had estimated, using a cohort model, effectively over 1997 to 2008. Over that period, unemployment fell by about 2%, from 7.5% to just over 5%. You are estimating over a period where unemployment is falling. If you use those estimates, therefore, to project forward, you are going to get a slightly rosy picture of labour participation going forward. Obviously, that helps the revenues. It also helps in terms of expenditure because it reduces expenditure and that again makes the numbers look good relative to a more pessimistic assumption.

Productivity growth rates: that is another key number that comes into these forecasts. It is put at 2.2%. Again, I would like to think it would be 2.2%, but that is optimistic given the recent history. There is an inflation wedge as well built into those forecasts. GDP inflation is

forecast to rise at 2.5% and the CPI is forecast to rise at about 2% going forward. Tom will correct me if I am wrong, I am sure. That implies that you are expecting revenues to rise at 2.5%, the inflation rate due to the price rises, but expenditure is only going up 2%, so you have a 0.5% gain there. I think that is right. I am not sure. Productivity, labour and the inflation wedge were three assumptions that I would like to highlight.

Q105 The Chairman: Thank you. If you are right on your view, the reality could be slightly more difficult as a consequence as most of those, if your perspective is correct, have the effect of underestimating the forthcoming fiscal gap. Am I right on that?

Professor Sefton: I would think the risk is on the pessimistic side on those numbers. Yes.

Q106 The Chairman: Yes. Thank you. Dr Weale?

Dr Weale: Could I add to what James said in some sense with a prequel point. The general methodology that the OBR used is what I regard as standard. Obviously, as James identified, the differences emerge because people make different assumptions. You asked whether the forecast accurately shows the impact of an ageing society. I suppose, given recent experience of the difference between budget outturns and budget projections, anyone would be doubtful about using the word “accurate”, but, as I say, in broader terms the methodology is standard. While we can differ over the assumptions, I would not differ over the methodology.

Tom will be able to clarify this. There was one point that might work in their favour, but looking ahead, of course, the retirement age or at least the state pension age is rising and you might think that that would lead to more people working and, therefore, to larger income tax revenues. We should ask Tom to clarify whether that was built in or not because, if not, that would be something pulling in the other direction.

Q107 The Chairman: Shall we do that now? On CAPEX, Robert Chote told us in June, in fact, they had forecasts onwards from current expenditure. That is an extremely low level of capital expenditure, is it not?

Tom Josephs: Yes. It may be helpful if I explain a little bit about the general approach we take. The way we do the projections is that we need to make an assumption in the future on constant government policy over the 50-year projections. Our remit requires us to look at the impact of current government policies and not to look at alternative policies. The way we do that on items of public expenditure is effectively to assume that spending on those items essentially rises in line with overall GDP growth in the economy. That does mean that we take the shares of expenditure at the end of our medium-term forecast and then project those forward.

The way we do that is by looking at areas of spending rather than particularly at capital or current expenditure. We have breakdowns of expenditure by function—health, education and so forth. At the end of our medium-term forecast, we look at the share that those items of public expenditure have and then project forward on that basis. Then, on top of that, we overlay our demographic trends, which means that the actual expenditure in our projections will vary according to the demographic pressures underlying that.

Q108 The Chairman: On the two specifics: what James Sefton said about CAPEX and what Martin Weale said about participation rates—

Dr Weale: James raised the question. My question was about tax revenues.

The Chairman: Are they correct in that?

Tom Josephs: It is the case, because the Government are planning to reduce expenditure over the medium term and then we take that as the starting point for our projections. As James Sefton says, that is essentially locked into the projections going forward.

Q109 The Chairman: As we said, this is not a session to beat up the OBR. It is to try to get an understanding of the variability. Your remit by Parliament and statute is to take current policies and you can see why; otherwise you are into the rather difficult field of second-guessing politicians. The only thing we know for certain is that current policies will not stay the same and we are interested in the variability issues of those. In a sense, that leads on to the second of these two questions: the impact of an increasing number of older people on the demand for public services and the cost of services and the funding of public services. That obviously brings in the issue about the expectations we will have about quality and the cost implications of that. I do not think that is a question for you, Tom, but I would like James Sefton and maybe Kayte and Martin to have a go at that. All history shows that we expect to spend more on better quality public services as we get wealthier. Why will it not be different in the next 10 years?

Dr Weale: Assuming we do go on getting wealthier, I expect there will be continuing pressure from the users of public services for increasing quality. Of course, the fact that the users are not necessarily the people who are paying for them contemporaneously does mean that the normal mechanisms to make people think about how they would want to spend their money do not work in quite the same way.

Professor Sefton: In terms of pressure on public services, you can look at education first. There, with falling fertility rates, the pressures are probably mild. On pensions, again if you look back over recent history, the Government have had some success in controlling pensions. They certainly feel able to rewrite pension statutes quite regularly and there do

not seem to be barriers to doing that. In terms of controlling pension expenditure, that seems possible as well going forward.

The big one is health, obviously, and health seems to be the one that is just uncontrollable. It is the one that can blow a hole in the finances. Again, if you look at the OBR projections, in annex B it did look at various alternatives. Certainly, when you look at history, at how much health expenditure has risen in real terms, it is roughly around about 3% over the last 20-25 years. That looked like the high end. If health expenditure carries on growing at the rate it has been doing, which includes rising expectations, the rising costs of drugs and everything, then that particular scenario looks probably more of a central estimate than a high estimate.

Kayte Lawton: I think that is true. One of the points the IPPR is quite keen to make on this kind of issue is exactly what you said; that as we get wealthier we want these things and it is not necessarily a direct impact of ageing, particular with regard to health spending. The actual ageing impact is perhaps overplayed, which can lead to a sense of, “Old people are a burden. There is a looming crisis here”. We are quite keen to say that, as we get richer, we make a conscious decision that we want to spend more on these things. I think everyone is exactly right that that will keep on happening and there is no reason to suggest that it will not.

I just wanted to go back on one point about the assumptions in the OBR’s work. We, as a think tank, have not done lots of technical work on this, so I do not have the sort of input that James and Martin will have. We were just interested in the policy assumptions they made about up-ratings of benefit rates and tax thresholds, because they make an explicit diversion from current policy to up-rate those in line with earnings. There are good reasons to do that over the long term, but it is important to understand the impact that has on public finances.

The OBR, in its first long-term expenditure report, did modelling on that to show the difference that those assumptions make. It is something that we noticed and perhaps raised an eyebrow about why it had departed from government policy on that. It is important that the impact that uprating decisions have on public finances over the long term is taken into account.

Q110 The Chairman: Thank you. I will call Baroness Morgan in a second. Let me just close with one question that we picked up from talking to the demographers last week. We were obviously trying to get a picture, not simply of the numbers in certain age cohorts going forward in 10 or 20 years, but an understanding of the risk of morbidity in those cohorts. We asked the question: do OBR or the Department of Health make forecasts of the likely prevalence or increase of the chronic conditions that are some of the big cost drivers on the health system? At least, if you make the current assumption about current morbidity rates and look at the increased numbers in those cohorts, you could have a stab at looking at how many more people with dementia or other chronic illnesses there will be in the future. They thought that this was not done. Is that correct?

Tom Josephs: That it was not—

The Chairman: Did you do that or did you just deal in the aggregate with health expenditure, rather than looking at some of the big cost drivers of the system?

Tom Josephs: We have not looked in detail at individual costs of treating different diseases and tried to model that in the future, which is obviously a very difficult thing to do. We do have some analysis where we look at the issue of whether healthy life expectancy will rise in line with general life expectancy. In our core model, as life expectancy increases, life spent in ill health increases at the same rate, which is really a function of how the model works. Clearly, it may well be that as life expectancy increases also time spent in ill health decreases.

We looked at producing sensitivity analysis of that to show the impact that it has on our projections.

It is fair to say that the impact that has on our projections is nowhere near as big as some of the issues that James was talking about around the level of productivity that you might see in the health sector. We agree with James that that is a very key issue for the future path of health spending. In our central projection, we assume that productivity in the health sector increases at the same rate as in the general economy and that implicitly means that the real provision of healthcare rises in line with incomes in the economy.

Q111 The Chairman: Why do you not assume that health productivity will continue at the same rate that it has continued in the past? That would be a more reasonable assumption, would it not?

