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The Treasury Committee

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Summary

The Chancellor of the Exchequer has taken a bold step in giving responsibility for drawing up the Government's budget forecast to an independent body, the Office for Budget Responsibility. The permanent arrangements for the Office are to be made in primary legislation later this year.

For the OBR to succeed, it will have to be, and be seen to be, independent. There are obvious challenges in ensuring the independence of a body which will produce the forecasts which the Government uses in its budget, and which will have to draw on government resources in its forecasting role.

As a minimum we recommend that the legislation should include:

- a) establishment of the OBR as an institution with its own legal personality, responsible for appointing its own staff;
- b) a requirement on the OBR to act transparently, objectively, and independently;
- c) a clear remit and set of core tasks;
- d) a requirement that the responsible select committee should have a veto over appointment or dismissal of the Chair of the permanent body and the members of the Budget Responsibility Committee;
- e) provision for a small group of non-executive directors to support the Budget Responsibility Committee;
- f) a requirement that government officials support the OBR when it is preparing forecasts;
- g) a requirement that the OBR has a right of access to the information it needs.

The legislation establishing the OBR should not require future governments to use OBR forecasts. It is possible that the power of the Government to use its own forecasts will counterbalance any incentive the OBR might have to be overly pessimistic. The OBR's reputation would suffer if it were shown that its forecasts were so significantly biased that the Government no longer considered them a reasonable base for policy-making. However, it would be a major step for Government to do this. Once the decision had been made, the OBR's credibility would be severely, and possibly terminally, damaged.

A great deal will depend on matters which cannot be provided for directly in statute, in particular the calibre of the members of the Budgetary Responsibility Committee and of the non-executive directors.

Our role in ensuring the independence of the organisation goes beyond our veto powers. Whether or not the OBR is established as a Parliamentary body, it is vital that it commands confidence across party boundaries. We will take evidence from the organisation regularly

as part of the budget process. We will intervene if we believe the OBR's independence is threatened. We expect the members of the Budget Responsibility Committee or the non-executive directors to report any concerns they have to us.

If it is to be successful, the OBR will provide clear, impartial forecasts and commentary which improve public debate. It will avoid being drawn into political controversy, even though the material it provides will inevitably be used by others in political debate.

The OBR's work should lead to greater public understanding of the purpose and limitations of the forecasting process, and realistic expectations of what it can deliver. The quality and authority of OBR forecasts can be measured over time, relative to other forecasts. Absolute accuracy is not a useful criterion.

Given the lack of institutional experience of bodies such as the OBR, and the range of views on the matter, we consider that the arrangements adopted for the permanent OBR should be subject to comprehensive review no later than five years after it is established by statute. This should include an assessment of the OBR's performance, remit and institutional accountability arrangements. In particular, we believe that the review should consider in the light of experience the case for the OBR becoming a Parliamentary body with its resources determined by a House of Commons body, such as the Public Accounts Commission.

1 Introduction

The interim Office for Budget Responsibility

1. On 17 May 2010 the Chancellor of the Exchequer announced the formation of an interim Office for Budget Responsibility (OBR), led by a Budget Responsibility Committee (BRC). The interim Committee was chaired by Sir Alan Budd, a founding member of the Monetary Policy Committee, and also comprised the economists Geoffrey Dicks and Graham Parker CBE.

2. The primary task of the interim OBR was to make two independent assessments of the public finances and the economy: one based on current policy prior to the June 2010 Budget and one at the time of the Budget, incorporating its measures.¹

3. The interim body's terms of reference also required it to:

- have a role in beginning an independent assessment of the public sector balance sheet and fiscal sustainability;
- judge whether Government policy was consistent with a better than fifty per cent chance of achieving the fiscal mandate set by the Chancellor of the Exchequer;
- provide advice to the Chancellor on the permanent OBR's roles and responsibilities, aims and objectives, and appropriate size, status and funding; and
- be accountable to Parliament for the delivery of its tasks.²

4. The interim OBR produced its pre-Budget forecast on 14 June 2010. Its Budget forecasts formed part of the Budget documents, published on 22 June 2010. On 6 July Sir Alan Budd announced he would be stepping down as head of the OBR. The OBR published its advice to the Chancellor on the formation of the permanent OBR on 12 July 2010 and the Chancellor responded shortly afterwards.³

5. This Committee was established on 12 July 2010. We immediately agreed to undertake a short inquiry into the structure of the permanent OBR. We took evidence from Sir Alan Budd and the other BRC Members at our meeting on 20 July and on 22 July from three experts in the field: Robert Chote, Director of the Institute for Fiscal Studies, Professor Timothy Besley, of the London School of Economics, and Professor Simon Wren-Lewis, of the University of Oxford. We also received 17 written submissions. In addition, we discussed the OBR in our budget hearings with Treasury officials and with the Chancellor of the Exchequer. We are grateful to all those who took time to contribute to our inquiry and particularly grateful to Sir Nicholas Monck KCB, for acting as specialist adviser.

1 Terms of Reference for the interim OBR: http://www.hm-treasury.gov.uk/d/obr_terms_of_reference_080610.pdf accessed 17 August 2010.

2 *Ibid.*

3 Ev 30

The work of the interim OBR

6. The interim OBR produced two forecasts in the run-up to a Budget which came less than seven weeks after the election. As the Chancellor described, its work is being applauded by the OECD and the IMF.⁴ The OBR's involvement in the forecast has already led to significant changes in approach, summarised in the Foreword to the pre-Budget forecast:

The first is our stress on the uncertainty of the forecasts, particularly of the fiscal forecasts. We illustrate this principally by the use of fan charts. The second is that we have based the range of fiscal outcomes around our central view of prospects. The previous Government used deliberately cautious assumptions for some key variables in its fiscal projections. We have departed from that practice and, as we have said, have used other methods to illustrate uncertainty. Finally, we have provided more detail than hitherto in relation to the fiscal forecasts. This improvement in transparency will, we hope, make it easier for commentators to understand our forecasts and should provide them with more information if they wish to make forecasts of their own.⁵

7. The OBR has also been far more transparent in the information it gives, and its explanation of its judgement. Giving evidence at the time of the June Budget, Mr Ramsden, the Government Chief Economic Adviser, told us:

it is worth stressing that what underlies all the OBR's forecasts is its commitment to transparency. I have been working on forecasting in the Treasury and the economy for 20 years and I think the OBR has made more progress on transparency in the last eight weeks than in my experience of 20 years working on forecasting and the transparency that goes with it. They have set out very clearly their assumptions and their judgments on the forecast and on the degree of rebalancing that they judge there will be.⁶

8. The interim OBR produced a Pre-Budget report and a Budget report in a very short space of time. It has increased the transparency of the forecasting process. Members of the Budget Responsibility Committee came to give evidence to us twice, and were exemplary witnesses. We wish to put on record our appreciation of the interim OBR's work, and, in particular, of the leadership given by Sir Alan Budd, Geoffrey Dicks and Graham Parker.

The current proposals for an independent OBR

9. The OBR has produced its advice on the structure of the permanent body. In summary, the OBR advised that:

- the OBR should produce forecasts for the economy and public finances;

4 Ev 30, para 2

5 OBR, *Pre-Budget Forecast*, June 2010

6 Treasury Committee, First Report of Session 2010–11, *June 2010 Budget*, Q141

- forecasts should be produced at least twice a year and include the official Budget forecast;
- the OBR should undertake broader analysis of fiscal sustainability;
- the technical independence of the OBR should be enhanced through the transfer of analytical capacity from the Treasury to the OBR;
- the OBR should employ a mix of external recruits and staff from the Treasury to produce forecasts and analysis;
- Parliament should have a role in the appointment of the members of the Budget Responsibility Committee; and
- the OBR should be located outside the Treasury building.⁷

The Chancellor broadly accepted that advice (which largely reflects proposals he made in opposition) when he set out his thinking in a letter to the Chair of this Committee published with our Report.⁸

Independent forecasting

10. The Office for Budget Responsibility was established against a backdrop of a widening public sector deficit and a related rise in public sector indebtedness following the global economic crisis and the economic downturn. There is growing academic scepticism about the objectivity of successive government economic forecasts and a lack of clarity about the full-scale of public sector liabilities.⁹ The OBR has been created to address the latter two issues.

11. The problem of how to ensure that forecasting is, and is seen to be, objective, and fiscal policy is responsible is a long-standing and difficult one. Some parallels have been drawn with monetary policy. There is a precedent for giving an independent body power to undertake economic policy functions on behalf of the Government in the shape of the MPC, which has the responsibility to conduct monetary policy in a way which ensures that the Government's inflation target is met. However, there are profound differences between outsourcing monetary policy in this way and outsourcing the forecasting process.

12. The MPC has a clear policy objective, with a measurable target and control of the instruments to achieve it. If the inflation target is breached, the Governor has to explain to the Government, the Treasury Select Committee and the public. In contrast, the OBR provides a forecast and commentary; it has no responsibility for policy on which it comments or which its work may influence internally. This requires the exercise of particular care and restraint by the OBR.

7 Advice on the Permanent Office for Budget Responsibility, http://budgetresponsibility.independent.gov.uk/d/obr_permanent_body_advice_120710.pdf

8 Ev 30

9 Ev w15, para 3 [Dr George Kopits]; Ev w6, para 3 [NIESR], Ev w10, para 11 [ICAEW]

13. Moreover, the MPC is part of an existing organisation with considerable resources, which is not directly dependent on government for those resources. The OBR is a new institution, founded at a time when spending is severely constrained, which has no existing institutional expertise on which to draw. **The previous Government wished to improve monetary policy-making by giving control of interest rates, within a policy framework set by Government, to an independent Bank of England: the current Government aims to improve fiscal policy making by giving responsibility for forecasting to an independent body. It is a bold step. However the MPC has a clear task and controls the means to achieve it. The OBR has a more complex relationship with government.**

Independent fiscal councils

14. Announcing the creation of the OBR in May 2010, the Chancellor said that the body would:

- ensure credible official economic and fiscal forecasts by removing the perceived ability of Chancellors to “fiddle the figures”;
- assess the feasibility of the Government’s fiscal targets; and
- provide an independent, objective and comprehensive assessment of fiscal sustainability.

The Chancellor argued that these measures would restrict the ability of governments to pursue unsustainable fiscal policies in future.¹⁰ In adopting this approach, the Chancellor effectively established the OBR as an independent fiscal council, a term adopted to describe a variety of bodies intended to bring some independent assessment to economic and fiscal policy.

15. Although the United Kingdom is an early adopter of the independent fiscal council, several institutions which perform some of its functions already exist. Professor Simon Wren-Lewis of Oxford University notes that macro-economists have become interested in such bodies “as a possible antidote to deficit bias: the tendency for government debt as a proportion of GDP to rise over time that has been observed in the OECD area as a whole.”¹¹ Professor Wren-Lewis has offered a range of reasons why a fiscal council might counteract this bias:

- By making fiscal positions more transparent, they may prevent governments deliberately concealing the extent of future deficits implied by current policies, or prevent governments being overoptimistic about their finances. The public may have insufficient information to differentiate between governments that are more efficient at managing spending, and those that pretend to be in order to win votes through spending increases or tax breaks. A fiscal council could help provide that information.

10 Speech by the Chancellor of the Exchequer, 17 May 2010, http://www.hm-treasury.gov.uk/press_02_10.htm accessed 17 August 2010

11 Fiscal Council’s web: see footnote 11.

- Because governments in a democracy may not be re-elected, there may be an incentive for them to discount the future heavily. [...]
- In the previous cases, if the public had full information and could discipline governments, deficit bias would not arise. An alternative reason for deficit bias is that the public may be selfish, in the sense that they attempt to exploit future generations, or they may be unable to resist immediate temptations. A fiscal council could attempt to apply political pressure on behalf of future generations, or provide moral pressure to discount the future less heavily. They may also prevent politicians pandering to these tendencies.¹²

16. Fiscal councils do not follow a single model, and vary both in their tasks, and in the degree of their separation from the executive. However, all are intended to improve economic and fiscal policy making by ensuring that there is a degree of independent technical scrutiny of the Government's proposals. An outline of arrangements for other fiscal councils is contained in Annex 1.

17. The primary function of the interim OBR was to produce the macroeconomic and fiscal forecasts prior to and alongside the June 2010 Budget. The Chancellor has confirmed that the permanent OBR will continue to produce official fiscal and economic forecasts, although he will have the right to disagree with those forecasts when making policy.¹³

18. Existing fiscal councils range from extremely small groups which are concerned with simply validating the Government's forecast and assumptions, to much larger bodies which may produce forecasts themselves, conduct economic research and publish commentary. The mix of tasks can vary widely. The US Congressional Budget Office (CBO) is the largest fiscal council. Its core work includes producing:

- a twice-yearly baseline projection of the economic and budgetary outlook over the next ten years;
- an independent estimate of the President's budget proposals, including comparison of the CBO's estimates with those of the administration;
- analysis of the spending and revenue effect of specific legislative proposals;
- an annual report on the long-term fiscal outlook; and
- an annual volume discussing the arguments for and against possible budget options.

Established under statute, the CBO assists the House of Representatives and Senate by producing "objective, nonpartisan and timely" reports and analysis. In keeping with this remit the CBO does not produce policy recommendations. Similarly, the CBO's long term projections provide a baseline which "is constructed according to rules set forth in law,

12 http://www.economics.ox.ac.uk/members/simon.wren-lewis/fc/fiscal_councils.htm#_Frequently_Asked_Questions

13 Ev 30 [Chancellor of the Exchequer]. The European Commission evidence identifies four Member States—Austria, Belgium, the Netherlands and Slovenia – where independent macroeconomic forecasts are used in the Budget process.

which generally instruct CBO to assume that current spending and revenue laws continue without change. Thus, the baseline is not a prediction of future budget outcomes. Rather, it reflects CBO's best judgment about how the economy and other factors will affect federal revenues and spending under existing laws."¹⁴ In contrast to the CBO, which received \$45.2 million in funding in 2010 and employs around 250 people, the Swedish Fiscal Policy Council consists of eight members and is assisted by a secretariat with four employees.¹⁵

19. While it is usual for fiscal councils to be concerned with making it difficult for governments to avoid or postpone necessary but unpopular decisions to stave off threats to fiscal sustainability, most fiscal councils do not themselves produce the forecast which the government uses in making its fiscal judgements.¹⁶ More often they produce an assessment of the official forecast (or an alternative forecast of their own) following its publication.¹⁷

20. Fiscal councils also differ widely in their relationship to Government and Parliament. The CBO in the US and the Parliamentary Budget Office in Canada are linked to Parliament. The Economic Council of Denmark contains representatives from many groups—unions, employers, the central bank and the Government. The Netherlands Bureau for Economic Analysis (CPB) describes itself as “a research institute that is independent with respect to content, but at the same time CPB is formally part of the central government.”¹⁸

21. There are advantages and disadvantages to every type of organisation. The simple validation model can help to reduce the danger that a fiscal council's independence may be called into question; however, given developments in recent years in the United Kingdom, it may not be enough to ensure confidence in a government's forecast. An organisation which produces the government's forecast may be felt to be too close to that government, or, conversely, may have to operate at such a distance it cannot effectively draw on government information.