Tom Josephs: We have looked in this report at that issue in quite some detail and it is certainly the case that the analysis that has been done by the ONS and some academic studies of productivity in the health sector suggests that productivity growth has been much lower than whole economy productivity. The ONS numbers, I think, suggest roughly flat productivity. Some studies suggest a bit higher than that.

I would say that measuring productivity in the public sector and in health is an extremely difficult thing to do. You have the issue of: effectively, what is output in the health sector? Some of the studies try to measure direct outputs—number of operations and number of consultant visits—and then attempt to adjust that for quality improvements, but it is a very difficult thing to do. There is lots of uncertainty around those estimates, which is why we have chosen to stick with a standard assumption of whole economy productivity growth but then show very clearly the consequences of something different happening.

Q112 The Chairman: You might, at another time, want to get a bit more under the skin of that because the cost increases of health expenditure, whether driven by volume or price, are reasonably apparent. Even if there were productivity increases, they are not necessarily going to be cost-saving productivity gains, are they? You have the potential for quite a significant divide, have you not?

Tom Josephs: Yes. You have certainly seen over the whole of the post-war period that nominal spending on healthcare has increased much more rapidly than most measures of real output from the sector suggest. It has clearly been a pressure in the past and is a key risk we identified for the future.

Q113 Baroness Morgan of Huyton: I shall be just a little more general, if I may. If I can go back really to the assumptions. Sorry, it is Tom again. Sorry, OBR. Obviously you have built in assumptions about the change in pension age. What assumptions, if any, have you built in about the number of older people working going forward?

Tom Josephs: On policy on the 50-year projections—this relates to the point Kayte was making on our assumptions on earnings and on tax thresholds as well—clearly, over the medium-term forecasts that we produce, for the next five years government policy is very clear and stated very clearly. Over the 50-year projections, in many cases government policy is not stated. Therefore, we have to make an assumption on what we see as a reasonable, constant policy assumption.

On pension age, that is an area where policy is stated quite clearly. We have factored in all the announced increases in state pension age. We do then make an adjustment in the way that the demographics work in the model, which means that more people will therefore be working around the state pension age, both in the run-up to the new state pension age and immediately after.

Professor Sefton: You said in the long run that you thought the unemployment rate would fall to about 5.2%. That was what you were targeting with your modelling. Given that we have gone through a crisis and you are now seeing a lot of long-term unemployed, there always tends to be a lot of structural hysteresis in the labour market. A lot of old people—not old, but my age—will have dropped out of the labour market and, looking back at previous recessions, some of them are unlikely to get back into the labour market. Again, what you assume about that and whether they are going to get back can make a large difference in terms of the projections and revenues and stuff. It is a difficult job. I think it is an almost impossible job forecasting it, but it is an area of uncertainty.

Q114 The Chairman: If we wanted later on to get just a sense of how wide the span could be, if you just made adjustments to one or two of these highly uncertain variables, is that relatively easy work to be done? The modelling facility is there, is it, to be able to make different assumptions about health service productivity or participant rates in the economy?

Tom Josephs: Yes. Every year in our report, we—

The Chairman: If we took a view that we did not think the health service productivity was going to be as sunny as that, you would be able to tell us what the consequences of that would be.

Tom Josephs: We have done that in the report. We have a huge, whole range of estimates of different productivities and the impact on spending in the sector.

Q115 The Chairman: We should do our homework and, if we cannot find it, come back to you then.

Tom Josephs: Yes.

Q116 Baroness Blackstone: I just want to pursue fiscal adjustment and fiscal planning. Assuming fiscal policies remain the same, and the way you work is assuming that government policies are current ones rather than alternative ones, how large a fiscal adjustment is going to be necessary to secure sustainability so that the ratio of debt to GDP does not get worse? I do not know whether you can produce such a figure. It will be interesting if you can.

Tom Josephs: We do produce those sorts of figures. The way we do that is we estimate something called the fiscal gap. What that does is tell you what the permanent adjustment you would need to make now in either tax or spending would be in order to hit a particular level of debt at a particular date in the future. In the report we show a whole range of these fiscal gap estimates for all the different projections that we do. To take an example, in our central projection, in order to reach a debt level of 40% in 2050, we estimate that you would need to make a permanent adjustment of 0.8% of GDP now. That would mean that you are alleviating the pressures on the public finances that are building up over that period from the demographic pressures that we set out in the report and, rather than debt rising, you would have debt reaching 40% of GDP.

Of course, in practice, you may not think it is sensible to make an immediate one-off adjustment in order to hit these targets, which are quite far in future, particularly given that these pressures are basically building up over quite a long time period. We also show that you can reach the same point, the 40% debt target, by making a gradual adjustment of 0.4% of GDP per decade over the next 30 or 40 years.

Given the uncertainty in these projections, these estimates vary quite considerably depending on your particular choice of assumptions and your particular choice of demographic paths in the future. For example, the one we were just talking about, where we assume lower productivity growth in the health sector, the equivalent one-off adjustment

would 3.2% of GDP; so much larger. It is important to emphasise that these projections are, as we have been talking about, very uncertain and so these estimates are also very uncertain, but they give an illustration of the kind of scale of adjustment that might be needed.

Q117 Baroness Blackstone: This is very long-term, if we are going to 2050, so it is not surprising the projections are pretty uncertain. If you were to do them over a 10-year period, how far does that increase the certainty, or are you still in the situation where you are very uncertain?

Tom Josephs: Recent experience shows very clearly that even very short-term forecasts are highly uncertain. One point to make is that any long-term projection is inherently very uncertain, but there are parts of the projections that we could have more confidence over. An example is we know that the demographic pressures from the baby-boomer generation will build up over the future and we can be reasonably certain that that will occur because that reflects events that have already taken place. Much more uncertain are all the other assumptions around longevity and migration and all the economic assumptions that we make.

Q118 Baroness Blackstone: All this work is not completely new. There must be some lessons to be learned from what has been done in the past. Can you tell us a bit about that?

Tom Josephs: Various vintages of population projections that the ONS has produced over time have moved about a lot. I think I am right in saying that the general trend is that the projections have generally increased over time. New vintages have projected higher levels of population in the future, but whether that will continue is very unclear.

Q119 Baroness Blackstone: Do the rest of you want to comment on this area?

Dr Weale: Another feature of the population forecasts, of course, has been that estimates of mortality rates have been revised down over decades now. The ONS has in some sense been trying to get ahead of the game. When I think of the problems of economic forecasting, I am quite glad that I have been involved in economic rather than demographic forecasting because the margins of uncertainty just seem to me so much greater. But it obviously does remain a major source of uncertainty.

The other point I would add is that the projections are assuming that the economy in some sense returns to normal after the crisis and, of course, that is something we have to bear in mind.

Q120 The Chairman: That is, is it not, the major immediate issue, because we are waiting with bated breath for the OBR's next sustainability report. In December, is it—5 December or something like that?

Professor Sefton: Our next medium-term forecast is in December.

Q121 The Chairman: Yes. Without putting words in your mouth, it will be surprising if that shows quite as optimistic a picture as last year's one. To a lay person—

Professor Sefton: I do add one thing. I do not know whether this is right. A quick equation, just to try to illustrate the uncertainty involved. It is a broad-brush relationship, but if you take the size of the primary surplus—that is the amount of revenues over and above the expenditures—how big does that have to be to support a certain debt to GDP ratio? There is a very simple relationship that the nominal interest rate on the debt minus the growth rate of the economy, in brackets, times the debt level to GDP roughly has to roughly equal the primary surplus.

The reason for bringing that up is to illustrate how important the interest rate and the long-term growth rates are in determining how much fiscal adjustment you are going to need, because if you pick figures that are in the OBR, that the interest rate is 5% and nominal growth is 4.75%, then R minus G is only 0.25%. Times the debt, you get a very small number, so it looks quite good. However, if you are less and, say, interest rates went slightly higher, 6%, growth never rose above 3%, and then you have the difference, less 3% times 80, which is 2.4%—I will correct that if I have that wrong—you get a much, much larger adjustment. The key point is it very much depends on your estimates of interest rates and growth rates. Those are the key numbers.

Q122 Baroness Blackstone: Can I just pursue that, too? Given the uncertainties that you have all emphasised, does it make any sense to try to have some sort of long-term plan to close the fiscal gap or should we just make incremental adjustments every year?