22. Given these difficulties, it may be hard to design a fully independent forecasting body responsible for producing government forecasts, unless there is significant duplication of expertise between the forecaster and the Treasury. This would be costly. We note that there are many views as to the appropriate tasks for the OBR, and for its remit.

23. The Government has taken a significant step, which is not without risks, in seeking to give an independent body responsibility for the forecast. Official forecasts may influence expectations. The benefits of surrendering control over the forecast can only be achieved if the OBR's independence is beyond doubt and its competence is

14 CBO's role in the budget office: <http://www.cbo.gov/aboutcbo/budgetprocess.cfm>

15 The Council assesses the extent to which the Government's fiscal-policy objectives are being achieved. These objectives include long-run sustainability, the budget surplus target, the ceiling on central government expenditure and that fiscal policy is consistent with the cyclical situation of the economy. The council also evaluates whether the development of the economy is in line with healthy long-run growth and sustainable high employment. Additional tasks are to examine the clarity of the Government's budget proposals and to review its economic forecasts and the economic models used to generate them. Finally, the Council should try to stimulate public debate on economic policy.

16 Advice from the Interim OBR to the Chancellor para. 38

17 Eg Canada, Hungary, Sweden, US

18 <http://www.cpb.nl/eng/org/cpb/organisatie/>

established. The OBR will have to demonstrate a commitment to transparency, objectivity and impartiality over a sustained period if it is to command and retain public confidence.

24. In this Report we examine some of the ways in which the independence of the OBR can be fostered, but one key factor, for which it is impossible to legislate, will be the quality of the organisation's people, and of the work they produce. The interim OBR, led by Sir Alan Budd, made an excellent start on which the permanent body can build.

25. Like any structure for an independent fiscal council, the model that the Chancellor has chosen for the OBR has its own advantages and disadvantages. Placing the entire process in the hands of a single body ensures a clarity of process and responsibility between government and the OBR that would be lacking were there rival forecasts.¹⁹ Robert Chote argued that the OBR as constituted by the Chancellor would reinforce the ability of Treasury officials to provide objective advice to ministers.²⁰ Similarly, the OBR's direct involvement in the Budget process means it is in a more influential position during the policy-making process than it would be as an external commentator. As Sir Alan Budd told us:

the Chancellor when he is considering policies must be considering their effect on the economy and it is the OBR who tells him, as best they can, what the effect on the economy of those policies will be, so to that extent the OBR does become a very important part of the budget decision-taking process.²¹

26. Adopting the OBR forecast has meant that the OBR and the Treasury have needed to work closely together on the budget: in evidence to the Committee, Sir Alan Budd maintained:

If one of the core activities of the OBR is to produce on Budget Day a fully articulated fiscal forecast with all the detail provided in the Red Book, then the involvement of officials working in the Treasury, HMRC and DWP is absolutely inevitable. They command the detailed knowledge of the policies and programmes; they work on the policy changes, if any; and they are the experts on the effects of those policy changes.²²

Involvement in the Budget process necessarily involves close contact between the Treasury and the OBR, whilst drawing up official forecasts is likely to involve some dependence on government resources.²³ Both of these have been seen to weaken the OBR's independence and are not easily resolved, as we shall see.²⁴

19 Ev w25, para 6 [Simon Hayes]

20 Q 79

21 Q 7

22 Q 1

23 Q 1 [Sir Alan Budd]

24 Ev w15, para 12 [Dr George Kopits] or Lars Calmfors, *The Guardian*, "How it is Done in Sweden", 28 July 2010

27. There are three key interrelated factors to consider when deciding how to make sure an organisation such as the OBR is effective:

- the tasks it should undertake;
- the resources it needs to carry out those tasks;
- its institutional structure, accountability and discretion;

28. **There is no “correct” model for an independent fiscal council; each arrangement will have its own advantages and drawbacks. In this Report we do not conduct an exhaustive examination of the various ways in which a fiscal council could be structured but focus on the Government’s proposals and how they can be made to work.**

29. **The OBR’s contribution to the formulation and improvement of public policy will be made through the substance of its work, which over time, can contribute to greater public confidence in fiscal policy making. It must avoid the trap of convincing itself (and consequently convincing the general public) that it or any other body has a monopoly of wisdom on short term forecasting, which is an inherently uncertain process. The OBR can only be effective if it is independent. Our proposals are designed to strengthen the OBR’s independence, and the perception that it is independent, notwithstanding its involvement in drawing up the Government’s forecast.**

30. **The OBR should avoid being drawn into seeking to apply political pressure through its commentary—even though many commentators will encourage it to do so. The OBR, is not and should not be, running fiscal policy.**

31. **This Committee will have a key role both in holding the OBR to account and in upholding its independence. The NAO audited OBR independence at the time of the Budget and identified the following criteria by which the independence of the judgement underlying the forecasts could be judged:**

- **The Budget Responsibility Committee had full discretion over the scope and nature of its judgments on the forecasts.**
- **The interim Office for Budget Responsibility had unrestricted access to the necessary data and analysis.**
- **The interim Office for Budget Responsibility had control over sufficient resources to consider the evidence and form a robust judgment.**
- **The interim Office for Budget Responsibility effectively scrutinised, questioned and challenged the information and advice it received.**
- **The Budget Responsibility Committee formed its judgments independently of any views of officials or Ministers.**

- **The Budget Responsibility Committee had autonomy over the content of its published reports and the means of dissemination.²⁵**

We consider that these criteria provide an excellent foundation by which to judge the future OBR, and will bear them in mind in our future work.

32. In this Report we have started from the framework proposed by the Chancellor: the OBR will be a new body, and it is reasonable to see whether those arrangements can be made to work. However, given the lack of institutional experience of bodies such as the OBR, and the range of views on the matter, we consider that the arrangements adopted for the permanent OBR should be subject to comprehensive review no later than five years after it is established by statute.

33. The review should include an assessment of the OBR's performance, remit and institutional accountability arrangements. In particular, we believe that the review should consider in the light of experience the case for the OBR becoming a Parliamentary body with its resources determined by a House of Commons body, such as the Public Accounts Commission.

34. This review should be carried out by a small team of external experts, possibly commissioned by the National Audit Office, and should report to us as well as to the Chancellor. This Committee should be consulted both about the scope of the review and about the arrangements for carrying it out.

²⁵ Examination of the forecasts prepared by the interim Office for Budget Responsibility for the emergency Budget 2010, HC(2010-11) 142

2 The tasks of the permanent OBR

35. The resources the OBR will need and how it should be structured will depend on the tasks it is to carry out. The broad parameters of the OBR's remit have already been set:

- The Office for Budget Responsibility (OBR) will make independent assessments of the public finances and the economy. It will have direct control over the forecast and make all the key judgments that drive the official projections. It will have full access to the necessary data and analysis produced by the Treasury.
- The OBR will also present a range of outcomes around its forecasts to demonstrate the degree of uncertainty. Based on these range of outcomes, in each Budget and Pre-Budget Report the OBR will confirm whether the Government's policy is consistent with a better than 50 per cent chance of achieving the forward looking fiscal mandate set by the Chancellor.
- The OBR will also have a role in making an independent assessment of the public sector balance sheet, including analysing the costs of ageing, public service pensions and Private Finance Initiative contracts.²⁶

These tasks can be distilled into forecasting, assessing the likelihood that the fiscal mandate will be achieved, and commentary about the sustainability of finances. However, that still leaves considerable detail unsettled.

Forecasting

What would successful forecasting look like?

36. However sophisticated the modelling, and however accurate the data used, forecasting will always require a considerable amount of judgement.²⁷ In future those judgements will be made by the OBR rather than the Chancellor. Our witnesses warned that giving the OBR responsibility for producing forecasts will not necessarily produce more accurate forecasts. As Professor Besley said, "this organisation is bound to fail if that is the way in which we judge it, because we know that the success of short-term economic forecasting is extremely limited", and Professor Wren-Lewis agreed that "forecasts are always wrong".²⁸

37. One of the reasons for establishing the OBR was to remove both the possibility that a Government might distort the forecasts (not necessarily intentionally), and the fear of such bias. Our witnesses also pointed to the fact that the existence of the OBR could improve public and political understanding of forecasting. Forecasts are inherently fallible but the OBR should aim to avoid a bias in either direction in each forecast of the economy and of public finances. If in the event there is a bias over time, the judgement of it would depend

26 http://www.hm-treasury.gov.uk/data_obr_work.htm

27 Qq131-132

28 Q 82

on the transparency and coherence of the underlying judgements, as well as the performance of other forecasters. Mr Chote suggested that it would be “very desirable” to set out “a reasonably user-friendly way how you approach the task of thinking about economic forecasting and economic analysis”.²⁹

38. One of the ways in which we will judge whether the OBR is a success is whether there is greater public understanding of the purpose and limitations of the forecasting process, and realistic expectations of what it can deliver.

39. There should, and will certainly, be analysis of the accuracy of OBR forecasts. Their quality and authority can be measured over time, relative to other forecasts. Absolute accuracy is not a useful criterion. Persistent pessimism or optimism will become apparent over time, justifiable on the basis of published explanations and methodology.

40. We can envisage a situation in which a government argues that an erroneous forecast had led it to pursue an ill-fated policy, thereby attempting to escape responsibility for its own decisions.³⁰ The permanent OBR might therefore be considered to have an incentive to produce cautious forecasts. By contrast there is some evidence that Treasury forecasts have tended to be optimistic. This may reflect government’s incentive to “talk up” the country’s economic performance. This matters because official economic forecasts can in themselves influence economic performance, affecting business confidence, currency, stock and government debt markets.

41. The Chancellor has reserved the right to use Treasury forecasts rather than OBR forecasts if he considers it necessary. Indeed, Professor Wren-Lewis considered that if “the Treasury decides that the OBR model is wrong in some sense, I think basically then it is up to the Treasury to decide whether it wants to move to an alternative model or an alternative way of doing things whereby it produces its own forecast and does not rely on the OBR.”³¹ In such cases, the Government would have to explain and defend its decision. The need for such an explanation suggests the Government would not take such a decision lightly, without evidence, or without considering the consequences for the public perception of its commitment to independent forecasting. **The legislation establishing the OBR should not require future governments to use OBR forecasts. It is possible that the power of the Government to use its own forecasts will counterbalance any incentive the OBR might have to be overly pessimistic. The OBR’s reputation would suffer if it were shown that its forecasts were so significantly biased that the Government no longer considered them a reasonable base for policy-making. However, it would be a major step for Government to do this. Once the decision had been made, the OBR’s credibility would be severely, and possibly terminally, damaged.**

29 Q 133

30 Q 111 [Professor Wren-Lewis]

31 Q 129

42. Simon Hayes of Barclays Capital was concerned that the existence of both MPC and OBR forecasts as ‘official’ forecasts could make the communication of economic policy difficult:

If the two forecasts are materially different, it will be difficult for the authorities to argue that monetary and fiscal policy are appropriately co-ordinated. If they are engineered so as not to be materially different, it raises the question of why effort is being duplicated across two public institutions.³²

We do not consider this a problem. The MPC is charged with setting interest rates on the basis of its own economic judgement; it is appropriate for it to retain its own forecasts. Part of the rationale for the OBR is to raise public understanding of forecasting; the uncertainties and judgements in the process are demonstrated by two forecasts.

Control of models and data

43. The forecasts produced by the interim OBR used the Treasury’s models and sub models. Simon Hayes considered that the OBR should “own” macro-economic forecasts:

There is a set-up cost associated with this but it need not be an onerous one. Diminishing returns quickly set in with macroeconomic forecasting—the accuracy gains from increased sophistication are questionable beyond a basic level—and the Treasury model should provide a suitable baseline.³³

Sir Alan Budd agreed, but considered that “ownership” was not necessarily straight forward:

The OBR must be able to use the models that are required for forecasting processes. Ownership is a slightly difficult issue, I am not even quite sure how it is defined, but certainly if a model is being used to produce OBR forecasts then in that sense it must be owned by the OBR. There is not just one model, there is a suite of models, but any model which the OBR is using it must own in the sense that it knows what it contains and is responsible for its outputs.³⁴

Professor Wren-Lewis agreed that “the OBR has to be in charge of the model it uses.”³⁵

44. Several witnesses drew attention to the way in which models could be tested and reviewed by outside experts, and this is something that the permanent OBR may wish to consider.³⁶ There was general agreement that the OBR should be open about the forecasting models it used. **The OBR should have discretion in the models it uses in drawing up its forecasts. It is a matter for the organisation itself as to whether it is content to use the Treasury models, or wishes to make changes. Whatever course the**

32 Ev w25

33 Ev w61

34 Q 28

35 Q 128

36 Q 123

OBR takes, there would be benefits in it being as transparent as possible about the models it uses. The OBR should also be cautious about attempting to increase the sophistication of the model in search of dubious increases in accuracy. As many witnesses pointed out, a sophisticated model cannot remove the need for forecasters to exercise their judgement and incremental benefits to an already highly complex model may be nugatory or perverse.

45. The OBR will also need to have confidence in the data underpinning the forecasts. Many witnesses considered the OBR should be given “statutory access” to data, other than the personal data used by HMRC. As well as using existing data, the OBR may need to suggest changes to the data collected. As Mr Chote said:

I think it should be deciding what data it needs to do the job it is tasked with doing. There is an iterative process there about looking at what you have through the normal channels and then saying, “Well, actually, this could be done better. We need more, different information,” or “Is this really being approached in the right way?” That sort of relationship you have seen in the past with the Bank of England interacting with the Office for National Statistics, raising any concerns they may have there, and I think the OBR would presumably raise similar sorts of concerns if it found, for example, that it was not getting the information it thought it needed to be able to validate the social security spending forecast, to take one example. The OBR should not be at all afraid of saying, “We want more or different information,” if it is available.³⁷

In written evidence, Professor Besley noted:

Some kind of link to ONS would be useful—the Bank as you know is asked every year to comment on ONS’s performance and OBR could be given the same status both in relation to ONS statistics relevant to the conduct of fiscal policy.³⁸

The OBR should have the power to check the quality of fiscal data itself, and to request that the ONS does so. It should also be free to use any existing data it thinks fit in constructing the forecast, and to recommend changes in data collection, if it considers that this would improve the forecast or its ability to assess the likelihood of achieving the fiscal mandate. Where a recommendation may increase the overall cost of the OBR’s work, it should be required to seek an external view on the benefits and costs of the change, and report this to the Treasury and to this Committee.