Dr Weale: It does make sense to have some long-term plan or long-term view about what needs to be done because in some sense the issue we face with an ageing population is how we are going to provide goods and services to people after they have retired and largely are not generating the incomes that they need to pay for them for themselves. People think of their own affairs. If you think, “I want to save up for my retirement so that I have something to live on after I am no longer working”, and you can apply the same principle to the public finances. Obviously you can only do that if you think about the situation now instead of waiting for the future when it comes.

Could I make one other point, which was elided together: a stable or falling debt to GDP level over the sort of horizon we are talking about. I should have thought one of the major sources of uncertainty is whether there is another crisis like that that we have recently experienced. Even if you look back to the milder episode of around 1990, that had a

significant effect on the government net financial position. As far as I remember, it was in some sense financed by asset sales rather than running up national debt, but you could imagine that if policy was simply to keep the debt to GDP ratio constant when there were not crises and then to let it rise during crises, you would end up with a problem. We need to have a long-term view of where we would like to be and we need to think not only of the sorts of marginal uncertainties that we have discussed but also of the possibility—I would not say more than that—that there would be another period of substantial economic disruption.

Q123 Baroness Blackstone: That is pretty convincing. Do you all expect further economic dislocation made worse by the huge pressures on public expenditure, partly from an ageing society? I am not sure that I agree that we can be as—I do not quite want to use the word “complacent”—pragmatic as you were about education expenditure. Fertility rates may have continued to come down a bit, but even that is not sure. We know from the very large increases in fertility in the immigrant population that there are now a lot of pressures on primary education in a city like London. Moreover, there may be a huge increase in demand for post-school education. At the moment, only 44% go to university and there is a demand for more apprenticeships and so on. I just want to get a feel for how optimistic or pessimistic you are on the general issue of dislocation.

Kayte Lawton: If we look back over the last 50 years, we have had a lot of population ageing already and we know that countries like the UK, the US and the Nordic countries are in quite a late stage of population ageing. We have not seen that rise leading to a continuously upward trajectory of public spending. We have not seen a fiscal crisis or a crisis of welfare states that were predicted a lot. There is therefore no reason to think that the

demographic trends and rise in national prosperity that we hope to have over the long term necessarily need to lead to a crisis any more so than they have so far.

If you look back over the last 50 years, what has happened is that policymakers and politicians have made choices about how money is spent and a lot of that has been dictated by things like ageing and demand for public services. That will be the same in the future and the question is how we as policymakers, politicians, people, citizens, make choices about that spending. There is possibly a slight danger of getting carried away with the OBR projections and thinking that they show you what will happen. The one thing the OBR projections show you is what will not happen, because policy will not be the same and people will make choices and change. I think those are the important questions, rather than saying, “We have this huge crisis building up and we need to worry about it”.

Q124 Lord Bichard: I just want to underline that, because that is where I was going. You are not making, any of you, a case for saying that our response to an ageing population should be driven by the projections. What you are saying is that we should, as with most public services, be trying to increase the productivity of healthcare and social care. We should be moving some of the costs on to the individual, whether that is through raising the pension age or whether that is, as we will come on to, through things like releasing equity and those kinds of activities. We should be concerned about improving the quality of life for all people, but not least people who are getting older. That is what you are saying. You are not saying we should all suddenly stop and realise there is a huge fiscal crisis coming at us that should drive our response to an ageing population because of the uncertainties.

Dr Weale: Sorry. You have described me as saying many things, and I suppose I thought of some more than the others. I should stress I am not commenting about the immediate fiscal position, but looking ahead it seems to me quite a strong case to say that a prudent public

sector would run its affairs to allow for the risk of increased pressures coming later on. It would be likely, at least to some extent, to save up in advance and you might well say—in fact, it is quite a good argument—that because of the uncertainty involved, far from saying, “We should not worry about it and it is all just too uncertain”, because of the uncertainty involved, that strengthens the case for ensuring that we have something in hand should it be needed.

If I could say more generally, over the last 20-25 years Britain has been one of the lowest-saving—this is looking at the nation’s saving, not just households—of the advanced economies and essentially it is because we have been a very low-saving economy that we now have worries about pensions and we have worries about all sorts of things. Again, as I say, this is not any comment at all about the current economic situation, but in the medium term the economy does have to be saving more. A part of that, I should have thought, would be likely to be the public sector thinking about what cost pressures and expenditure pressures might come in the future, even though and almost because they cannot be forecast with certainty.

Q125 The Chairman: Would anyone else like to comment on Lord Bichard’s suggestion?

That was what you were saying. James Sefton?

Professor Sefton: You are absolutely right that we are getting hung up on the numbers; also replying to Baroness Blackstone’s comment. The point was you can show where the pressures are going to come and this is one thing that you can forecast. You can say that, even if education expenditure did rise, we are talking numbers of plus and minus 1% of GDP, whereas pensions is plus or minus 2-3% of GDP, whereas health is plus or minus 6% of GDP. You can see where the big changes or the real pressures are going to rise.

To follow on what Martin said, on our projections, because of the demographic change or the baby-boomers retiring in between 2020 and 2030, you can see, if we are going to have stable debt to GDP ratios, that you should be starting off that period with a very low level of debt. You should not be taking this 80-90% GDP through to 2020, because then you will possibly face substantial pressures.

Q126 The Chairman: That is, in a sense, one of the key issues—that the fiscal consequences of an ageing population by themselves are not that dramatic. It is much more about what the overall demand on the health service will be. The issue is that we look as if we will end the 2020s with a high level of aggregate debt and if we have a fiscal balance or a primary balance by then we will all be extremely pleased. We have, in a sense, used up the sort of caution that you have in the system by having a low level of debt to be able to absorb shocks in the system. It is a bit crude and layman, but is that broadly true?

Dr Weale: I would certainly say, having just had a big shock, the capacity for absorbing another big shock is much less than one would have liked. That is not because it is forecast. Shocks, by their nature, are things you cannot forecast.

The Chairman: Exactly.

Tom Josephs: Just quickly on the sort of general question: what is the point of these projections? I would say that we are very clear that there is a huge amount of uncertainty around the projections and that is why we try to be very transparent about all the assumptions we have made and show a huge range of different scenarios to show the implications of taking different judgments. People can then pick and choose the ones that they prefer. It is also clear that under most of those scenarios you essentially see the pressure from these demographic trends building up.

It is not as if that only comes through under some very specific assumptions. It is pretty much there throughout all of the scenarios we do and that kind of general trend and general risk to the public finances comes through quite clearly. I do not think it would be very sensible to say, “Well, there is a huge amount of uncertainty. Therefore, we can just ignore these projections”. There is quite a clear message.

Q127 Baroness Blackstone: I am assuming, from what you are saying, even though, as Kayte Lawton said, it is a matter for policy choice as to what we do, that you would assume there will be very direct pressures as a result of demographic change in the current fiscal position on healthcare, social care, residential care and pensions as far as the elderly are concerned. I would just slightly qualify what Lord Filkin was implying, which was that there are pressures on health services generally, but so much of this comes from the elderly population. If you look at the proportion of expenditure on health on the elderly, it is a very, very large chunk of it. You would all agree that all of these services are going to be under considerable pressure.

Tom Josephs: Those pressures build up over quite a long time period, but yes.

Q128 Baroness Finlay of Llandaff: Can we just move a little bit to something that is perhaps the elephant in the room, which is the Dilnot Commission on Funding of Care and Support and where that is going and the size of the risk that the proposals may represent at the moment? Linked to that, I want to ask you whether you feel that the present levels of social care provision, in particular, can be maintained and, if they are, what the implications will be in relation to the quality of those. All the pressures are about driving up the quality and highlighting examples of poor quality, but the cost of that social care is a huge part of the expenditure from the health and social care budget.

Dr Weale: A general comment to break the silence. The services provided are different, but I do not see that as terribly different or distinct from the issues associated with the provision of healthcare. Of course, what the Dilnot commission did identify was some form of insurance for people who want to protect themselves or their descendants from the uncertainty surrounding how much social care will be needed. That has to be seen in the context where a lot of the dialogue at the moment is people using social care, particularly residential care, wanting other people's children to pay for it so that they can leave legacies to their own children, which is an understandable biological equilibrium, I suppose. But, as I say, in broad terms, I do not see the pressure issues as being terribly different from those associated with healthcare, where there are the same points about quality: an increasing very elderly population and so on.

Q129 Baroness Finlay of Llandaff: I would completely agree with you, because where you put that line between what is so-called health and so-called social care is arbitrary and they are completely interlinked. It may be that the whole provision may need to renegotiate where that line sits. I wonder if you have any thoughts on that.

Kayte Lawton: Just small points on the issue of social care. I think what has been said is true. It is worth noting that social care is now a very small part of public spending and you can argue about whether that is right or wrong. It is much clearer that ageing pushes up demand for social care in a way that perhaps the relationship is less clear for health, but we are starting from a low base in social care. I do think it is important to look at the quality issues. They are potentially different in healthcare and particularly the low wages and low quality that we have in social care. I would imagine that as we continue to age there will be more and more calls for quality to improve, which has to be partly about improving wages. There is a sort of pressure there, but, taken as a whole, social care does not have the huge

impact that something like healthcare or pensions have, just because we do not spend very much on it at the moment.

Q130 Baroness Finlay of Llandaff: Or is it that we are spending it but it is being put in the health budget, so it comes under things such as continuing care, inpatient care or care at home and it is being delivered, then, by people who are not regulated and who would really sit more in the social care sector? I am thinking about the care assistant; the care delivery.

Kayte Lawton: Yes. I am sure all of those things are true and I probably do not have enough expertise on the detail of social care to say much more.

The Chairman: Are there any other comments from the panel? No.

Q131 Lord Bichard: There is an argument that people should be expected to pay out of the value of their homes for some of the care that they need. Local authorities can already do that, but they do not do it because of the problems you might describe as bridging problems. You incur the costs now, but you do not get the value released until later. Do any of you have any thoughts on how that issue could be addressed? Should we be looking for someone to do the bridging? Who should take the risk and how should this show up in public accounts?

Dr Weale: In general terms, of course, mortgages do exist, although typically not in that context. In other words, there is not any obvious procedural difficulty in securing debts on property.

Lord Bichard: It could be an equity release arrangement.

Dr Weale: It would amount to equity release. No, I have not studied this. From what you were saying, I was wondering whether the issue was as much political as anything else; that is not politically popular.

Q132 Lord Bichard: What is not politically popular?

Dr Weale: Relying on a large scale on it. You said that local authorities tend not to do it. I found myself wondering whether it was not just that it did not create money upfront, a financing problem that you would have thought could be resolved.

Q133 Lord Bichard: How might it be resolved? Local authorities are having their budgets reduced by 28-29% over three or four years. They are not in a strong position to be releasing resources themselves. If they pay for additional costs in the hope that they are going to get some of that back in 15 years' time, it is not an attractive option at the moment. Could the Government have some role in facilitating that?

Professor Sefton: On the equity release of reverse mortgages, from what I understand, the market is not particularly big at the moment. It is just not very big and, because of the risk effectively that you do not get the payment until the house is vacated, whatever the reason, there is considerable price risk there in these reverse mortgages and they tend to price in that risk at quite a high level. Therefore, there is a certain reluctance, as I understand from people in the industry, for people to take on these reverse mortgages. Again, this is a bit outside my areas of expertise, but maybe there is a role for Government in trying to reduce that risk. Certainly, if it can be reduced, then it would possibly push up the rates that people get on their reverse mortgages and that would expand the market. The market is, at the present moment, relatively small.

Q134 Baroness Finlay of Llandaff: Can we come back, then, with a different approach, just hearing Lord Bichard's question, and that is whether you feel that, rather than there being a central policy about how the services, particularly care services, are funded, there is

a subtext policy of, “Let it happen by stealth”, whereby, as local authorities get more and more squeezed, as NHS provision goes through the turmoil it is going through at the moment and people want to access more convenient appointments in a service that is becoming increasingly squeezed, they will on an individual basis opt out into private care provision. Allowing that to happen by stealth allows any Government not to have to take the political risk of declaring any kind of policy on the issue, but in the long term this drift out from public service provision into privately-funded, privately-provided provision to plug the gaps that people need is something that is going to happen. In the public sector, the regulatory framework will remain more than the actual provision on the ground.

Professor Sefton: It would be unfortunate if it was done by stealth because I think there is a lot the Government can do to get a better outcome. There is a danger, if it is done by stealth, that you do not get the best outcome. You get the one that nature sort of floats towards and there are some other questions on this list that I thought we were going to address about intergenerational transfers. That for me is a big question. When you do it by stealth, what is the intergenerational outcome that you will end up with and who will be the winners and losers in terms of the generations? Obviously, if you have an explicit policy, you can try to come to a better outcome than you would if you did it by stealth.

Q135 Baroness Finlay of Llandaff: That was one of the questions that I was going to pick up. Shall I pick it up now? How much should public policy take account of intergenerational transfers implied by current policy and should we focus more on these than on what the fiscal position is at any one point?

Dr Weale: I think we need to focus on both. There are many features of the political economy of public finances, which means that people may receive benefits in some sense at a higher level than their historic contributions to the public finances would have paid for and,

of course, that is not magic. It has to be paid for by someone else. It is an intertemporal shift. The other substantial intertemporal shift in the economy that has taken place has been the increase in house prices and the way that transfers resources from young people to old people. I certainly think that in reviewing whether policies are desirable or not we should not simply be thinking about what we can afford today but also about whether we regard any intergenerational implications they have as being desirable.

Professor Sefton: I ask my students regularly in class, “Are you angry at the generational deal you are getting?” I am always surprised by the response. I get very few. Maybe they are just reticent. They do not hold up their hands. They do not seem that angry. They should be angry. I think the deal they are getting is poor. Martin mentioned that there are a lot of transfers going on within the system that are from the young towards the old and the awareness of it is very poor. We can break it down to that, but eventually it will come out. Land prices, house prices: that is one huge transfer. Then there is the rising Government debt, partly because we bailed out the banks and saved the claims. The claims belonged to the pensioners. They were in the pension fund. This was a large debt. You were again transferring the debt to the future generations to pay off. Unemployment is very high now. In the crisis, again, youth unemployment is the highest; so they are bearing the costs there. There are a lot of big changes on education as well. The costs of education have been borne much more by the private than the public. That is another large transfer on to the younger generation. A lot of the transfers of the burden of this crisis are on the young and there are a lot of shifts in policy that put the burden on the young. Added up, it makes for a big, big shift and big, big transfers.

One attempt that we have had to look at it is a thing going on called the National Transfer Accounts. It is run by Ron Lee and Andrew Mason in Berkeley in the US. They try to look at these transfers and compare them across countries and see whether they differ. We

recently calculated one for the UK. The transfers look at the difference at each age between your income and your consumption and somehow that difference between the consumption and income has to be financed. It can either be financed through public transfers, private transfers or savings. What you observe in the UK is that the percentage of that deficit when you are young is mostly financed through private transfers in the UK, a much higher percentage of private transfers than in any other European country; whereas the transfers in old age are mostly through public transfers in the UK. Again, we are on the high end of the range of countries there. You can see it in those numbers that the UK is not transferring, through public transfers, to the young. It is transferring to the old.

There are obviously offsetting mechanisms at work in the economy to say that it goes through the private transfers and it is going through the family and whatever. Again, that is the offsetting mechanism in the UK, but it is markedly different from some of our European partners.

Q136 Baroness Finlay of Llandaff: You say, though, that this will play out and at the moment the younger generation are not angry about it, but you are anticipating that they will become more aware and more angry. What do you see as the social consequences then of that anger?

Professor Sefton: I have not seen it yet. Maybe they will just put their heads down and work harder and make sure they are okay. Maybe it becomes an individual burden. I would not dare forecast that there is going to be a generational uprising.

Q137 The Chairman: Let us stay with the argument, because it is an extremely important one for us. Clearly, the argument that is put against is that the pensioners are suffering because quantitative easing has destroyed the value of their savings and their

annuities; they did not go to university and the current generation does go to university. There is a stack of arguments against that as well. One can schedule all those issues. For us, the interesting issue is how you have a more informed debate about some of these issues and make them more explicit in public policy debate. Are there any thoughts on how we articulate these almost unintended consequences of policy drift and wanting to make them more explicit so that we have more public—

Baroness Blackstone: Can I just ask a supplementary on that? We have often said that we ought to look at the distributional consequences of policy development, but we always look at it in terms of horizontal rather than vertical distribution; in other words, within a particular generation rather than inter-generationally. Is there something that prevents us thinking much more about intergenerational impact of policy change? I was strongly opposed to the shifts made in charging young graduates the cost of their tuition and higher education because it is highly regressive in generational terms. That has never ever been discussed properly and that is just one example of this. It is shifting the expenditure from rich, middle-age, middle-class parents, not so much the elderly, on to young graduates.