Frequency of forecasts

46. There was some disagreement in the evidence we received about how often forecasts should be produced. The Industry Act 1975 requires the Government to produce a minimum of two forecasts a year. Forecasts will have to be produced with each fiscal event. In general opinion favoured two forecasts,³⁹ but it has been suggested to us that four

37 Q 124

38 Ev w33

39 Q35, Ev w33, Ev w24

forecasts a year would be worthwhile.⁴⁰ It has also been suggested that the OBR should monitor the fiscal environment between forecasts to establish how the reality is deviating from the forecast.⁴¹ In normal circumstance, we see no case for more than two forecasts a year: even if short-term forecasting were more precise than it actually is, changing tax and spending plans within year is intrinsically undesirable. While we agree with the NIESR that “expert commentary on state of the public finances should not be left to twice yearly forecasting rounds”;⁴² we do not consider that this is a task for the OBR; such commentary is already widely available. While there may be cases when sudden shocks to the economy mean it is desirable to have a further forecast, we expect that to be rare. **While forecasting will be a key task of the OBR, there is no point in devoting resources, either to increase detail or frequency, to forecasts which will have no practical application or benefits. In normal circumstances, the OBR should produce two sets of forecasts a year. An extra forecast would be desirable if there were significant monetary or fiscal policy changes or significant external shocks.**

Sustainability analysis

47. The interim OBR was given two tasks in relation to fiscal sustainability: beginning work on an independent assessment of the public sector balance sheet and fiscal sustainability and providing an initial discussion of public sector liabilities and their implications for the public finances.⁴³

48. In its advice to the Chancellor, the interim OBR proposed an annual report on the longer-term sustainability of the public finances. This would include long-term fiscal projections.⁴⁴ It would be particularly important that the organisation examine factors such as the Private Finance Initiative and pension liabilities, which some have argued may currently not be properly presented. It should consult with other interested parties before deciding how these should be represented.

49. The OBR’s engagement in this will not be without controversy. It is notable that although each year the Congressional Budget Office prepares a baseline budget, showing projections for the next 10 years, its independence is safeguarded by legal rules about how that budget should be constructed:

The baseline is constructed according to rules set forth in law, which generally instruct CBO to assume that current spending and revenue laws continue without change. Thus, the baseline is not a prediction of future budget outcomes. Rather, it reflects CBO’s best judgment about how the economy and other factors will affect federal revenues and spending under existing laws. Each summer, CBO updates its

40 Robert Barrie, Credit Suisse, Ev w15

41 *Ibid.*

42 NIESR

43 Interim OBR Terms of Reference: [HTTP://www.hm-treasury.gov.uk/d/obr_terms_of_reference_080610.pdf](http://www.hm-treasury.gov.uk/d/obr_terms_of_reference_080610.pdf)

44 Interim OBR Letter to the Chancellor, paras 34-35

baseline projections, incorporating a new economic forecast and the effects of laws that have been enacted to date in that session of Congress.⁴⁵

We also note that “in accordance with the CBO’s mandate to provide objective and impartial analysis, CBO’s reports contain no policy recommendations.”⁴⁶

50. We support the interim OBR’s recommendation that the permanent OBR should produce an annual report on the long-term sustainability of the public finances. This report should contain no policy recommendations.

Commentary

51. The terms of reference for the interim OBR required it to make a judgement on whether the Government’s policy was consistent with a better than fifty per cent chance of achieving its fiscal mandate.⁴⁷

52. Several of our witnesses argued that the new OBR should have a wider commentary and research function on fiscal sustainability, arising out of the functions outlined above. For example, Professor Besley argued for an OBR with a broad remit along the line of “safeguarding fiscal sustainability in the UK” and be able to comment on issues falling within that remit:

Taking an example from the past, had the OBR existed since, say, 2000, I would hope it would have produced commentary on some of the risks around fiscal policy with respect to the taxation that was being raised from the financial sector and that it would have felt perfectly justified to raise such an issue independently because it felt it was an important part of the outlook. To constrain artificially in any way the ability of this body to comment on what is germane to that broad objective I think would compromise its independence and compromise its institutional integrity.⁴⁸

53. The staff of the International Monetary Fund (IMF) went further than Professor Besley. They suggest that the OBR could have a role in “scoring” individual government policy and reform suggestions from non-governmental sources, including the Opposition.⁴⁹ Professor Wren-Lewis also advocated the costing of Opposition policies by the OBR; although Professor Besley and Robert Chote both expressed concern about the resource implications of such a move, which would be considerable.⁵⁰

54. There are other risks associated with an OBR with a commentary function that is too broad. The Institute for Fiscal Studies stated in its February 2010 ‘Green Budget’, and Robert Chote reiterated in his evidence to us, that the OBR should comment on whether

45 <http://www.cbo.gov/aboutcbo/budgetprocess.cfm>

46 *Ibid.*

47 Terms of Reference for the Interim OBR

48 Q 82

49 Ev w19

50 Q 86

changes to the fiscal rules were consistent with long-term sustainability. However, the Green Budget continued:

An OBR should not be tempted to offer advice on broader economic policy issues, as some of its overseas counterparts do (for example, in Sweden). The cost of commenting on broader economic policy could be getting drawn unnecessarily into conflict with other parts of the policymaking process and thereby reducing the credibility of the OBR on its key function—the production of high-quality independent fiscal forecasts.⁵¹

55. Dr George Kopits, the Chairman of the Hungarian Fiscal Council, emphasised the importance of the OBR avoiding “normative judgements or formulating policy recommendations, as this may be seen as a departure from nonpartisanship.”⁵²

56. Simon Hayes, of Barclays Capital, drew a distinction between the OBR’s becoming involved in the setting of the mandate—which he considered could impinge on its independence—and commenting on the likelihood of the Government achieving its mandate—which he considered to be desirable.⁵³ The interim OBR’s advice to the Chancellor examined this issue, but did not make a recommendation.⁵⁴ He further suggested that the OBR could promote best practice in fiscal policy.⁵⁵

57. Dr Frank Eich, of The Pensions Corporation, said that he saw an important role for the OBR in raising the quality of public debate on longer-term economic and public finance issues. Dr Eich thought that the OBR should produce work that is accessible to non-specialists and actively engage with Parliament, media and the public to improve understanding.⁵⁶

58. The OBR’s contribution to public understanding should not be confused with self promotion. This commentary function should be one of informing public debate through disseminating better understanding of fiscal policy and long-term economic trends, identifying possible risks in the structure of the economy and provision of data. Beyond any duties set out on the face of the legislation, the statute should give the OBR absolute discretion over the work it undertakes. The legislation should leave the OBR able to conduct work on the fiscal policies of political parties along the lines proposed by Robert Chote in evidence on 16 September 2010. There may be also particular subjects which the Treasury, or this Committee, consider should be examined by the OBR. We would expect the OBR to consider such proposals carefully and, where appropriate, to explain its decisions.

51 Institute for Fiscal Studies, *The IFS Green Budget: February 2010*, pp. 257-258; also Q 82 [Robert Chote]

52 Ev w15, para 9

53 Ev w24, para. 10

54 Advice from the Interim OBR to the Chancellor,

55 Ev w24, para 10

56 Ev w26, para 3 [Dr Frank Eich]

59. As an additional defence of OBR impartiality, we recommend that the OBR's core tasks should be set out on the face of the legislation.

60. A particular source of controversy is whether the OBR should comment on the Government's fiscal mandate. There were a variety of views among our witnesses and the interim OBR did not reach a conclusion.

61. Some argued that the OBR should restrict its commentary to whether the mandate was achievable and government policy consistent with it. They suggested that the Monetary Policy Committee was insulated to some extent from political controversy by the fact it was not involved in setting the inflation target and argued that the OBR could benefit in a similar way.⁵⁷ Simon Hayes was concerned that the OBR could become too closely associated with a mandate that had been adopted on its advice. This could undermine its perceived objectivity when assessing the likelihood of the mandate being met.⁵⁸

62. At the other extreme, NIESR argued that sustainability was integral to the mandate and the OBR would be best placed to assess the current fiscal mandate and manage change to the fiscal mandate itself. However they accepted this would probably involve separating the OBR from the official forecasts.⁵⁹

63. Robert Chote argued that the OBR should be able to comment on whether the mandate was consistent with short-term sustainability. However, it should stay clear of issues such as the pace of consolidation.⁶⁰

64. We agree with Mr Chote that it would be inappropriate for the OBR to have a role in setting the fiscal mandate. This should be a political decision. Once the mandate is set, any OBR commentary should be based on aggregate fiscal figures, not on individual measures.

57 http://budgetresponsibility.independent.gov.uk/d/obr_permanent_body_advice_120710.pdf

58 Ev w24 [Simon Hayes]

59 Ev w6

60 Q 82

3 Staffing and Resources

65. The staffing and resources of the OBR are closely related both to its functions and to the need to establish its independence.

66. The staffing of the interim OBR was determined by the need to produce pre and post-Budget forecasts within a very short space of time. Accordingly, the interim OBR consisted of an independent BRC heading up an organisation consisting of a secretariat of eight, based in the Treasury building and relying on government analysts.⁶¹ Sir Alan Budd and his colleagues have stated that emphatically their work was free from ministerial involvement.⁶² However, the set-up of the interim OBR is not compatible with the perception of independence required to ensure the permanent body's credibility.

The dilemma

67. The majority of fiscal councils comment externally on government forecasts or produce their own forecasts. They are not, therefore, involved in the policy-making process leading up to the publication of a Budget. The information they use is for the most part in the public domain. The staff of the council are employed entirely by the council itself.

68. The OBR is in a more difficult position. In the run up to the Budget it is producing the official forecasts for government, in the light of policy options that have not yet been settled—let alone made public. The requirements for confidentiality and access to internal government information and knowledge are therefore much higher. The question is, how to ensure these requirements are met without compromising the OBR's independence?

69. Sir Alan Budd described the dilemma as the most difficult facing the OBR. He put it like this:

If one of the core activities of the OBR is to produce on Budget Day a fully articulated fiscal forecast with all the detail provided in the Red Book, then the involvement of officials working in the Treasury, HMRC and DWP is absolutely inevitable. They command the detailed knowledge of the policies and programmes; they work on the policy changes, if any; and they are the experts on the effects of those policy changes. Of course, all their forecasts are subject to the scrutiny of the OBR, and the OBR makes all the judgments and accepts responsibility for those forecasts, but the officials are essential to the process, so the challenge, Chairman, is as follows: how does the OBR perform this task which has been allotted to it, which involves using departmental officials, whilst ensuring its independence and satisfying the world that it is independent?⁶³

61 Advice from the Interim OBR to the Chancellor, paras. 43-44, http://budgetresponsibility.independent.gov.uk/d/obr_permanent_body_advice_120710.pdf

62 See above, para 44

63 Q 1

70. Sir Alan identified around 100 staff in the Treasury, HMRC and DWP who are involved in drawing up the Budget forecasts. The Treasury has subsequently given us a breakdown of their grades and functions.⁶⁴ Sir Alan was emphatic that these posts could not simply be taken out of the Treasury, nor duplicated in the OBR:

Not only would it be a waste of money, Chairman, they could not do it because so many of these 100, the people I think of as the expert analysts, are only able to do it because they work in the departments and help produce the policies and monitor the forecasts. They are part of these departments and that is where they gain their knowledge, so if they were not there they would not be able to perform that role.⁶⁵

71. Not all witnesses have accepted this argument. The submission from IMF Staff is representative of several that call for a significant expansion of OBR staff sufficient to allow it to perform all its functions without external resources.⁶⁶ The Social Market Foundation point out that a small core organisation, such as the interim OBR, will suffer major information asymmetries when dealing with the Treasury. However their preferred proposal, an OBR with a larger core staff, but falling short of the 100 or so officials involved in the process, only restates the problem. How large should the OBR be?⁶⁷

72. Sir Alan Budd argued that it would not be cost-effective or practical to duplicate or move into the OBR all the officials who spend some of their time on the Budget forecasts. We accept that there is a trade-off between delivering the most robust independence and perception of independence and making the most efficient and effective use of resources.

73. In this chapter we look at the core staff the OBR will need; we consider the terms on which it should have access to staff within government in Chapter 4.

Core staff

74. At the heart of the OBR there should be a core of staff who are employed full time and work exclusively for the OBR. This core of staff needs to be sufficient to provide enough independent oversight of the forecasting process that the OBR can credibly ‘own’ the forecasts.⁶⁸ The core staff also need to be able to produce the annual sustainability report, undertake ‘spot-checks’ of departmental data and models and undertake other research and commentary as required, and to maintain a dialogue with other forecasters. It has also been accepted by the Treasury that the OBR should control its public relations function.⁶⁹

64 Ev 36 [HMT Supp]

65 Q 3

66 Ev W20, Para 5 [IMF]

67 Ev w10, para1 [SMF]

68 Q 30

69 Q 14

Challenge

75. If much of the information and analysis underpinning the forecast will continue to come from civil servants working within government departments, then the OBR needs to have the powers and resources to challenge the forecasts and to review the way data is collected and used in producing those forecasts. Sir Alan considered the members of the BRC had performed this task effectively themselves.⁷⁰ However, when we asked:

do you think there would be any merit in putting together a small team in the OBR who were very capable people who might even draw on highly specialist outside advice if necessary, to go in and challenge a specific piece of the forecast. Would the fact that you had a hit squad of that type act as a deterrent, because people would know that there is a very small risk that this group might descend on them if your successor concluded he was not happy with the figures he was receiving?

Sir Alan responded:

It is an extremely interesting idea. At the moment we are the hit squad and we have others who assist us in this role. It might be helpful to augment our role in one way or another but perhaps I will ask my colleagues what they think.

Mr Parker: I very much agree. We already do that.⁷¹

76. The core staff of the OBR should be sufficiently large to support an investigative team which would be able to go into a department and scrutinise the data a department used or the way a particular part of the forecast had been drawn up. The OBR should also have sufficient resources to hire outside contractors to look into particular aspects of the forecast data.

77. Section 156 of the Finance Act 1998 gives the Comptroller and Auditor General a right of access to all relevant Government documents he may reasonably require to carry out his audits of budget assumptions, and the right to have explanation of those documents. We recommend that, with the exception of material related to individual taxation, the OBR should have similar rights of access to all relevant documents.

Forecasters

78. Sir Alan Budd in his evidence suggested there were three compiling and co-ordinating posts that he would like to see moved to the OBR permanently. Graham Parker said he would like to see slightly more of those posts moved over:

[...] there are people in the Treasury who do spend the great majority of their time on forecasting issues, and it probably makes sense for them to be in the OBR. They do not just compile, they do not just add up numbers; they also perform the same kind

70 Q 19

71 Q 19

of challenge function that we are going to do in this forecast and already have done that.⁷²

79. The Treasury's memorandum identifies ten officials who spend a majority of their working time on the June forecasts. The amount of time spent on the forecasts, along with the nature of their role (being the centre of expertise on forecasting) suggests these are the posts whose status *vis a vis* the OBR is most important.⁷³

80. There are then a further 20 HM Treasury staff who spend approximately 50% of their time on economic analysis and issues. Professor Wren-Lewis told us that the OBR would not have special expertise in macroeconomic forecasting compared to the forecasts produced by the Bank of England and others and argued that the OBR should focus its resources on fiscal forecasting and sustainability issues.⁷⁴ The OBR will certainly need macroeconomic expertise, not least to satisfy itself that the material provided to it is satisfactory. However, providing the BRC is satisfied it has the expertise it needs, many of these posts might remain in the Treasury.

81. A total of 30 Department of Work and Pensions staff are involved in the forecasts. We do not consider that these posts need to be under the direct control of the OBR. Indeed it is unlikely that the necessary expertise could be built up outside DWP. As long as the OBR has the staff needed to enable it to challenge departments' forecasts, and, when necessary, check the underlying data, these posts should remain within the DWP.

Research functions

82. Although we do not consider the OBR should have the leading role in economic research which some of our witnesses suggested, it is clear that it will need some sort of research function, both to ensure that the economic models and sub-models used to produce the forecasts are as good as possible, and to help in its wider role. Not all this research need be conducted in-house, but some sort of research budget will be needed. A specific member of OBR staff should be responsible for directing the organisation's research programme.

Staff numbers

83. Although many of those who submitted evidence called for the OBR to have adequate staff resources (and in one case, "a substantial executive staff")⁷⁵, few of our witnesses quantified the numbers required. However, drawing upon international comparators, Professor Besley thought that a "team of around 20 economists in total would be enough to establish an esprit de corps, to cover relevant expertise etc."⁷⁶ Professor Simon Wren-Lewis suggested that between 20 and 30 staff would be reasonable. As he said:

72 Q 11

73 Ev 36 [HM Treasury Supp]

74 Q 106

75 Directorate General EU

76 Ev 33

You are never going to match the resources which the Congressional Budget Office have; I think they have between 200 and 250 personnel, but they do a lot more than we are thinking the OBR will do. So I would have thought 20–30 is a reasonable number.⁷⁷

84. The model chosen by the Chancellor means that the OBR will not be the full time employer of many of the people supplying information and analysis which it will, after challenge, use in making its forecasts. Nevertheless, the permanent OBR will need to be larger than the interim organisation, and to command more resources. It will also need to be able to draw on expertise within the Treasury, the DWP and HMRC. We do not attempt to suggest precise numbers for core staff, as the OBR might choose to hire people for specific tasks, or contract out some research, but note that in addition to the 10 Treasury staff whose functions should move to the OBR, we have also identified a need for a research director, macroeconomic expertise, and some sort of investigative team to ensure data are properly used. The BRC must be confident that the OBR has the core staff it needs. The safeguards over funding we propose in paragraph 112, and the independent directors we propose in paragraph 96, should ensure that any concerns are raised with us as part of its budget procedure, as outlined by Mr Chote on 16 September.

Duplication

85. We accept that the Treasury may wish to replace some of those staff who we propose should be moved to the OBR. Given the limited number of posts involved, we consider that the advantages of independence are well worth the costs of any duplication. The staffing of the OBR should be one of the subjects examined in the five year review we recommend.

4 Independence

The importance of independence

86. Our witnesses all stressed the importance of the OBR being independent and being seen to be independent. Sir Alan Budd was emphatic in his belief that the interim OBR had achieved complete independence from ministerial involvement in the production of its forecasts. In his view “That is what matters and it is essential that that is achieved and demonstrated to be achieved.”⁷⁸

87. There has, however, been scepticism about the OBR’s independence in some quarters since it was created, particularly following the controversy regarding public sector employment forecasts in early July 2010.⁷⁹ As Dr Kopits indicated in his evidence, the substance of these concerns are less important than the fact they exist:

there cannot even be a scintilla of doubt in the eyes of the public about the OBR’s independence and impartiality, as negative perceptions may undermine the OBR’s reputation from the outset, requiring a major effort at changing such perceptions. It is for this reason that the recent editorials and comments in major newspapers expressing suspicion—regardless of the facts—about the impartiality of BRC need to be addressed in the statute enacting the OBR.⁸⁰

88. A substantial challenge to ensuring that the OBR is both independent and seen to be independent is the potential conflict between its two roles: on the one hand a watchdog for fiscal sustainability and on the other providing the forecast the government will use to draw up the Budget.⁸¹ This is intimately connected to the issue of staffing and resources, which we have already examined. In this chapter we focus on the structure, powers and constitutional status of the organisation.

Status

89. As the Institute for Government (IfG) has indicated, the different structures of arms-length public sector bodies are a complex and confused area. There are nearly 800 such bodies, divided into at least 11 categories.⁸²

90. Witnesses differed on what they considered to be the appropriate status for a permanent OBR. Broadly their suggestions fell under three headings: a non-ministerial department, an independent public interest body, and a Parliamentary body:

- The most relevant example of a non-ministerial department is the UK Statistics Authority (UKSA). The UKSA was established by the Statistics and Registration

78 Q 74

79 See para 124

80 Ev w17, para 11

81 Q 1 [Sir Alan Budd]; Ev w20, para 1 [Professor Matthew Flinders]

82 Ev w1, para 4 [Institute for Government]

Services Act 2007. Ministers are responsible for the statutory framework within which the UKSA operates. However, the Authority reports directly to Parliament on the exercise of its functions, primarily through the Public Administration Select Committee (PASC). Unlike most non-ministerial departments it does not report to ministers. The Chair of the Authority is subject to a pre-appointment hearing by PASC.⁸³ While Ministers do not control the Authority or clear its publications they act as a conduit for formal communications with Parliament.

- An alternative model was suggested by the IfG. They suggested a rationalisation of arms-length bodies into four categories: constitutional bodies, independent public interest bodies, departmental sponsored bodies and executive agencies. They proposed the features of a public interest body as being the most suitable for the OBR. These features are: Parliamentary approval rights in relation to appointments, direct accountability to Parliament for decisions taken with its statutory framework and Parliamentary protection for its budget and from governmental override of its decisions.⁸⁴ Sir Alan Budd endorsed the features of the Institute's model in his evidence to us.⁸⁵
- The third option is that of an Independent Parliamentary Body, along the lines of the Electoral Commission or Independent Parliamentary Standards Authority. This body could be directly accountable to Parliament through a parliamentary Committee, which would answer to the House as a whole for its activities. Its budget would be set by an appropriate House of Commons body rather than the Treasury.⁸⁶

91. As Professor Flinders observed, the appropriate status of the OBR is closely related to its remit. An independent parliamentary body would be well suited to an OBR whose role was that of an external fiscal watchdog.⁸⁷ However, it is difficult to reconcile this model with an OBR whose primary functions include developing forecasts *for* government in order to inform decisions taken *by* government. While we are drawn towards clarity of the model proposed by the Institute for Government, we accept that the model chosen for the OBR may well be a hybrid, designed to ensure the organisation's independence, while allowing it to work closely with the government on the forecast, and minimising duplication of functions. **The body should have the maximum independence possible. It should operate from offices outside the Treasury and have its funding secured by the measures set out in paragraph 112. We believe the best structure for this would be to have the OBR established as a Non Ministerial Department. The Statistics Authority offers a useful model of how such a department can function. It is roughly the size we envisage for the permanent OBR (or even smaller), with 27 staff—23.6 full time equivalents. While a Non Departmental Public Body could be established in ways which maximised its independence, it would appear to be linked to the Treasury**

83 Ev w4, para 1, and Ev w5, para 7 [UKSA];

84 Ev w2, para 2 [Institute for Government]

85 Q 37

86 Ev w22, para 1 [Professor Matthew Flinders]

87 Ev w21, para 4 [Professor Matthew Flinders]

because of the Estimates process, and there would be inevitable doubts about its independence.

Structure

92. The interim OBR was headed by a Budget Responsibility Committee, consisting of the Chairman and two members, one with a macroeconomic background and one with a public finances background. The advice from the interim OBR endorsed this model and it is to be adopted for the OBR in the near term, although the contents of the legislation are not yet known.⁸⁸

93. Robert Chote endorsed having one macroeconomic forecaster and a fiscal forecaster, but he also stressed the need for the BRC as a whole to have effective communication skills and political awareness.⁸⁹ NIESR stressed the importance of at least one BRC member having direct experience of fiscal forecasting, to ensure its ability to challenge the Treasury.⁹⁰ In contrast, the ICAEW suggested that “to avoid group-think” the OBR should contain “at least one individual who is not an economist, but has expertise in public finances, accountancy and fiscal sustainability issues.”⁹¹

94. We agree with the Government’s assumption that the BRC should have three executive members, including its Chairman, reflecting the balance of skills required to undertake the OBR’s functions. Although it will be essential for the Committee to contain respected economists, as the ICAEW suggests, other skills may also be appropriate. While the organisation will not have any direct political role, the BRC should have sufficient political awareness to avoid involvement in political controversy.

95. Whilst there was general approval for the three-person BRC model, some witnesses wanted it to be subject to the scrutiny of non-executive board members. Professor Wren-Lewis argued for a larger, supervisory board, comprising non-executive members with experience in the OBR’s areas of expertise. On Professor Wren-Lewis’ model this board would provide a supervisory function and could undertake the appointment process for the BRC Chairman.⁹² Professor Besley supported this approach, suggesting that such a board could offer some protection to a future OBR Chair who became drawn into political controversy.⁹³ Professor Flinders suggested that at least one board member should be recruited from outside the United Kingdom or have international experience of fiscal forecasting.⁹⁴ A comparable structure might be the UK Statistics Authority, which has a board comprising three executive members and four non-executive members.⁹⁵

88 Ev w30, para 7 [Chancellor of the Exchequer]

89 Q 140

90 Ev w6, para 5

91 Ev w11, para 2

92 Q 88, Q 134

93 Q 136

94 Ev w22, para 3 [Professor Flinders]

95 Ev w5, para. 6 [UKSA]

96. The permanent OBR should also have a small group of non-executive directors, containing two or three people working on a *pro bono* basis, with a senior non-executive director, drawn from those with considerable experience in relevant fields, such as the Treasury forecasting, the Bank of England or the private sector, and at least one should have had some forecasting experience. Previous political experience should not necessarily be a bar to appointment.

97. The non-executives should not be involved in the forecasting process. Their primary role should be to safeguard the independence of the OBR and they should have a duty to warn this Committee of anything which appears to threaten that independence, including any questions about resources. They should be available to advise to the Chair and members of the BRC, and, if necessary, the Treasury Committee.

Appointment and dismissal

98. Sir Alan Budd told us that the independence and quality of people appointed to the BRC would be crucial to establishing the OBR's credibility, especially early in its existence when the organisation does not have a long track record behind it.⁹⁶

99. The Chancellor of the Exchequer proposes that the Chair of the BRC will be appointed on a five-year term, renewable once. In evidence to us on the June Budget, the Chancellor told us the appointment would require the agreement of this Committee. In that evidence session we pressed him as to whether the Committee would have a veto over the dismissal of the Chairman of the BRC. After initial hesitation, the Chancellor has accepted that he should only be able to dismiss the Chairman in exceptional circumstances and with the agreement of this Committee.⁹⁷

100. Other members of the BRC will also be appointed on five-year terms, renewable once. The Chancellor proposes that these posts should be subject to pre-commencement hearings by this Committee, similar to those undertaken for Monetary Policy Committee members.⁹⁸

101. The Chancellor's proposal to give a Committee a veto on an appointment is, to our knowledge, unprecedented. The idea was broadly welcomed by our witnesses.⁹⁹ However, Professor Flinders raised a number of concerns, including the implications for other appointments. In particular he argued that too close an involvement by this Committee ran the risk of politicising the appointment, particularly where there was disagreement between the Chancellor and Committee on an appointment. He cited the political fallout following the recent pre-appointment hearing for the Children's Commissioner as an example of the possible dangers. He was of the view that *members* of the BRC should not be subject to a hearing by this Committee.¹⁰⁰

96 Q 50

97 Ev 30, para 11 [Chancellor of the Exchequer]

98 *Ibid.*

99 For example, Q 5

100 Ev w23, paras. 18-22

102. We understand the risks of politicisation raised by Professor Flinders. However, these risks are lower in a situation where the appointment can only go ahead on the basis of a consensus between the Government and this Committee. In the case of the Children's Commissioner, the political fall-out resulted primarily from the then Government's decision to press ahead with the appointment despite the Committee's opposition to it.

103. Several of our witnesses stressed the importance of the BRC having a range of skills sufficient to cover its remit and perform its duties effectively.¹⁰¹ Indeed Robert Chote suggested that the hearings should look at the BRC as a whole, rather than individual members.¹⁰²

104. This Committee has successfully established a process of hearings for Monetary Policy Committee members by restricting its judgement to the preferred candidate's personal independence and professional competence. **We consider that to avoid the politicisation of the BRC's role, candidates should be judged against clearly defined criteria. We intend to use the criteria of personal independence and professional competence as the basis for our hearings with BRC members.**

105. In evidence the Chancellor told us that if we thought it appropriate, the Committee's power to veto a candidate:

will be put in the statute which I propose to present to Parliament later this autumn because I want there to be absolutely no doubt that this is an independent body, that this person has the support and approval of the Treasury Select Committee in undertaking that work, that they come here to give evidence.¹⁰³

106. There is a risk that rejection of a candidate could precipitate a crisis. One way to reduce both that risk and the risk of politicisation would be to give the Committee Chairman and the senior member from the largest opposition party¹⁰⁴ the right to some involvement in recruitment, including the right to ask questions, but not to vote. Such involvement would mean that the two Committee members would be able to brief the Committee on the successful candidate's credibility, and reduce the risk that a well qualified candidate might be rejected by the Committee. It would also give the Chancellor and the Committee early warning if a particular candidate was likely to be regarded with scepticism by the Committee. The Committee should also have access to the successful candidate's application papers, on a confidential basis, and this should be made clear when the post is advertised.

107. We support the Chancellor's proposals for a "double lock" on the appointment and dismissal of the OBR Chair. We should also have the right to veto other BRC executive members proposed by the Chancellor.

101 See para 93.

102 Q 140

103 HC (2010-11) 350, Q 213

104 Assuming the Committee retains a government chair.

108. While we welcome a statutory role for the Committee in the appointment and dismissal of the Chair of the Budget Responsibility Committee, the relevant provisions will have to be carefully drafted to ensure that the legislation does not purport to dictate parliamentary proceedings, or expose them to judicial review.

Finances and back-office support

109. The Statistics Authority told us that “on grounds of financial economy and efficiency, the Authority shares various IT, finance, procurement and human resource systems with the ONS”. We do not object to the OBR operating a similar fashion. However, **the OBR needs to have full control over its communications, and this function should not be shared with the Treasury press office.**

110. The OBR needs to have enough resources to carry out its statutory duties well, but not so many that it increases the sophistication of its work with diminishing marginal benefit or uses its discretion to expand the scope of its work beyond its statutory remit and the views expressed in this report. In addition it is essential that the Treasury should not be able to starve the organisation of resources, either through restricting its ability to draw on Treasury resources during the time of the forecast, or through restricting its funding. The OBR’s budget should be set on a rolling five year basis.

111. It is possible that the OBR will feel at some stage that it does not have enough resources. If this were to happen, we propose that the OBR should first get an outside opinion on the reasonableness of its existing costs and the benefits that additional resources would make possible. It should also seek the views of the non-executive group one of who would need to have had experience of economic analysis and its costs. It would then report the results of this consultation in writing to the Treasury and to us.