Dr Weale: No. In general terms, one hears the distributional comments after a budget day, “This has been bad for a family with two children, but good for an old aged pensioner couple”. Of course, the family with two children are going to turn into a pensioner couple. The more informed question is, “How does it affect different people over their likely remaining lifetime?” They are going to be very imprecise, like everything else, but those are the sort of questions that people have the techniques to answer. If politicians were to press for answers to those sorts of questions they could be delivered and they could be delivered without knocking a large hole in anyone’s budget.

We need very much to think about those sorts of questions. If you think in general terms about how you might find a popular tax benefit policy you would get two very different

answers depending on whether you looked at the welfare of current young people—was it something they would be happy with knowing they were going to have to live with it for the whole of their lives—versus what you would get if you looked at the current population, because the current population would include people who may not be expecting to work anymore and therefore may not be terribly worried about taxes on labour income but will think it is unfair that income from capital should be taxed in the way that it is. You get these two very different answers and even thinking about the two sorts of different answers that you get and why you get them can clarify policy.

Kayte Lawton: Yes. I do think in policy terms we do have a big problem in this country about how we do long-termers and how we get long-term priorities into our decisions about public spending. You can see that with the most recent spending review that we had where the NHS was protected, you have to pull up the pensions and then capital spending is slashed. It is easy to cut back on those sorts of long-term investments where there is not that constant political demand that politicians feel they have to respond to. But we all know the long-term impacts of not doing that investment and that is problematic. I fear that those discussions are not properly held in the public debate, so people are not told about the impact of not building power stations and roads and investing in home building over a long term. Those things do not feature in the discussions we have.

I always think it is interesting to look at some of the Nordic countries and the way that they structure their spending. Obviously we know they spend more of the share of GDP than we do, but they also structure their spending in quite a different way. They invest much more in things like education, in training, in labour market programmes and in childcare. It feels to me that that spending is much more focused on long-term strategic priorities. They have a sense that public spending should be there to drive jobs and growth, not just to respond to, “We’re getting older and richer, so we want better pensions and healthcare”. The opposite

of that is the US model where spending is really concentrated on pensions and healthcare and there are huge problems in infrastructure investment.

I personally need to do more work on understanding where that has come from in the Nordic countries, but you can see a real sense of long-term strategic priorities in the way that politicians structure spending and there seems to be some sort of consensus, politically, that that is the right thing to do. They spend less on healthcare and more on some of the pro-jobs-type policies. Perhaps, ahead of the next spending review, if there could be a much more open and public debate about our long term priorities, that would help.

We are talking internally of ideas about how to get the parties and governments to set out their long-term objectives and perhaps tell us in their spending reviews or in big policy announcements how what they are saying fits into long-term objectives as well as how it delivers short-term benefits. Some of those things are important, but it is difficult to do well.

The Chairman: It is fascinating and I would welcome spending another hour on it, but we should come at it from a different way through Baroness Tyler. Do you want to open up some of those issues on your questions?

Q138 Baroness Tyler of Enfield: Yes. The area I wanted to get into generally was the politics of all of this, by which I do mean the big and difficult choices that politicians of whatever hue have to take; how they take them and the political and public debate that surrounds them. I wonder if I could just start, Kayte, with the point you were just making. We were very interested in that bit of your evidence that talked about needing this clear set of national strategic priorities to help inform some of these longer-term decisions. I think I am right in saying you felt that should be very much informed by big democratic debate. Two issues there: first of all, what stops that from happening at the moment? Secondly, would

that not almost slow things down because of the time it would take to get any sort of consensus going?

Kayte Lawton: Yes. The first thing to say is that we do not have a perfect answer on this. We need to do more work on the democratic processes that you need in place. As I was just alluding to there, there are things that you can do around the big set-piece announcements, whether that is the budget, the spending review or the Autumn statement where politicians set out their long-term priorities and explain how the decisions they are making today support that. There is a certain extent to which you are then reliant on those Ministers to do that and to be honest about the priorities and trade-offs. There is a danger that you will be told, “These are all our long-term priorities in every policy area and everything we are doing supports all of them”.

You have to make a case to politicians that they need to say, if asked a question about a Nordic-style approach to affordable childcare, “We are going to invest in that for the long run and these are our arguments for why we think it is a good idea and that means, unfortunately, we are going to make some difficult choices about health or about pensions provision”. I do not know how you make politicians do that because there are obvious voting problems around some of that for them, but in time what we want to do is to make these arguments to politicians that they need to be doing that. Also, just having those debates in public will mean that voters will start to ask some of those questions, but none of it is easy at all.

Q139 Baroness Tyler of Enfield: Just to continue on this point. You did make the point about people voting and Professor Sefton may have thoughts on this. I just wondered how you felt about the extent to which the demographic changes are likely to worsen the overall fiscal position. We have talked about the degree to which that is going to be the case. Older

people tend to vote more than younger people. What is the extent to which you think that makes it more difficult to take the measures that might need to be taken to try to address these fiscal issues? Do you think there is a mismatch in expectations between what the state will pay for and what individuals need to pay for and what people are willing to pay for in tax levels generally?

Professor Sefton: The trouble with the intergenerational question—we had it when we did the generational council and tried to communicate the results to people—is that it is a very, very difficult concept to communicate. In fact with the Treasury, when we tried to communicate it, we gave up. We simply did not get anywhere with it. What are the right measures that quantify the net transfers of a generation with the Government? Have they done well out of policy or badly compared to another generation? Coming up with a figure to quantify that is very difficult and, until you have those figures, it is very difficult to have a debate because people are not quite sure of the size of it.

The only work that I know of is John Hills' work in 1992 where he tried to identify the welfare generation. Which generation had benefited the most out of their net transfers with the Government? It was the generation born in the 1930s, I think, that he identified as the welfare generation. Then he comes up with a number in pounds and then you have something to quantify—you have a concept—and it will come out very clear from the numbers that the current generation and what they expect to transfer with the Government are very heavy contributors to the public purse whereas previous generations had benefited from the public purse.

Dr Weale: You mean current young people?

Professor Sefton: Current young people, yes. Current young people will be contributors whereas older generations have not been. Until you have those numbers to start on it is very hard to even get the debate going.

Q140 The Chairman: That did not stop you earlier, James, giving a very clear view that there was intergenerational unfairness going on at present, did it?

Professor Sefton: Yes, that is a very fair comment.

The Chairman: No, I am not being cheap because if we wait for the numbers we will never have a debate and it is important to have a debate.

Q141 Baroness Tyler of Enfield: Just to summarise what I wanted to ask: in terms of trying to reframe this national debate, do you think it is going to be more productive to focus on the focus that you have put on intergenerational inequities or possibly on the focus that Dr Weale put of taking a life course perspective and understanding what is going to happen to you through the course of your life and indeed your overall family situation, which has intergeneration aspects to it?

Dr Weale: I do not see a clear distinction between them. What is going to happen to current young people over their life course reflects the history of these generational transfers. They are, more or less, two different ways of looking at the—

Baroness Tyler of Enfield: It is two different ways of coming at the same thing.

Dr Weale: Explaining both of them to people would be helpful and saying, “There has been this transfer and this means that, even though you earn X, you are only going to have Y to spend because a part of it is going to be transferred to the people who are doing well out of the welfare system”.

Q142 Baroness Tyler of Enfield: None of this is easy territory, as you have all acknowledged, for any of us to get our heads around. Is there a way of doing it other than

trying the approach, “You should be getting very angry”? Is there another way into this debate?

Lord Bichard: May I add a supplementary to that? I was really struck by Baroness Blackstone’s comment about tuition fees. I had not thought of it in quite the same way. What is there that we can learn from that? That was an example of expecting a group to make a much greater contribution to a public service. It was sold, in so far as it was sold, or it was imposed on the basis that universities needed it and you, the individual, were going to benefit a great deal in your later life by the economic benefits of it. It was not absolutely popular but it has happened and the world has not come to an end. Are there things that we should be learning about that shift towards the individual for the payment of a public service that we could apply to older generation?