112. If the OBR is not to be a fully Parliamentary body, it needs transparency in the resources it is given, and the House needs to know the Government’s proposals in time for intervention to be effective. To that end we recommend:

- **the OBR budget should be given its own line in the estimates;**
- **that budget, accompanied by an explanatory memorandum prepared by the OBR itself, should be sent to the Treasury Committee in confidence at least six weeks before the Estimate is laid.**

These measures will allow us to ensure that the BRC and the non-executives are content with what is proposed. They should have a duty to raise any concerns they have with the Committee.

Relationship with the civil service

113. If the OBR is to be a small organisation, with some links to the Treasury, at least in terms of drawing on Treasury staff to make the forecast, then there is merit in the *staff* of the organisation being civil servants, although members of the Budget Responsibility Committee should not be. Although we think it is essential that the OBR should have its own ethos, it would be unrealistic to expect that many people would wish to make their entire careers there. Not only will it begin by importing those Treasury officials responsible for coordinating the forecast, the Treasury is likely to have a pool of expertise which the OBR may wish to draw on in the future. Moreover, the Treasury itself could benefit from

staff who had experience of working within the OBR. Classifying OBR staff as civil servants would make such interchange easier.

114. Although there is a case for the staff of the OBR to have the status of civil servants, and we accept that initially many of them will be drawn from the Treasury, the staff of the OBR should not be restricted to career civil servants. We would like it to draw expertise from many different sources. Dr Kopits told us:

in Hungary, open recruitment by the FC over a three-month period resulted in a substantial staff, drawn from the private sector (including academic professionals), the central bank, and government (including the Finance Ministry). It has been truly surprising the speed at which these young professionals (aged between early 20s and early 40s) have been ready to produce solid analytical work¹⁰⁵

115. **While we accept that there is a case for those employed by the OBR to be civil servants, we consider that the OBR should have sole responsibility for hiring and firing its employees. Although many of its staff may come from within the civil service, it should draw its staff from as wide a range of sources as possible.**

116. Even if the OBR has control over those who work directly for it, nearly 100 people within the civil service will be involved in drawing up the forecasts. **There need to be structural assurances that the officials who remain in government are giving the OBR full and objective advice, and cannot be subject to pressure from the Treasury or other departments. First, their annual appraisals should contain an explicit OBR comment on the way they have performed their forecasting tasks. Second, such officials should have the duty to raise any concerns they have with the BRC or with the non-executive board, just as civil servants generally have the right to raise matters with the civil Service Commissioners. If there were widespread concerns about the objectivity of the data or advice fed into the forecasts from within Government, we too would expect to be informed and we would not hesitate to intervene.**

Formalising the relationship

117. Although the measures above should do a great deal to ensure that the OBR has the power and resources it needs, **the relationship between the OBR and government departments should be set out clearly in formal memoranda of understanding between the OBR and departments it deals with: those memoranda should make it clear that during forecasting periods the OBR has the right to control the forecasting resources of government and that such staff have a duty to give the OBR full and objective advice.**

118. The Ministerial Code requires Ministers to “be mindful of the Code of Practice for Official Statistics, and notes that observance of the Code is a statutory requirement on all organisations that produce National Statistics in accordance with the provisions of the 2007 Act”. **The Ministerial Code should be amended to require Ministers to respect the**

105 Ev w17, para 6

OBR's independence and to note that during the forecasting periods the OBR has the right to control the forecasting resources of government.

The role of the NAO

119. At the time of the Budget, the NAO produced an “Examination of the forecasts prepared by the interim Office for Budget Responsibility for the emergency Budget 2010”.¹⁰⁶ This was because the Finance Act 1998 gave the NAO the task of examining and reporting on conventions and assumptions underlying the fiscal projections submitted by the Treasury for examination. As the Comptroller and Auditor General said:

Until there is a statutory basis for the new arrangements, my duties under the 1998 Finance Act remain. To reflect the interim arrangements, the Chancellor has requested that I undertake an examination with the following scope:

To consider whether key economic and fiscal assumptions underpinning the interim Office for Budget Responsibility's forecasts were independently arrived at.¹⁰⁷

The legislation establishing the permanent OBR will have to deal with the organisation's relationship with the National Audit Office. **We consider that the establishment of the OBR means that provisions of the Finance Act 1998 requiring the NAO to audit budget assumptions are no longer necessary. However, the OBR should be subject to the same sort of NAO scrutiny as any other part of government.**

¹⁰⁶ HC(2010-11) 142

¹⁰⁷ HC(2010-11) 142, Statement of responsibilities, paras 2-3

5 Conclusion

Legislative framework

120. The Treasury's task is now to prepare the legislation setting up the permanent OBR. As a minimum we recommend that legislation should include:

- a) establishment of the OBR as an institution with its own legal personality, responsible for appointing its own staff;
- b) a requirement on the OBR to act transparently, objectively, and independently;
- c) a clear remit and set of core tasks;
- d) a requirement that the responsible select committee should have a veto over appointment or dismissal of the Chair of the permanent body;
- e) provision for a small independent group to support the BRC;
- f) a requirement that Government officials support the OBR when it is preparing forecasts and that they have a duty to give the OBR full and objective advice;
- g) a requirement that the OBR has a right of access to the information it needs;
- h) a requirement for a review of the organisation five years after it is established.

We have not set out in detail how these might be accomplished.

121. In preparing this Report we have become aware of some anomalies in the current legislative framework relating to fiscal forecasting. The framework for government economic decision-making is still governed by the Code for Fiscal Responsibility, any revision of which requires approval by the House of Commons. The Code should have been revised as a consequence of the Fiscal Responsibility Act 2010, but although the necessary Order was laid, no steps were taken to approve it. The Code for Fiscal Responsibility requires a Pre-Budget Report, a Budget Report (containing an economic and fiscal projection) and other fiscal reports to be published by the Treasury. The Treasury should bring forward a revised Code for approval to ensure the OBR has control of the publication of its forecasts. It should also, if necessary, reflect changes in primary legislation and any changes to the way Government proposes to make its fiscal reports to Parliament.

Non statutory measures

122. While the statutory measures set out above will provide a framework within which the OBR can operate independently, its independence will also depend on the way in which it is perceived. The Budget Responsibility Committee has a difficult task. There are fiscal councils, such as the CBO in the US and the Parliamentary Budget Office in Canada which are clearly Parliamentary in remit, and which do not produce forecasts for the government, but produce independent forecasts and analysis for Parliamentary use. There are also

councils such as the Swedish Fiscal Policy Council, which produce their own analysis, and review government forecasts and the models used to produce them. To avoid any perception of bias, staff of the Hungarian Fiscal Council cannot move between the Fiscal Council and the Treasury or National Bank on secondment. Such councils are clearly independent, but do not necessarily and directly increase confidence in the Government data.

123. There are organisations which produce forecasts for Government. However, we note that the CPB, the Netherlands Bureau for Economic Policy Analysis, has a staff of over 170. The Belgian Federal Planning Bureau has a staff of about 100. There must be a risk that the relatively small size of the OBR and its close involvement in producing material for government means that it will not be seen as independent. We hope the difficulties are not insuperable. The CPB is “independent with respect to content, but at the same time CPB is formally part of the central government.” It has existed since 1947. **If the OBR is to be credible, members of the Budget Responsibility Committee will need not only to be independent but to demonstrate that independence from the Government’s own Treasury team.**

124. Forecasts can become embroiled in party political controversy. The use made of the OBR’s employment figures earlier this year, when, in response to a leak of an internal Treasury document, the OBR brought forward the release of its own employment projections, is an illustration. It is unfortunate that the OBR’s figures were released shortly before Prime Minister’s Questions. The OBR has now agreed a standard time to release its documents, but there are wider lessons. **Although the forecasts will be produced by a nonpartisan body, the future path of the economy is the subject of intense political debate. The OBR’s forecasts will inevitably be used in that debate. To preserve its reputation for political impartiality, it is essential that the OBR takes all reasonable steps in the presentation of its words to inhibit them from being misused or misrepresented.**

The Committee’s role

125. **The current proposals for the OBR envisage that this Committee will have a role in controlling both the appointment and the dismissal of the Chair of the OBR. Our role in ensuring the independence of the organisation goes beyond that. Whether or not the OBR is established as a Parliamentary body, it is vital that it commands confidence across party boundaries. We will take evidence from the organisation regularly as part of the budget process. We will intervene if we believe the OBR’s independence is threatened. We expect the members of the Budget Responsibility Committee or the non-executive directors to report any concerns they have to us. Only if it is independent will the OBR be successful.**

Success criteria

126. It will be useful if we put forward some criteria for judging the success of the OBR. **The most important sign of the OBR’s success will be that it establishes and retains a reputation for independence and impartiality. While its forecasts and publications**

should improve political debate, the organisation itself will be under pressure to be drawn into partisan disputes.

127. There are other criteria for success, which should also increase the perception of the OBR's independence. Although the criteria may develop further over time, these may help the permanent OBR in its early decisions and will also be relevant to the 5 year review of the OBR's performance, remit and institutional accountability arrangements which we have recommended earlier. Almost all of the criteria have been met by the work of the interim OBR.¹⁰⁸

128. Absolute accuracy of short-term forecasts should not be among the criteria, as forecasts are inherently fallible whether or not they are, in the Chancellor's words, "fiddled". The OBR should not slip into believing, or encouraging others to believe, that it has some unique access to reliable knowledge of the future. **But an important criterion is that the OBR should seek to avoid significant bias over time in its forecasts, its assessment of trend growth, or its judgements about the probability of the government's mandate being met on the policies announced.**

129. **The work of the OBR needs to achieve and retain a high professional standing through objectivity and transparency and by testing the models it uses and its analysis, including work on the long term balance sheet, with outside economists. The OBR should not seek extra resources, either to extend its economic analysis or to get new data, beyond the point at which the benefits can be clearly seen to justify the costs.**

130. **The OBR's reports should be comprehensible to non-experts, like the output of the interim OBR, and suitable for use in public debate. Its work should improve the quality of that debate. But the OBR should not itself run education campaigns.**

131. The OBR should give priority to the remit specified in the legislation. It should have sole discretion in deciding whether to undertake other work proposed by others.

132. **There are significant risks facing any new organisation. The approach put forward by the interim BRC avoids the risk that the forecaster will lack information available to Government, or that there will be wholesale duplication of resources. It does, however, increase the risk that the OBR will not be seen as independent, and this could undermine the potential gain from this reform: increased trust in the forecasts used in government policy making. We will scrutinise this carefully.**

¹⁰⁸ The exception is control over the dissemination of its forecasts; we presume the OBR forecast appeared with the Budget itself because of the current requirement for the *Treasury* to publish forecasts.

Conclusions and recommendations

The Interim OBR

1. The interim OBR produced a Pre-budget report and a Budget report in a very short space of time. It has increased the transparency of the forecasting process. Members of the Budget Responsibility Committee came to give evidence to us twice, and were exemplary witnesses. We wish to put on record our appreciation of the interim OBR's work, and, in particular, of the leadership given by Sir Alan Budd, Geoffrey Dicks and Graham Parker. (Paragraph 8)

Independent forecasting

2. The MPC has a clear policy objective, with a measurable target and control of the instruments to achieve it. If the inflation target is breached, the Governor has to explain to the Government, the Treasury Select Committee and the public. In contrast, the OBR provides a forecast and commentary; it has no responsibility for policy on which it comments or which its work may influence internally. This requires the exercise of particular care and restraint by the OBR. (Paragraph 12)
3. The previous Government wished to improve monetary policy-making by giving control of interest rates, within a policy framework set by Government, to an independent Bank of England: the current Government aims to improve fiscal policy making by giving responsibility for forecasting to an independent body. It is a bold step. However the MPC has a clear task and controls the means to achieve it. The OBR has a more complex relationship with government. (Paragraph 13)

Independent fiscal councils

4. The Government has taken a significant step, which is not without risk in seeking to give an independent body responsibility for the forecast. Official forecasts may influence expectations. The benefits of surrendering control over the forecast can only be achieved if the OBR's independence is beyond doubt and its competence is established. The OBR will have to demonstrate a commitment to transparency, objectivity and impartiality over a sustained period if it is to command and retain public confidence. (Paragraph 23)
5. In this Report we examine some of the ways in which the independence of the OBR can be fostered, but one key factor, for which it is impossible to legislate, will be the quality of the organisation's people, and of the work they produce. The interim OBR, led by Sir Alan Budd, made an excellent start on which the permanent body can build. (Paragraph 24)
6. There is no "correct" model for an independent fiscal council; each arrangement will have its own advantages and drawbacks. In this Report we do not conduct an exhaustive examination of the various ways in which a fiscal council could be structured but focus on the Government's proposals and how they can be made to work. (Paragraph 28)

7. The OBR's contribution to the formulation and improvement of public policy will be made through the substance of its work, which over time, can contribute to greater public confidence in fiscal policy making. It must avoid the trap of convincing itself (and consequently convincing the general public) that it or any other body has a monopoly of wisdom on short term forecasting, which is an inherently uncertain process. The OBR can only be effective if it is independent. Our proposals are designed to strengthen the OBR's independence, and the perception that it is independent, notwithstanding its involvement in drawing up the Government's forecast. (Paragraph 29)
8. The OBR should avoid being drawn into seeking to apply political pressure through its commentary—even though many commentators will encourage it to do so. The OBR is not, and should not be, running fiscal policy. (Paragraph 30)
9. This Committee will have a key role both in holding the OBR to account and in upholding its independence. The NAO audited OBR independence at the time of the Budget and identified the following criteria by which the independence of the judgement underlying the forecasts could be judged:
 - The Budget Responsibility Committee had full discretion over the scope and nature of its judgments on the forecasts.
 - The interim Office for Budget Responsibility had unrestricted access to the necessary data and analysis.
 - The interim Office for Budget Responsibility had control over sufficient resources to consider the evidence and form a robust judgment.
 - The interim Office for Budget Responsibility effectively scrutinised, questioned and challenged the information and advice it received.
 - The Budget Responsibility Committee formed its judgments independently of any views of officials or Ministers.
 - The Budget Responsibility Committee had autonomy over the content of its published reports and the means of dissemination.

We consider that these criteria provide an excellent foundation by which to judge the future OBR, and will bear them in mind in our future work. (Paragraph 31)

10. In this Report we have started from the framework proposed by the Chancellor: the OBR will be a new body, and it is reasonable to see whether those arrangements can be made to work. However, given the lack of institutional experience of bodies such as the OBR, and the range of views on the matter, we consider that the arrangements adopted for the permanent OBR should be subject to comprehensive review no later than five years after it is established by statute. (Paragraph 32)
11. The review should include an assessment of the OBR's performance, remit and institutional accountability arrangements. In particular, we believe that the review should consider in the light of experience the case for the OBR becoming a

Parliamentary body with its resources determined by a House of Commons body, such as the Public Accounts Commission. (Paragraph 33)

12. This review should be carried out by a small team of external experts, possibly commissioned by the National Audit Office, and should report to us as well as to the Chancellor. This Committee should be consulted both about the scope of the review and about the arrangements for carrying it out. (Paragraph 34)

Forecasting

13. One of the ways in which we will judge whether the OBR is a success is whether there is greater public understanding of the purpose and limitations of the forecasting process, and realistic expectations of what it can deliver. (Paragraph 38)
14. There should, and will certainly, be analysis of the accuracy of OBR forecasts. Their quality and authority can be measured over time, relative to other forecasts. Absolute accuracy is not a useful criterion. Persistent pessimism or optimism will become apparent over time, justifiable on the basis of published explanations and methodology. (Paragraph 39)
15. The legislation establishing the OBR should not require future governments to use OBR forecasts. It is possible that the power of the Government to use its own forecasts will counterbalance any incentive the OBR might have to be overly pessimistic. The OBR's reputation would suffer if it were shown that its forecasts were so significantly biased that the Government no longer considered them a reasonable base for policy-making. However, it would be a major step for Government to do this. Once the decision had been made, the OBR's credibility would be severely, and possibly terminally, damaged. (Paragraph 41)

Control of models and data

16. The OBR should have discretion in the models it uses in drawing up its forecasts. It is a matter for the organisation itself as to whether it is content to use the Treasury models, or wishes to make changes. Whatever course the OBR takes, there would be benefits in it being as transparent as possible about the models it uses. The OBR should also be cautious about attempting to increase the sophistication of the model in search of dubious increases in accuracy. As many witnesses pointed out, a sophisticated model cannot remove the need for forecasters to exercise their judgement and incremental benefits to an already highly complex model may be nugatory or perverse. (Paragraph 44)
17. The OBR should have the power to check the quality of fiscal data itself, and to request that the ONS does so. It should also be free to use any existing data it thinks fit in constructing the forecast, and to recommend changes in data collection, if it considers that this would improve the forecast or its ability to assess the likelihood of achieving the fiscal mandate. Where a recommendation may increase the overall cost of the OBR's work, it should be required to seek an external view on the benefits and costs of the change, and report this to the Treasury and to this Committee. (Paragraph 45)

18. While forecasting will be a key task of the OBR, there is no point in devoting resources, either to increase detail or frequency, to forecasts which will have no practical application or benefits. In normal circumstances, the OBR should produce two sets of forecasts a year. An extra forecast would be desirable if there were significant monetary or fiscal policy changes or significant external shocks. (Paragraph 46)

Sustainability analysis

19. We support the interim OBR's recommendation that the permanent OBR should produce an annual report on the long-term sustainability of the public finances. This report should contain no policy recommendations. (Paragraph 50)

Commentary

20. The OBR's contribution to public understanding should not be confused with self promotion. This commentary function should be one of informing public debate through disseminating better understanding of fiscal policy and long-term economic trends, identifying possible risks in the structure of the economy and provision of data. Beyond any duties set out on the face of the legislation, the statute should give the OBR absolute discretion over the work it undertakes. The legislation should leave the OBR able to conduct work on the fiscal policies of political parties along the lines proposed by Robert Chote in evidence on 16 September 2010. There may be also particular subjects which the Treasury, or this Committee, consider should be examined by the OBR. We would expect the OBR to consider such proposals carefully and, where appropriate, explain its decisions. (Paragraph 58)
21. As an additional defence of OBR impartiality, we recommend that the OBR's core tasks should be set out on the face of the legislation. (Paragraph 59)
22. We agree with Mr Chote that it would be inappropriate for the OBR to have a role in setting the fiscal mandate. This should be a political decision. Once the mandate is set, any OBR commentary should be based on aggregate fiscal figures, not on individual measures. (Paragraph 64)

Staffing and resources

23. Sir Alan Budd argued that it would not be cost-effective or practical to duplicate or move into the OBR all the officials who spend some of their time on the Budget forecasts. We accept that there is a trade-off between delivering the most robust independence and perception of independence and making the most efficient and effective use of resources. (Paragraph 72)

Core staff

24. The core staff of the OBR should be sufficiently large to support an investigative team which would be able to go into a department and scrutinise the data a department used or the way a particular part of the forecast had been drawn up. The

OBR should also have sufficient resources to hire outside contractors to look into particular aspects of the forecast data. (Paragraph 76)

25. Section 156 of the Finance Act 1998 gives the Comptroller and Auditor General a right of access to all relevant Government documents he may reasonably require to carry out his audits of budget assumptions, and the right to have explanation of those documents. We recommend that, with the exception of material related to individual taxation, the OBR should have similar rights of access to all relevant documents (Paragraph 77)
26. The model chosen by the Chancellor means that the OBR will not be the full time employer of many of the people supplying information and analysis which it will, after challenge, use in making its forecasts. Nevertheless, the permanent OBR will need to be larger than the interim organisation, and to command more resources. It will also need to be able to draw on expertise within the Treasury, the DWP and HMRC. We do not attempt to suggest precise numbers for core staff, as the OBR might choose to hire people for specific tasks, or contract out some research, but note that in addition to the 10 Treasury staff whose functions should move to the OBR, we have also identified a need for a research director, macroeconomic expertise, and some sort of investigative team to ensure data are properly used. The BRC must be confident that the OBR has the core staff it needs. The safeguards over funding we propose in paragraph 112, and the independent directors we propose in paragraph 96, should ensure that any concerns are raised with us as part of its budget procedure, as outlined by Mr Chote on 16 September. (Paragraph 84)

Duplication

27. We accept that the Treasury may wish to replace some of those staff who we propose should be moved to the OBR. Given the limited number of posts involved, we consider that the advantages of independence are well worth the costs of any duplication. The staffing of the OBR should be one of the subjects examined in the five year review we recommend (Paragraph 85)

Independence status

28. The body should have the maximum independence possible. It should operate from offices outside the Treasury and have its funding secured by the measures set out in paragraph 112. We believe the best structure for this would be to have the OBR established as a Non Ministerial Department. The Statistics Authority offers a useful model of how such a department can function. It is roughly the size we envisage for the permanent OBR (or even smaller), with 27 staff—23.6 full time equivalents. While a Non Departmental Public Body could be established in ways which maximised its independence, it would appear to be linked to the Treasury because of the Estimates process, and there would be inevitable doubts about its independence. (Paragraph 91)

Independence structure

29. We agree with the Government's assumption that the BRC should have three executive members, including its Chairman, reflecting the balance of skills required to undertake the OBR's functions. Although it will be essential for the Committee to contain respected economists, as the ICAEW suggests, other skills may also be appropriate. While the organisation will not have any direct political role, the BRC should have sufficient political awareness to avoid involvement in political controversy. (Paragraph 94)
30. The permanent OBR should also have a small group of non-executive directors, containing two or three people working on a pro bono basis, with a senior non-executive director, drawn from those with considerable experience in relevant fields, such as the Treasury forecasting, the Bank of England or the private sector, and at least one should have had some forecasting experience. Previous political experience should not necessarily be a bar to appointment. (Paragraph 96)
31. The non executives should not be involved in the forecasting process. Their primary role should be to safeguard the independence of the OBR and they should have a duty to warn this Committee of anything which appears to threaten that independence, including any questions about resources. They should be available to advise to the Chair and members of the BRC, and, if necessary, the Treasury Committee. (Paragraph 97)

Appointment and dismissal

32. We consider that to avoid the politicisation of the BRC's role, candidates should be judged against clearly defined criteria. We intend to use the criteria of personal independence and professional competence as the basis for our hearings with BRC members. (Paragraph 104)
33. We support the Chancellor's proposals for a "double lock" on the appointment and dismissal of the OBR Chair. We should also have the right to veto other BRC executive members proposed by the Chancellor. (Paragraph 107)
34. While we welcome a statutory role for the Committee in the appointment and dismissal of the Chair of the Budget Responsibility Committee, the relevant provisions will have to be carefully drafted to ensure that the legislation does not purport to dictate parliamentary proceedings, or expose them to judicial review. (Paragraph 108)

Finances and back office support

35. The OBR needs to have full control over its communications, and this function should not be shared with the Treasury press office. (Paragraph 109)
36. If the OBR is not to be a fully Parliamentary body, it needs transparency in the resources it is given, and the House needs to know the Government's proposals in time for intervention to be effective. To that end we recommend:
 - the OBR budget should be given its own line in the estimates;

- that budget, accompanied by an explanatory memorandum prepared by the OBR itself, should be sent to the Treasury Committee in confidence at least six weeks before the Estimate is laid.

These measures will allow us to ensure that the BRC and the non-executives are content with what is proposed. They should have a duty to raise any concerns they have with the Committee. (Paragraph 112)

37. While we accept that there is a case for those employed by the OBR to be civil servants, we consider that the OBR should have sole responsibility for hiring and firing its employees. Although many of its staff may come from within the civil service, it should draw its staff from as wide a range of sources as possible. (Paragraph 115)

Relationship with the civil service

38. There need to be structural assurances that the officials who remain in government are giving the OBR full and objective advice, and cannot be subject to pressure from the Treasury or other departments. First, their annual appraisals should contain an explicit OBR comment on the way they have performed their forecasting tasks. Second, such officials should have the duty to raise any concerns they have with the BRC or with the non-executive board, just as civil servants generally have the right to raise matters with the civil Service Commissioners. If there were widespread concerns about the objectivity of the data or advice fed into the forecasts from within Government, we too would expect to be informed and we would not hesitate to intervene. (Paragraph 116)
39. The relationship between the OBR and government departments should be set out clearly in formal memoranda of understanding between OBR and departments it deals with: those memoranda should make it clear that during forecasting periods the OBR has the right to control the forecasting resources of government and that such staff have a duty to give the OBR full and objective advice (Paragraph 117)
40. The Ministerial Code should be amended to require Ministers to respect the OBR's independence and to note that during the forecasting periods the OBR has the right to control the forecasting resources of government (Paragraph 118)

The role of the NAO

41. We consider that the establishment of the OBR means that provisions of the Finance Act 1998 requiring the NAO to audit budget assumptions are no longer necessary. However, the OBR should be subject to the same sort of NAO scrutiny as any other part of government. (Paragraph 119)

Legislative framework

42. The Treasury's task is now to prepare the legislation setting up the permanent OBR. As a minimum we recommend that legislation should include:

- a) establishment of the OBR as an institution with its own legal personality, responsible for appointing its own staff;
- b) a requirement on the OBR to act transparently, objectively, and independently;
- c) a clear remit and set of core tasks;
- d) a requirement that the responsible select committee should have a veto over appointment or dismissal of the Chairman of the permanent body;
- e) provision for a small independent group to support the BRC;
- f) a requirement that Government officials support the OBR when it is preparing forecasts and that they have a duty to give the OBR full and objective advice;
- g) a requirement that the OBR has a right of access to the information it needs;
- h) a requirement for a review of the organisation five years after it is established.

We have not set out in detail how these might be accomplished. (Paragraph 120)

43. In preparing this Report we have become aware of some anomalies in the current legislative framework relating to fiscal forecasting. The framework for government economic decision-making is still governed by the Code for Fiscal Responsibility, any revision of which requires approval by the House of Commons. The Code should have been revised as a consequence of the Fiscal Responsibility Act 2010, but although the necessary Order was laid, no steps were taken to approve it. The Code for Fiscal Responsibility requires a Pre-Budget Report, a Budget Report (containing an economic and fiscal projection) and other fiscal reports to be published by the Treasury. The Treasury should bring forward a revised Code for approval to ensure the OBR has control of the publication of its forecasts. It should also, if necessary, reflect changes in primary legislation and any changes to the way Government proposes to make its fiscal reports to Parliament. (Paragraph 121)

Non statutory measures

44. If the OBR is to be credible, members of the Budget Responsibility Committee will need not only to be independent but to demonstrate that independence from the Government's own Treasury team. (Paragraph 123)
45. Although the forecasts will be produced by a nonpartisan body, the future path of the economy is the subject of intense political debate. The OBR's forecasts will inevitably be used in that debate. To preserve its reputation for political impartiality, it is essential that the OBR takes all reasonable steps in the presentation of its words to inhibit them from being misused or misrepresented. (Paragraph 124)

The Committee's role

46. The current proposals for the OBR envisage that this Committee will have a role in controlling both the appointment and the dismissal of the Chair of the OBR. Our role in ensuring the independence of the organisation goes beyond that. Whether or not the OBR is established as a Parliamentary body, it is vital that it commands

confidence across party boundaries. We will take evidence from the organisation regularly as part of the budget process. We will intervene if we believe the OBR's independence is threatened. We expect the members of the Budget Responsibility Committee or the non-executive directors to report any concerns they have to us. Only if it is independent will the OBR be successful. (Paragraph 125)

Success criteria

47. The most important sign of the OBR's success will be that it establishes and retains a reputation for independence and impartiality. While its forecasts and publications should improve political debate, the organisation itself will be under pressure to be drawn into partisan disputes. (Paragraph 126)
48. An important criterion is that the OBR should seek to avoid significant bias over time in its forecasts, its assessment of trend growth, or its judgements about the probability of the government's mandate being met on the policies announced. (Paragraph 129)
49. The work of the OBR needs to achieve and retain a high professional standing through objectivity and transparency and by testing the models it uses and its analysis, including work on the long term balance sheet, with outside economists. The OBR should not seek extra resources, either to extend its economic analysis or to get new data, beyond the point at which the benefits can be clearly seen to justify the costs. (Paragraph 130)
50. The OBR's reports should be comprehensible to non-experts, like the output of the interim OBR, and suitable for use in public debate. Its work should improve the quality of that debate. But the OBR should not itself run education campaigns (Paragraph 131)
51. There are significant risks facing any new organisation. The approach put forward by the interim BRC avoids the risk that the forecaster will lack information available to Government, or that there will be wholesale duplication of resources. It does, however, increase the risk that the OBR will not be seen as independent, and this could undermine the potential gain from this reform: increased trust in the forecasts used in government policy making. We will scrutinise this carefully. (Paragraph 132)

Annex: Fiscal Councils overseas

Source: Professor Simon Wren-Lewis¹⁰⁹

Austria

The Public Debt Committee established in 2002, receives financial support from the Austrian Central bank. It provides recommendations on the direction of fiscal policy, and the overall fiscal stance.

Belgium

The Federal Planning Bureau, established in 1994, provides a range of services along similar lines to the CPB in the Netherlands. In addition, the High Council of Finance, which was reformed in 1989, oversees the coordination of regional and national fiscal policy. It sets medium term objectives for regional and national budget deficits, and proposes annual targets, which form the basis for government negotiations. The High Council is chaired by the Minister of Finance, but has representatives from inside and outside government. Although it has no formal decision making power, it does exert considerable influence.

Canada

The Parliamentary Budget Office provides independent analysis to Parliament on the state of the nation's finances, the government's estimates and trends in the Canadian economy, and upon request estimates of the financial cost of any specific proposals.

Denmark

The Economic Council, established in 1962, prepares economic reports and forecasts on a range of issues including fiscal policy.