The Chairman: Yes, it is a good question. Can we take it as a separate question; otherwise we will lose the first one?

Lord Bichard: It is a comment really, I suppose.

The Chairman: Can we come back to that after we have dealt with the previous one, otherwise we get wreckage. You cannot answer two questions at once. Mike. Will you come back to that when we have had that one? Claire, I have forgotten your question now.

Baroness Tyler of Enfield: I think it was about—

Lord Bichard: It was meant to reinforce the question.

Baroness Tyler of Enfield: Given that this is tricky stuff for any of us to get our head around, is there a way into it that makes it real for people other than saying, “You should be getting very angry about this”, which is obviously one way of doing it?

Professor Sefton: Martin touched on the key issue when he said that we should look at the houses of old people and the transfers. That is the number one issue. Housing is the number one store of wealth. There is a strong feeling that that should be protected and that it is

their right to pass that on as an inheritance to their children by private transfer. So it is keeping it in the family rather than making it a public transfer—forcing people in some way to use that wealth towards their health and therefore saving the taxpayer money. Therefore, redistribution again to the younger generation is done through public transfers and hopefully the distributional consequences of that will be a better outcome. That is the key issue: the housing and what the housing does, because that is the major store of wealth.

Q143 The Chairman: If you are thinking about intergenerational policy, just because there are intergenerational policy effects, it is pretty obvious, is it not, that younger people will work longer than was the case ten years ago and that the state pension age will rise even further than current projections? You do not need a big guessing machine to get there. You could therefore argue that it is fairer that the current older generation have some of that consequence accelerated to them, politics apart, so that they are also contributing towards their own care. Would not another mechanism for addressing the issue be that you raise the state pension age earlier and that you push policies to increase labour participation for older workers more vigorously?

Professor Sefton: We are all in it together.

The Chairman: Yes.

Dr Weale: It is certainly true that if expenditure exceeds income there are two things you can do: one is to do with your expenditure and the other is to do with your income. Raising participation rates of old workers is a way of raising both the Government's tax revenue and the nation's income.

The Chairman: Okay. Lord Bichard, you cannot have forgotten your question?

Lord Bichard: Is it the supplementary one?

The Chairman: Whether it was supplementary or not you were clear what you wanted to ask, so do have a go.

Q144 Lord Bichard: Are there lessons that we can learn from tuition fees? You are making the point, which is absolutely right, that a lot of older people are sitting on quite a lot of wealth. We are making the point that the cost of health services, and social care in particular, is increasing. We are making the point that, in generational terms, although it is a difficult debate to have, the younger generation have probably suffered more than the older generation. Could not the same case that was made on tuition fees be made through a public debate for older people to carry more of the burden of their care? How can we do that better?

Dr Weale: No. Hearing you saying that, I was thinking of the issue of when people are expected to use their homes to pay for residential care and the sense that that was what led to the Dilnot commission. That is a politically sensitive issue. One can extend that politically sensitive issue to a wide range of other public services but, of course, that will make it more and more politically sensitive. If there were to be greater means testing or means testing of provision of a range of services you would have many more unhappy elderly votes.

Q145 Lord Bichard: No one says it is going to be easy, but we cannot leave it there. We know the politics of this are quite difficult, but the politics of tuition fees was pretty difficult, too. People always talk about means testing. They do not talk often enough about taxing because that is another way of getting to the issue that may be more acceptable. What we are trying to explore is: are we going about this in the right way? Are we framing the debate in the right way? Are we missing a trick here? It is all very well us talking to you about the fiscal consequences of an ageing population. One of the major fiscal consequences of the

Dr Weale: That is really an issue for politicians to do the engaging, not—

Lord Bichard: We are all in this together, though.

The Chairman: Just to keep score, Baroness Morgan was signalling and then Baroness Shepard. You wanted to come in with your question did you?

Baroness Shephard of Northwold: I wonder if I could come in with my question, because I do have to go at 11.30am.

The Chairman: Please do.

Q146 Baroness Shephard of Northwold: I predicted before you came that you would certainly say, when it got very difficult, “This is a job for politicians”, because actually it is. Of course it is. In what sense do you think there is not at the moment a public debate? It does seem to me that on every channel at every hour and in every newspaper and every day there is something about this issue: about how are we going to deal with an ageing population, increasing health needs and so on. I believe there is a public debate, rather as there was, shall we say, on badgers. There has been the public debate and there was a decision and today I see on the monitor there is going to be another decision. What do you do? What would you call a public debate? There is one, I think. You might be able to give advice, if not to politicians, on how to make the choices or at least how to step up the debate and make it relevant to people. I feel there is one. I feel that people will, of course, take sides according to their own interest, which voters always do, understandably. But, as

Lord Bichard said on the fees issue, in the end the Government said, “Right, that is it. We have listened to the debate”. But there was a debate. How do we do it? It was in Kayte’s submission from the IPPR that there should be a debate. How should it be done?

Kayte Lawton: What are those debates about: particular policy choices around tuition fees or how we deal with NHS? They are not sufficiently tied to a sense of what—it sounds a bit grand—our national strategic objectives are; by which I mean: what do we want to be doing as a country? We have a very difficult economy at the moment. Everyone is very aware of high levels of unemployment and those sorts of problems. Do we want to, as a country, prioritise jobs and growth? Not just as an emergency response, but over the long term, do we want to look like Sweden or Denmark, which have the highest employment rates in the world and, because of that, very dynamic economies and better living standards? I would say those are the sorts of things we should be prioritising and that means you have to make some choices about other areas of services that are incredibly popular in the short term.

It is the role of politicians, but it is also the role of people like us to make this case to politicians that they should be doing this and to set out what their priorities are and then we can have an election. If there are parties with different priorities we can choose the ones we want. When we talk about things like tuition fees I do not have the sense from politicians about where they see the higher education fitting into our priorities or where they see health spending and NHS fitting into our priorities in a long-term sense. It is all quite short term, appealing to different groups of voters. I know they have to do that and that is completely understandable, but some sense of long-term priorities—employment, jobs, living standards, things around childcare, and supporting families to deal with difficult choices—are all the kinds of things that I would be looking for those politicians to be prioritising.

Q147 Baroness Shephard of Northwold: It is interesting that you say all these things because, to my ear, that is what all politicians of all parties are saying all the time. They are talking about jobs and growth. They are talking about childcare. They are talking about long-term prosperity. They think they are doing it. I am one, but that is what they think. How can it be done better so that it is clarified for voters, because it is such a valid point? The way we take public opinion is through elections, of course. How can it be done better?

Kayte Lawton: They do talk about it, but if you look at the structures of public spending it is not set up in a way that does that. I would think, as a think-tank, that I want to be out there saying that to people and that being in the press and on the news. Then eventually, if lots of people do that, voters will be saying to politicians, “Well, you are not backing us up”. We are still having a situation where the NHS is taking up a huge amount of our budget, where benefits that perhaps are not completely focused on work and jobs and so on are taking up a lot of our spending. We are using the benefit system to plug holes in things like rents, childcare costs and low wages rather than having a proper strategic review of what is driving our costs in those areas and proper reforms to bring those costs down. All of those things are not happening. You are right, there is a gap between the rhetoric and the action, but it is probably incumbent on people like us to make those arguments to drive forward politicians in these areas.

Professor Sefton: Also, the debate has to be changed. If you look at the education versus the healthcare thing, to paraphrase slightly, people say, “I have worked the whole of my life. I should be looked after when I am old”. For young people they say, “Well, you are going to get the benefits of your education because you are going to earn more. Therefore, you should pay towards it”. Alternatively, you could say —

Baroness Shephard of Northwold: I could add, “and what is more, I did not have the chance you have”. They could add that to young people.

Professor Sefton: Or you could change the debate and say, “Look, if you are a responsible adult you should make provision for your old age, so you should be able to look after yourself. The young people are going to be the future of the country and therefore we should invest in them.” But that is not the terms of the debate. It is the former, not the latter.

The Chairman: Other comments on Baroness Shepard’s question and on Kayte’s gloss on it?

Dr Weale: I suppose the debate, as James said, is conducted in very general terms and not in the sense of what the intergenerational transfers that we mentioned a moment ago are. In an environment of generally rising prosperity, you can produce an argument that there ought to be some sort of transfers from young people to older people, but I suspect it would be harder to defend those on the scale that we have seen them. People talk about their priorities, but not very much about the implications of those priorities and who gains and, more importantly, who loses from particular choices.

Q148 Baroness Blackstone: What underlies some of this is the need for very, very substantial cultural shifts in attitudes. We are all in it together, as you said. Of course, politicians have to play a very big part in that and they have to be braver, more courageous, in some respects, but that is quite a hard question to ask them to pursue. It is also important that those who shape policy through doing the analysis and looking at the consequences of different kinds of approaches and so on try to work on these issues as well, along with journalists and the broadcast media. Asking the question, “Should there be more employment among older people”, has to be turned from, “They are going to make me go on working and I had expected to retire when I was 60”. Also, working is a very positive way of spending time in your 60s and indeed your 70s: first, you will earn some money;

secondly, you will have a lot of contact with the rest of the world; thirdly, you will have something interesting to do; and you are more likely to be healthy as a result of all of these, both mentally and physically and so on. I am just giving you one example of this.

These are the sort of issues that need to be challenged. Civil servants should be thinking about them, as well as Select Committees like this, and people should be writing about them.

It is challenging pre-conceptions about what will make for a happier and more satisfactory life, because not working at all from the day you are 59 and a half is not going to necessarily make for a happy old age. That is one example.

Dr Weale: Perhaps I may add a bit of substance to that. An interesting study in the United States showed that a change in state pension arrangements meant that a slightly younger cohort was somewhat disadvantaged. It was found—or at least the study suggested—that their mortality rate declined relative to that of the people just older than them. The author suggested that the affects you described were in place.

The Chairman: Can you send us the link for that?

Dr Weale: Yes, I can.

The Chairman: Thank you. Other comments on Baroness Blackstone's question?

Q149 Baroness Finlay of Llandaff: I should like to follow up on that. I am just reflecting on the history of the university fees debate. Initially it was kicked off, if I recall rightly, by some vice chancellors who saw their Higher Education Funding Council for England income not necessarily keeping pace with their costs and, therefore, by charging fees, that would become a way forward. In a way, the group who had a vested interest in maintaining the institution of the universities began to kick off that debate. If that is the case, as seems to often happen with these debates in politics, who would be the people who would have the vested interest in kicking off this debate along the lines that Baroness Blackstone has

outlined about working longer and shifting responsibility for old age? Would it in fact be your organisations?

Dr Weale: I was thinking you would ask the question: which generation, which cohort, would have the interest? Of course, as far as I can see, the cohort is the cohort that has a low voting rate and tends not to be very politically engaged. That, to some extent, explains the current terms of the debate.

Baroness Finlay of Llandaff: Exactly, but they are so disparate that it takes a critical mass of people coming together to begin to articulate the arguments around it.

The Chairman: I wonder if we should leave that hanging for a second and come back to Graham Tope's question. Then we have a few minutes to come back to other issues that either you want to make us think about or that we want to test you on.

Q150 Lord Tope: I just have a contribution to the last bit. It is about managing expectations. Most of our generation have grown up acquiring wealth, much of which is invested in our home, and we expect that we are going to leave that to our children or else it is going to be available for us to travel the world or whatever we want to do. We do not believe that we worked hard all our lives and acquired our homes in order to transfer that money to a care home or to our care and our children naturally are expecting that as well. To some extent it is about changing that expectation. If we have moved to assuming and accepting, fairly or otherwise, that people are going to have to pay for their university education then perhaps we need to be doing a bit more about getting people to understand about paying for their care when they are too old to look after themselves. If you look back not very many generations that was a family responsibility anyway. It is only fairly recently that that has changed.

Sorry, Chair, I will get back to my question now, which is headed, “The Scale of the Challenge”. We have probably been on that all morning. Do the UK’s past experiences of fiscal adaptations to ageing give clues about how manageable the current demographic challenge might be?

Dr Weale: One example I would give relates to the late 1970s and early 1980s. People started to worry about demographic influences on ageing and the old age pension was indexed to prices instead of wages, which obviously led to substantial savings. At the time the Government thought that people would adjust to that. They would gradually build up private savings to make up for the fact that they were getting less out of the state pension than they might have inferred.

But, in fact, at least the way I read it, the policy proved to be unsustainable so in 1997, when we had a change of Government, the new Government introduced the very popular policy of pension credit. One can see it in different ways, but in some sense that was filling the gap that had arisen because the state pension had not grown as rapidly and people had not behaved in the way that had been hoped. If you rely on people to do things for themselves and you do not help it happen then you may well get to a situation where, as then, the policy becomes politically unsustainable. Any policy does need to be very carefully handled. Not only do you need to get people to think about it well in advance but you need to have mechanisms in place to make it easy for them to do more than just worry about the implications.

Kayte Lawton: Just to follow on from that, there is an interesting point about understanding that demand for some of these big public services and cash transfers will be there regardless of how much the government of the day decides to allocate to those things. Just because public spending is cut back or we find ways to make reforms that perhaps reduce spending on things like health and pensions does not mean the demand is not there and then that gets

filled in by private spending. You can see a very close relationship between private and public spending, particularly on things like healthcare. You just have to be very aware of the kind of implications of that, both in terms of equity and also efficiency, and whether private spending is ever going to be as efficient.

There is a reason that we do some of these things publicly. It is not just because it achieves better outcomes for people in terms of equitable outcomes but also because it tends to be a more efficient way of providing these things. John Hills of LSE has done lots of work on this looking at various pension reforms. At times when Government have tried to pass on more cost to individuals than employers, that has not had the success that they thought it would do because the market is not there. The market is not willing to take some of those risks. I just think that is an important point when we are thinking about all these issues: the relationship between private and public and spending.

Tom Josephs: In terms of this scale of challenge, post-war social security spending has basically been on a pretty steady upward path, as has health spending in the UK, mainly driven not by the demographic pressures that we are thinking about for the future but other factors. Essentially social security has risen because of increases in the generosity of the system and healthcare has risen mainly because of increase in demand for better care. The pressures that we are thinking about for the future are different from the ones that we have seen over the past.

In purely fiscal terms rather than the distributional questions that you have been talking about, the adjustment that we think you might need to make over the course of the next 50 years is not a huge one, particularly if you were to do it gradually over time. The adjustment that has been made in the short term—in the medium term in the Government's fiscal consolidation plans—is much greater than the one that we are talking about for the future.

Q151 Lord Tope: In their written evidence to us the Fabian Society argued almost that: that given the scale of change since the Second World War, the scale of change to be needed is quite achievable without too much difficulty. Are you agreeing with that?

Tom Josephs: As I say, these pressures build up gradually over quite a long time period, which does mean that there is plenty of time to make these adjustments. Certainly the scale of those adjustments does not look that large compared to adjustments that have been made in the past or are being made now.

Q152 The Chairman: Is there a problem or is there not in terms of the fiscal gap because of ageing?

Kayte Lawton: I would go back to some of the points that I was trying to make about priorities. I do not think there is necessarily a huge problem about the sort of overall amount of spending that we could expect to see. The real challenge is how those demographic pressures and the rising prosperity drive the particular structure of our spending. If we look back over the last 50 years we have seen a very rapid rise in social security and overall increases in healthcare spending and at the same time defence and capital spending has been cut back, partly to pay for that. Obviously that has long-term implications that I do not think, as I said before, have been properly taken into account. The real question is how those drivers shape choices about public spending rather than a sense that there is any big fiscal gap in ageing.

Q153 Baroness Morgan of Huyton: I am on to question 9. We have gone all over the place and we have touched on some of this already. It is about the tax and benefits system. I am just wondering whether you can talk a bit more about any possible change you see that would be useful in the tax and benefit system. I am slightly wary that we say quite glibly,

“Well, it is good to increase the pension age. That will get more people working. So that is going to be good for the fiscal situation. It is good for everybody’s health”, and we do not recognise that there will be at least a body of people who cannot get jobs. We are seeing older women at the moment finding it very hard to get work and they probably will not get back into the labour market. Even if more people are able and fit for a lot longer, there is nevertheless a group who are not. Therefore, if we just automatically keep shifting the pension age up, are we then increasing the benefits bill for another group or are we just going to give up on that group?