Hungary

The Fiscal Council of the Republic of Hungary was set up in 2009 as 'an independent state institution that endeavors to ensure the responsible management of public resources.' It prepares macroeconomic forecasts which represent the baseline for budgetary decisions. It also provides comment and advice on fiscal planning more generally, within the context of existing fiscal rules.

Netherlands

The Netherlands Bureau for Economic Policy Analysis (CPB) was founded in 1945. It is an independent research institute and has its own independent external advisory body. It provides economic and fiscal forecasts as inputs into the budgetary planning process. It also evaluates (at the parties' request) the election programme of

¹⁰⁹ http://www.economics.ox.ac.uk/members/simon.wren-lewis/fc/fiscal_councils.htm

government and opposition parties. The Bureau also provides economic expertise over a wide range of specific issues, such as labour market reform.

Slovenia

The Public Finance Act of 2009 requires the creation of an independent advisory body to provide assessments of the public finances.

Sweden

The Swedish Fiscal Council was established in 2007. It consists of eight members and is assisted by a secretariat with four employees. The mission of the Council is to provide an independent evaluation of the Swedish Government's fiscal policy.

United States

The Congressional Budget Office (CBO) has a mandate to provide the United States Congress with 'objective, nonpartisan, and timely analyses to aid in economic and budgetary decisions on the wide array of programs covered by the federal budget and information and estimates required for the Congressional budget process.' Established in 1974, it provides objective and impartial assessments ('scoring') of policy proposals that have a significant influence on decision making. It also provides an overall assessment of the likely path of deficits and debt into the medium term. However, the requirement of impartiality that is crucial for its influence at the microeconomic level restricts its scope to offer clear advice on the macroeconomic stance of fiscal policy.

Formal Minutes

Thursday 16 September 2010

Morning sitting

Members present:

Mr Andrew Tyrie, in the Chair

John Cryer	Andrea Leadsom
Michael Fallon	Mr Andrew Love
Mark Garnier	Mr George Mudie
Stewart Hosie	David Rutley

Office for Budget Responsibility

The Committee considered this matter.

[Adjourned till this day at 2.00 p.m.]

Thursday 16 September 2010

Afternoon sitting

Members present:

Mr Andrew Tyrie, in the Chair

Michael Fallon	Mr Andrew Love
Mark Garnier	Mr George Mudie
Stewart Hosie	David Rutley
Andrea Leadsom	Mr Chuka Umunna

Draft Report (*Office for Budget Responsibility*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 132 read and agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Written evidence was ordered to be reported to the House for printing with the Report.

Written evidence was ordered to be reported to the House for publishing with the Report.

Papers were ordered to be reported to the House for placing in the Library and Parliamentary Archives.

[Adjourned till Tuesday 12 October at 9.30 am

Witnesses

Tuesday 20 July 2010

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Sir Alan Budd, Chairman, **Mr Geoffrey Dicks**, Member, and **Mr Graham Parker CBE**, Member, Office for Budget Responsibility Ev 1

Thursday 22 July 2010

Professor Simon Wren-Lewis, Professor of Economics, Oxford University;
Professor Tim Besley, Professor of Economics, London School of Economics;
 and **Mr Robert Chote**, Director, Institute for Fiscal Studies Ev 13

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8	Directorate General for Economic and Financial Affairs of the European Commission	Ev w13
9	Robert Barrie, Head of European Economics, Credit Suisse	Ev w15
10	Dr George Kopits, Chairman, Fiscal Council, Republic of Hungary	Ev w15
11	Economic Perspectives Ltd	Ev w18
12	Staff of the International Monetary Fund	Ev w19
13	Professor Matthew Flinders, Professor of Parliamentary Government & Governance, University of Sheffield	Ev w20
14	Simon Hayes, Chief UK Economist, Barclays Capital	Ev w24
15	Dr Frank Eich, Senior Economist, Pension Corporation	Ev w26

List of Reports from the Committee during the current Parliament

Session 2010–11

First Report	June 2010 Budget	HC 350
Second Report	Appointment of Martin Weale to the Monetary Policy Committee of the Bank of England	HC 475
Third Report	Appointment of Robert Chote as Chair of the Office for Budget Responsibility	HC 476

Oral evidence

Taken before the Treasury Committee on Tuesday 20 July 2010

Members present

Mr Andrew Tyrie, in the Chair

John Cryer
Michael Fallon
Mark Garnier
Stewart Hosie
Andrea Leadsom

Mr Andrew Love
Jesse Norman
David Rutley
John Thurso
Mr Chuka Umunna

Witnesses: **Sir Alan Budd**, Chairman, **Mr Geoffrey Dicks**, Member, and **Mr Graham Parker CBE**, Member, Office for Budgetary Responsibility, gave evidence.

Q1 Chair: Sir Alan, thank you very much for coming before us again. We are particularly grateful to you for coming twice in a week. We are also grateful to you for doing the job that you are doing briefly in the beginning, which is the creation of a new and difficult institution, and we recognise that its early days have been somewhat bumpy. The issue of the structure and the statutory basis of this institution is now going to be absolutely crucial and I would like to begin by asking you a straightforward question but I think it opens up a lot of the issues: what do you think is the biggest single problem with developing a genuinely independent OBR?

Sir Alan Budd: Thank you very much, Chairman. I believe that the biggest single challenge is as follows. If one of the core activities of the OBR is to produce on Budget Day a fully articulated fiscal forecast with all the detail provided in the Red Book, then the involvement of officials working in the Treasury, HMRC and DWP is absolutely inevitable. They command the detailed knowledge of the policies and programmes; they work on the policy changes, if any; and they are the experts on the effects of those policy changes. Of course, all their forecasts are subject to the scrutiny of the OBR, and the OBR makes all the judgments and accepts responsibility for those forecasts, but the officials are essential to the process, so the challenge, Chairman, is as follows: how does the OBR perform this task which has been allotted to it, which involves using departmental officials, whilst ensuring its independence and satisfying the world that it is independent? Perhaps I could emphasise the point that the independence which matters is the independence from ministerial interference in the forecasts, and that has been achieved completely. In the introduction to our Pre-Budget Report we paid tribute to the energy, enthusiasm and professionalism of the officials who helped us, and I repeat that now. This is largely a problem of perception but to me it is also the core challenge.

Q2 Chair: When you talk about that group of officials, how many officials are we talking about, the group who if one were to call the forecasting period harvest time, how many need to work on the

harvest briefly to get it in before returning to their normal functions in the Treasury of engagement in overall policy formulation?

Sir Alan Budd: I think our best estimate is about 100 people. They perform various roles which I would happily describe, but 100 is a fairly good count of the people who are absolutely essential to the production of those forecasts.

Q3 Chair: And your concern is that it would be a waste of public money for you to have 100 and for the Treasury to retain 100?

Sir Alan Budd: Not only would it be a waste of money, Chairman, they could not do it because so many of these 100, the people I think of as the expert analysts, are only able to do it because they work in the departments and help produce the policies and monitor the forecasts. They are part of these departments and that is where they gain their knowledge, so if they were not there they would not be able to perform that role.

Q4 Chair: How can we give the public confidence that these people really are giving you their honest and completely independent answers rather than ones that the Treasury themselves might prefer to hear or that they think the Chancellor might have preferred that they give you?

Sir Alan Budd: We could have a long discussion, Chairman, which I would love to have, about the role of officials. I have always felt that it is the role of officials to provide the best advice they can. I cannot really imagine ministers wanting anything else. They might or might not be comfortable with this advice, but if they do not believe that officials are giving their best advice then they should be worried by that, I think, so I assume that these people (and as far as I can see they absolutely do) are giving us their best advice. They are joining with us in this difficult endeavour of producing forecasts. It comes back to a question of perception. Of course, it is our job to make sure and test that they are giving these honest answers because we want nothing else from them.

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Q5 Chair: I expect we will come back to this issue later on in cross-examination. I just want to ask you one more question which is about the “double lock” announced by the Chancellor last week which gives us a role in approving the appointment of your successor and future heads of the OBR. What role do you think this Committee might usefully play in scrutinising the performance to the point where people, it might be concluded, should be dismissed from that job if they were not performing? Is there any opportunity for creating symmetry of treatment between appointment and dismissal as far as the Treasury and Parliament is concerned?

Sir Alan Budd: My view on that is that the same double lock procedure should apply. It seems perfectly reasonable for this Committee to conclude that the Chairman is not fit to retain this role. I do not think the Committee should have the right on its own to dismiss someone, nor for that matter should the Chancellor, so I think the dual lock should apply and just as, so to speak, you have a veto over appointments so each party should have a veto over dismissal.

Q6 Chair: That is the question I asked the Chancellor at the end of the last evidence session and he gave a rather different reply.

Sir Alan Budd: Well, we are the independent OBR!

Chair: Thank you for your independent advice on that point. Mark Garnier?

Q7 Mark Garnier: Can I refer you to a letter you wrote from the OBR to the Chancellor. You talk about the structure of the OBR and that it has two consequences. “The first is that the OBR becomes a central part of the policy decision process while, in accordance with its Terms of Reference, it neither offered nor was asked for policy advice. The second was that some Treasury officials performed both roles, ie giving advice to the Chancellor and helping the OBR produce the forecasts.” What I am slightly concerned about is this means that the OBR almost becomes the tail wagging the dog and could mean that the Chancellor was making policy based on what you were saying and that, oddly enough, gives you quite a strong lean on the policy of the Chancellor. Can you comment on that?

Sir Alan Budd: That can indeed be the case, that the Chancellor when he is considering policies must be considering their effect on the economy and it is the OBR who tells him, as best they can, what the effect on the economy of those policies will be, so to that extent the OBR does become a very important part of the budget decision-taking process. That is absolutely true.

Q8 Mark Garnier: Do you think that makes you more or less important than the Treasury officials?

Sir Alan Budd: I do not think it is necessary to answer that question. We are both performing our roles. Officials are performing their role in advising on policies and their consequences. We are particularly advising on their consequences as far as the economy is concerned and as far as the fiscal

forecasts are concerned. Those are not the only considerations of course which determine the Chancellor’s choices.

Q9 Mark Garnier: But there are also a lot of other organisations that are also providing commentary on this. To a certain extent you are getting information slightly earlier than maybe other people would be, so again I keep coming back to this point that that actually makes you incredibly crucial in the policy-making process and even though there is obviously an intention to have you independent, does that not mean that at the heart of what you are doing you can influence policy?

Sir Alan Budd: I do agree. To the extent that the Chancellor takes into account our views of the effects of his policy choices on the economy, then we are certainly influencing his policy. We are doing that; I think that is quite inevitable.

Q10 Mark Garnier: It is interesting that yet another organisation is involved. The current Chancellor has accepted the OBR’s forecasts as the basis for Treasury policy. What do you think is going to be the case in the future? George Osborne is not going to go on for ever. What do you think will happen with the next Chancellor? Do you think the next Chancellor will be as willing to take your forecasts in the same context as the current Chancellor does?

Sir Alan Budd: I am not sure that I can speculate on that for a moment. We know the task that the present Chancellor has set us and it will be, if there is another Chancellor, for he or she to decide whether he or she wishes to continue with the same practice.

Q11 Mark Garnier: What implications would a more arm’s length relationship between the Treasury and the OBR have for the forecasting process?

Sir Alan Budd: As I said in answer to the question from the Chairman, I do think this is largely a matter of perception, but there are changes which would be organisationally for the better. We arrived and we started forecasting immediately and to a certain extent that determined the way in which we did it. I think after the experience of one round there are lessons that can be learned both about the whole forecasting process and about the question of where individual posts ought to be between the Treasury and the OBR. For example, I believe that there are perhaps three posts of people (my name for them is compilers or co-ordinators) who take all the information, add it up, put it together and feed it back into the process so that it produces the economic forecast and produces the fiscal forecast. I think there are three posts there which would be better placed in the OBR. I am very nervous, Chairman, that I am going to be the sole person answering questions and of course I always like to pass the more difficult questions to my colleagues! Graham Parker is a much more experienced forecaster within the Treasury context than I am and it may be helpful if he comments on that.

Mr Parker: I think it may be slightly more than three. We have to decide where to draw the line. However, there are people in the Treasury who do

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spend the great majority of their time on forecasting issues, and it probably makes sense for them to be in the OBR. They do not just compile, they do not just add up numbers; they also perform the same kind of challenge function that we are going to do in this forecast and already have done that. For example, when the HMRC send in tax forecasts these people in the Treasury will scrutinise these forecasts very closely and challenge the tax department, “Why have you made this judgment?” et cetera. In a sense, that is what we have had to do this time and it would help us if we had some officials in the OBR who will do it with us.

Q12 Mark Garnier: Separate from the Treasury?

Mr Parker: Yes. Because they are spending most of their time on forecasting they should be in the OBR and not in the Treasury.

Q13 Mark Garnier: You are suggesting taking them from the Treasury and leaving the Treasury without those people?

Mr Parker: Yes.

Q14 Jesse Norman: Sir Alan, when we spoke last time one of the things that looked as though it might have compromised at least the appearance of independence was the shared PR function that you had at the time between the OBR and the Treasury. I just want to push on a bit further with that line of thought in relation to the idea of independence and whether it is really achievable. Is it contemplated by you—and there obviously will be some permanent staff because the thought would be that some people would come over at a senior level to provide the challenge function—that their pay will be set by the OBR? Will the OBR have its own budget and spending powers? Will it have an HR department that manages the career progression of its people? How are those kinds of institutional things going to work out?

Sir Alan Budd: Some of those are details which certainly have not yet been resolved although they are all very important to us. For example, I do assume of course that the OBR will have its own budget. If, as we currently suggest, the size of the OBR is between 15 and 20 people then it will need all the resources in terms of management that such a group of people would normally expect to have. There are problems for a small unit—HR resources can be rather expensive per head—but those are the sorts of decisions that will be taken very, very carefully indeed and as far as is practicable of course those who are employed by the OBR will have all of the support that one would expect people to have.

Q15 Jesse Norman: It does seem to slightly stretch the idea of independence if it is going to have the kind of relationship that we seem to be glancing at with the Treasury whereby only 15% or 20% of the available resource is within the OBR, and unless some of these other aspects are built in it seems to me those apparently small institutional aspects are rather important. The OBR as a consumer of advice will be official and professional rather than political

and we have noticed very much how political forecasts have become warped over the last few years and that is what this is designed to prevent. There are two ways in which independence can be. There can be intellectual independence and there can be institutional independence. How will you be ensuring that as a mindset and in terms of the inputs and the thinking that the OBR has in it, that its own thinking will be genuinely independent rather than governed by the same Treasury mindset and possibly the same Treasury inputs?