We had a brief conversation last week about flexible retirement. Everyone says, “Yes, that is a really good idea”, but has anybody done any serious work about that and is that remotely a runner? How can we make the tax and benefit system assist people to work longer and encourage people to work longer while recognising that not everybody can do so?

Dr Weale: On flexible retirement, I cannot quote any particular study on this but I have heard people say that in countries that try and have flexible retirement nearly everyone retires at the earliest opportunity. Of course, that in part depends on the terms. I do not know of evidence to suggest that the terms on which people can defer the state pension have a significant impact on people’s decisions to go on working beyond the state pension age. More probably that is just seen as a form of financial planning. People bet on their own life expectancy or look at their parents and ask whether it will give them a good deal.

I am not sure what can be gained from flexible retirement but in some sense the issue you raised is slightly different from that. It is: how much and how generously do we support people whose health is poor and who find it very difficult to work for one reason or another; and how do we manage to do that without encouraging people who are perfectly capable of work to take advantage of that? Of course, that is the classic problem in designing a social security system. The move to the universal credit is intended to reduce some of the

distortions but there is the general problem. If you withdraw benefits only gradually then you can easily find that you need to put more money into the system. That is not unique to the issue of retirement. I would say that that is a more general problem and we do have a major policy change coming whose effects we will then be able to study.

Professor Sefton: I cannot give you the exact paper but work has been done by the IFS on the sensitivity of people to changing tax incentives at retirement or from the ages of 50 to 65. The econometric evidence is that they are quite sensitive to those changes in incentives. There is an opportunity there for various tax changes. The obvious ones are to make the contributions into the state pension more valuable when you are older. Also the tax-free limits on contributions into private pensions are already age related but you can exaggerate that relationship. You can make it more pronounced, so again increasing incentives. Again it is not going to be a massive difference, but there are at the margin things that you can do. Yes.

Q154 The Chairman: There are both fiscal benefits and there are economic benefits of more older people who can work longer in ways that they wish to rather than feeling too forced to. It is pretty fundamental in terms of how we address the benefits of an ageing population. As a crude statement that is true, is it not? There is quite a big shift to do in employer attitudes and the attitudes of some of the institutional representatives of employers who see this as, “No, we would like to get shot of them all at 65”. I am being crude, but there is not a great willingness to think that this is an important agenda. There are exceptions—some of the supermarkets—but by and large this is seen as a problem rather than an opportunity by employers. I am putting it rather crudely. That is one of the issues that has to be shifted: the attitude of employers to flexible work and longer working. That is pivotal to addressing these issues. Do you agree or not?

Kayte Lawton: Yes, I definitely agree. I have done less work on keeping older people in the labour market but there are some interesting arguments. Professor Paul Gregg makes the point a lot that there are potentially regulatory changes that you can make to improve labour supply essentially among people where that is weak at the moment—mothers, disabled people, and older people. He talks a lot about some of the maternity leave reforms where you are using regulation to encourage women to stay in the labour market—giving them the maternity rights and so on with which to do that. It is difficult to shift employers' attitudes in the sort of abstract sense but you can use smart regulations to open up opportunities for part-time work, for flexible working, for parental leave policies and so on. Over the long term they could have an impact. At the moment the politics are difficult there because of the economy and some of the political debates that we have about labour market regulation, but I do not think we should let that stop us particularly. There are some interesting avenues there.

The Chairman: Thank you.

Q155 Lord Bichard: Sorry, Chairman, and this may be completely off the wall. I just worry sometimes that we are not as imaginative as we might be. Are there ways in which we could use incentives to encourage older people, if not to be in full-time work, to be making a contribution back to society? It is, for example, quite possible to envisage a world where civil society is making a greater contribution to the care of the very old and older people who are not very old could be making a very useful contribution to civil society in that respect if they were given some incentive or some recognition for doing so. I am not sure what it might involve but we are now prepared to say to people who are not looking for work, "If you do not look for work you do not get a benefit". If you are old and you are not contributing in some way or another, maybe some penalty should be attached to that.

These debates never seem to me to take place and I wonder why. Are we using all of the incentives at our disposal to encourage older people not just to be a negative burden on the state but be a positive part of society?

Baroness Blackstone: Should we also be thinking about ways in which we can incentivise employers more? You talked about regulatory ways of doing so, but your examples were about younger women and therefore not terribly relevant to this. Are there regulatory approaches in relation to employers' behaviour with respect to older employees or are there other ways of incentivising them as well as the sort of things that Michael Bichard was talking about in relation to the elderly themselves?

Kayte Lawton: This is more for people with long-term health problems, which is often older people, but one thing off the top of my head is whether they can have some right to retention or right to return to a job in a similar way as maternity leave works: if you have a period of ill health and you need to take a number of months off your employer then is required to take you back. When people hit their crisis moments in their 50s they often drop out of the labour market and they do not come back. That is just one example. You could look at the kind of reforms that have worked in improving mothers' labour supply and look at whether there are ways in which they could then be applied to people with health problems and people who are older as well.

The Chairman: Other comments on either Lord Bichard's or Baroness Blackstone's question.

Dr Weale: I have two comments. First, of course, Lord Bichard was suggesting a range of incentives outside the normal range that is discussed. That was an interesting point.

On the issue of changing employers' attitudes, of course, we do have to wait to see the effect of the abolition of a fixed retirement age. One might think that that would be something that would be likely to change employers' attitudes and, of course, participation

rates by old people have been rising recently after a long period, down to the late 1990s when they were declining. That process has been reversed. A part of it is people thinking about how they are going to pay for retirement but I should have thought that it must also point to a slightly more sympathetic working environment as well.

The Chairman: You will be almost relieved.

Q156 Baroness Finlay of Llandaff: I thought you were just winding up on that. I was struck when you were talking, Kayte, about the expectations in society versus the age shift in society. I wonder whether you have any way of weighting the difference in the economic pressures that will be brought by the much higher expectations of the generation that is coming through now from the way that they live and the services that they should obtain versus the overall apparently lower expectations of the cohort that are currently much older.

Kayte Lawton: No, I have not done a huge amount of work on those questions about expectations. I am mainly drawing on the kind of OECD studies that look at the way in which, at the national level, income affects demand for things like healthcare relative to the impact of ageing but we have not looked much at shifting expectations. It has not been part of our work, I am afraid.

Q157 Baroness Finlay of Llandaff: My other thought was in relation to your comment that in those areas where people have been given the option of flexible retirement, they all go flexibly early. That is an all around expectation. How does one shift that expectation so that they would want to stay there for longer? There are some parts of society—the university sector in some areas is a classic—where those who have retired continue to contribute on a notional, sessional basis and probably contribute far more, particularly in the

teaching arena and mentoring. It may be one session a week but they may be running several tutorial groups and doing quite a lot and remaining active in sharing their expertise. They become very cheap in the system.

Dr Weale: Yes, I suppose I would caution against thinking that it is easy to generalise from the people who work in universities. They typically love what they are doing and want to go on doing it.

Baroness Finlay of Llandaff: There are people in healthcare who love what they are doing, even at what you would term a low level. There are some domestics who are devastated at having to retire because they love going into the hospital and working.

Dr Weale: Yes, but equally you would probably find that the proportion of people who want to carry on until they drop is higher in academics than in most other occupations.

Q158 Lord Bichard: Then you need to look for incentives to encourage them to do so if you are going to get the kind of intergenerational transfer that you have been talking about. We have a behavioural insight unit in the Cabinet Office that is supposed to be looking at how we encourage people to change their behaviour and maybe, since this is one of the biggest policy challenges that we face in this country, they ought to start turning their attention to this issue rather than some of the other things they were looking at.

Dr Weale: I should expect that the increase in the state pension age will have a very perceptible impact. With the increase in women's state pension age there were some hints that maybe participation above age 60 was rising even before the pension age went up. I do not know how far that view has survived the decision but not getting a state pension is quite an incentive to go on working.

The Chairman: Thank you very much indeed. We have had two hours of you. I think it is one of those many transcripts when we will want to look and think about what you have

been saying to us and may require us to do some more serious follow-up work on it. Thank you for your good humour in coping with us as politicians at times asking you as economists to answer questions for politicians, but that is the nature of outsourcing and how it works. It has been extremely helpful for us, even if at times probably slightly frustrating for you. Thank you very much indeed.