Sir Alan Budd: I have always had reservations about this notion of the Treasury mindset. I am prepared to accept that there may be something to that, but, whatever it is, the mindset of the OBR must be and can only be the mindset that produces completely independent, honest forecasts which are the best forecasts that can be produced. That will clearly apply to those who are working within the OBR. I think the following is also true: to the extent that the OBR is using resources within the Treasury and other departments, I would expect the OBR to be consulted when the people who are reporting to us are having their assessments because the Treasury, I think, uses 360 degree appraisal and the OBR will appear somewhere on that circle. The other way in which the OBR can, and will I think, help to create the approach that it believes is necessary—and I repeat I think it is in fact already there—will be through the part it plays in the appraisal of the individuals who report to it. I think that is perfectly fair. I am saying that without having consulted the Treasury about it, but I think they would normally expect that to be the case

Q16 Jesse Norman: And employing independent advice from external sources as and when necessary as well?

Sir Alan Budd: Yes.

Q17 Jesse Norman: Will you be reporting to Parliament exclusively or will you be reporting through the Chancellor?

Sir Alan Budd: Yes, I recognise there is an ambiguity there and it is almost certainly my fault. I think we report to Parliament in the way that we are currently doing. Here we are giving evidence to the Treasury Committee so this is us reporting to Parliament. We report through the Chancellor in the sense that the Chancellor is the minister responsible for the office and therefore when there need to be matters raised within the House it is the Chancellor of the Exchequer who is the responsible minister.

Q18 Jesse Norman: But forecasts will not be circulated to the Treasury in advance of being published to Parliament, for example?

Sir Alan Budd: As the discussion we have just had has revealed, forecasts are an essential part of the budget process, and it would not be possible to publish, so to speak, the interim forecast that we are producing day-by-day during the forecasting round to Parliament, in advance of the publication of the Budget. I simply do not think that would be possible.

Q19 Chair: Can I just take you back to the point that I raised earlier about whether the public could be confident that in all cases you are getting wholly impartial advice? When you rely on the 100 who are going to stay in the Treasury most of the time and work for you or be accountable to you (even if they have some staff reports done by you) only during harvest time, during forecast time, do you think there would be any merit in putting together a small team in the OBR who were very capable people who might even draw on highly specialist outside advice if necessary, to go in and challenge a specific piece of the forecast. Would the fact that you had a hit squad of that type act as a deterrent, because people would know that there is a very small risk that this group might descend on them if your successor concluded he was not happy with the figures he was receiving?

Sir Alan Budd: I will also ask my colleagues to answer that question. It is an extremely interesting idea. At the moment we are the hit squad and we have others who assist us in this role. It might be helpful to augment our role in one way or another but perhaps I will ask my colleagues what they think.

Mr Parker: I very much agree. We already do that. We did it during this forecast. We looked at every bit of the forecast coming to us and we had usually at least one meeting, if not more, in which we said, "What on earth are you doing here? Why are you doing this?" et cetera.

Q20 Chair: Did anybody change their forecast in the light of the tough treatment you gave them?

Sir Alan Budd: Yes, and tough it is!

Mr Parker: I hope it was not that tough but, yes, all the time. We had a list of action points coming out of these meetings which said, "Can you look again at this judgment?" and we had another forecast come back as a result.

Q21 Andrea Leadsom: Very closely related to that, I am very keen to know a bit more about this very recent experience because obviously this was the first time that the OBR was meeting and trying to independently forecast and at the same time you were under enormous pressure, much more so than you would be in a normal annual process. I wondered particularly, Sir Alan, whether your colleagues could enlighten us a bit as to the strengths and weaknesses and perhaps give us a bit of a flavour for where the real problems were in the time-frame in the speed with which you had to get the organisation up and running and actually deliver something?

Sir Alan Budd: Do you want to start with my colleagues and then I will answer, starting perhaps with Geoffrey Dicks, for whom it was a completely new experience.

Mr Dicks: We did have something like 100 meetings in the course of the five or six weeks that we were producing the two forecasts. I think you should distinguish between my role as the macroeconomic forecaster and Graham's role as the public finances forecaster, with Alan sitting on top of the two. My main interactions were with the Treasury forecasting teams and Graham's main interactions, having got the macro-economic forecasts and all the inputs that

go into the public finances, were with HMRC and DWP, so he was interrogating the individual bits of the public finance forecast, taking his line, and what I was doing was interrogating the individual bits of the economic forecast. I think we said last week that in the time available we had to take the existing Treasury framework (though a permanent OBR might like to develop a different economic model) and within that economic framework there are a number of key decisions that have to be made. I think our first decision—and we talked about this last week—was on the output gap and trend GDP, and on both of those we departed from the assumptions that had been in the March Budget. All forecasts are iterative. You feel your way to where you want to be or where you think the numbers and analysis are leading you and you hope you get to the right place at the end. I think the role of any forecaster, whether you do it by yourself or whether you do it with a team, is to interrogate the numbers that are coming out of it. Do these make sense? Are they theoretically consistent? Are they consistent with the evidence as it is evolving? Of course, the big thing about the Treasury model is that it does add it all up so at least in an accounting sense it is coherent.

Q22 Andrea Leadsom: You say you had about 100 meetings in a very short period of time. How many of those were with just Treasury officials and how many were with independent organisations, think-tanks and City analysts and so on? Did you take many soundings from them as well?

Mr Dicks: No, apart from the seminar that we arranged specifically to get outside advice on the establishment of the permanent OBR. I suppose you could take outside advice but you could not have a two-way conversation with outsiders, no.

Q23 Andrea Leadsom: So it is purely internal. Are there weaknesses? Did you feel at the time that you had enough information and enough time to come to the right conclusions or are there weaknesses in what the OBR was able to put forward in the time?

Mr Dicks: We would have liked a longer period. Five or six weeks to produce two separate forecasts including all the effects of the Budget was a daunting task. I have spent the last 34-odd years being a macroeconomic forecaster. I have seen all the Budget Red Books so I knew how the Treasury model worked. Essentially all macroeconomic models work the same, but I knew how they constructed their forecasts over the medium term. Graham of course has spent many, many years doing a similar thing on the public finances. That is why Alan asked us to come along because he thought we could hit the ground running.

Q24 Stewart Hosie: Sir Alan, last week you said you no longer had access to any sensitive information which you used in your forecasts and none of that since the Budget has been published. Can you describe in general terms the sort of sensitive information you might have had access to and why it might have been sensitive during that budget-setting process?

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Sir Alan Budd: The information I had access to was the Budget proposals. Our forecast is a market-sensitive piece of information, so I was fully aware of the Budget proposals, I was fully aware of the final Budget package and I was aware of our forecast.

Q25 Stewart Hosie: Which leads us to the real key question for me then: do you think the Treasury would be as comfortable giving access to you or your successor to not just sensitive forecast information but sensitive policy information if the OBR was much more independent, if it was much more arm's length than it currently is?

Sir Alan Budd: I think it would be completely bound by all the confidentiality and secrecy requirements that currently apply to Treasury officials and indeed apply to us.

Q26 Stewart Hosie: I am just speculating widely for a moment here that there is another tranche of quantitative easing planned and you have to do a new forecast, or the Chancellor reins in the Special Liquidity Scheme for the banks; would they be really so keen to offer that policy information to your successor sufficiently far in advance of the policy being announced to allow the forecasts to be done? Do you think the trust is there?

Sir Alan Budd: I would not expect to be advised in any way at all about the content of MPC discussions or decisions until they were announced in the normal way. I would not expect to have any privileged access to such information.

Q27 Stewart Hosie: And at that point would you expect the OBR then to change its forecast on the basis of announcements made at that point?

Sir Alan Budd: We have made a proposal about the frequency with which the OBR would produce forecasts and they certainly would not be made just in response to a changed decision by the Monetary Policy Committee.

Q28 John Cryer: Sticking with forecasting, who do you think should own the model used for the OBR forecasts?

Sir Alan Budd: I can answer it and I can also ask my colleagues to do so. The OBR must be able to use the models that are required for forecasting processes. Ownership is a slightly difficult issue, I am not even quite sure how it is defined, but certainly if a model is being used to produce OBR forecasts then in that sense it must be owned by the OBR. There is not just one model, there is a suite of models, but any model which the OBR is using it must own in the sense that it knows what it contains and is responsible for its outputs.

Q29 John Cryer: So just to confirm, what you are saying is that the OBR itself will make the decisions about what modelling is used?

Sir Alan Budd: Yes, because it has the responsibility for the resulting forecasts.

Q30 John Cryer: And presumably in that context the OBR would also make the decisions about the changes to the modelling? If there were a decision about changing the sort of models that were used that would be made by the OBR not by any other body?

Sir Alan Budd: Yes, again, you are giving the impression that there is just one model, and I will ask my colleagues also to reply, but the OBR must be responsible in the sense that it knows of any change that is being made; it has either made it itself or agreed with it. Graham Parker might want to say something.

Mr Parker: It is probably worth saying that there are a lot of models here. There is the macro forecast, the economic forecast which is done using the Treasury model, and there is a whole range of separate models for each tax and for each of the major AME components. Some of them are very simple spreadsheets and some of them are quite complicated econometric models, et cetera, but there is a model for each of the main bits of the public finance forecast. For most of these the ownership is, in a sense, where they reside. It has to be within either the tax department HMRC or for social security benefits within DWP. They are fed by confidential data on individual taxpayers, for example, which the OBR will not have access to, so they actually have to reside in the departments but, as Alan says, I would expect the OBR to either lead suggestions for improvements and changes or at least be consulted on and agree to those. We would certainly have control over all the inputs and outputs to those models when those models were being used for our forecasts. Some of the models are also used for other purposes, that is another issue, but certainly the OBR will have a lot of say in what is actually being inputted into the model.

Q31 John Cryer: I did not mean to give the impression that I thought there was just one model, obviously there is a plethora of them, but you say the OBR will have an input or the OBR will make those decisions about what sort of modelling you will use?

Mr Parker: I am not sure we will necessarily have the final say but we have already been consulted about possible changes to some of the tax models and that work may be done over the summer where we think there is a bit of a gap at the moment and something needs to be done, et cetera, but we would not necessarily initiate all these requests, rather the departments themselves will, so it will be a joint process to some extent.

Sir Alan Budd: My answer was directed to these rather large aggregate models which are used for the economic forecasts.

Q32 David Rutley: Just to clarify then, the aggregate model would be owned by OBR?

Sir Alan Budd: Ownership is a difficult issue to me. We would have control over it and access to it.

Q33 David Rutley: Let me ask a different question then: is it the same as the Treasury's model?

Sir Alan Budd: At the moment there are not two models for aggregating, there are many, and they are used jointly by the Treasury for its purposes and by the OBR for its purposes, and when they are being used by the OBR then we are responsible for their content and for their nature and certainly for the outputs that these models produce.

Q34 David Rutley: Just expanding the questioning on forecasting to frequency, you state clearly that you think that there should be two forecasts?

Sir Alan Budd: At least two.

Q35 David Rutley: When you say “at least” what would your optimal number be then? Should there be three? Should there be one in the autumn, right before the Budget, and then one right after to assess the impacts? What would you think would be the sensible number and at what point in the process should they kick in?

Sir Alan Budd: I also think that two is a sensible number. When I say “at least” that is because I do not want to leave the Chancellor the choice of choosing only to have one. This is a constraint that we are trying to impose on him rather than on ourselves. I do think two is a very sensible number, the second being roughly halfway through the fiscal year, so the autumn is a sensible time to produce a new forecast, to assess how the previous forecast is going in terms of both the economy and the fiscal numbers, and, if appropriate, to comment on how progress is being conducted towards the mandate that one would have more information on that. So two a year is rather a good number but certainly one would leave open the possibility that the Chancellor could request additional forecasts.

Q36 David Rutley: Would you also want to have a different forecast if there were shocks in the system for example and you perceived there to be a need to do another forecast prior to a Budget, for example?

Sir Alan Budd: I think that would be something done by consultation but one can imagine conditions in which new information is so important that it would be sensible to reassess the state and the future of the economy.

Q37 David Rutley: On a totally different subject—structures—in your note to the Chancellor in paragraph 61 you talk about, broadly, three options. Obviously one of the things we are all agreed on is the importance of the independence of the OBR and you talk about there being three options—office or agency of the Treasury, executive non-departmental public body or non-ministerial department. You seem quite agnostic on that. I probably am not agnostic, I just do not know what some of these bodies are, and it would be great if you give your thoughts now that you have probably had a further chance to reflect on which of these would be most appropriate. We do have other models like the National Audit Office and there are learnings from other international bodies. Have you had a chance to further reflect and think about which of these would help secure independence?

Sir Alan Budd: Thank you. I found the report from the Institute for Government *Read before Burning*, which, as I am sure the Committee knows, is a report about what it calls arm’s length bodies, very helpful. It actually mentions the OBR in this report and it suggests that there should be a category called an independent public interest body with not total independence but a fair degree of independence, one from the top in terms of independence, and that would seem rather a good model and rather a good category for the OBR to fit into. That is my personal view on this matter so as I have thought about it further I thought that was a very neat way of categorising bodies and rather a good place to put the OBR.

Q38 David Rutley: Where would that fit in those three options then?

Sir Alan Budd: I think that is why they are trying to make a different one. I suspect it is somewhat closer to a non-ministerial department but here you are taking me out of my comfort zone!

Chair: We will come back to it. Michael Fallon?

Q39 Michael Fallon: When it comes to the mandate, you have produced six paragraphs examining the arguments for and against whether you should comment on fiscal policy, but you do not actually set down your own view. Do you not have one?

Sir Alan Budd: My view on most things, Mr Fallon, after a great deal of thought is that it is all very difficult, and that was my provisional thought, and it remains so in this case. I can honestly see arguments on both sides. If this becomes a very authoritative, skilled body, then it would seem desirable that it uses those skills to help solve some questions which are challenging for everybody, and I think that includes the design of mandates, for example, and what I continue to hope is that this body would analyse such issues and such questions without being charged with or choosing to give advice. It would not be an independent source of advice for the Chancellor but it would be an independent source for analysis. I have discussed this matter at various times with one of your later witnesses, Professor Simon Wren-Lewis, and if you were to ask him the same question I would be very interested to hear his answer. Without wishing to commit him, he does believe that both things can be done, that you can have a body which considers these matters but does not give advice on them, and I think that is rather a good model, and I think the core of the OBR’s activities should be the provision of these forecasts and the analysis of long-term sustainability

Q40 Michael Fallon: But if a future Chancellor sets himself a fiscal rule and then starts to bend it, what you are suggesting is that you would be doing the analysis of how he had bent it and where he had bent it but would not actually tell anybody?

Sir Alan Budd: I would have to think what was meant by bending, but may I give an example? There are those who claim that the Golden Rule, which had to hold over the cycle, became discredited

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because the Treasury was able to change its view on when the cycle began and ended. Under these proposed arrangements which cover us I do not think that such a change would be possible. It would be the OBR which would have determined when the cycle began and ended. The Chancellor has a mandate for the cyclically adjusted public sector net borrowing. It is going to be the OBR which determines what the cyclically adjusted figure is, not the Treasury, so that is at least one possibility of bending which is removed under the current arrangements.

Q41 Michael Fallon: But there may be others that do not directly affect the sustainability issue but yet still touch on fiscal policy that you may be analysing but you would not necessarily publish advice on.

Sir Alan Budd: I find it hard to think of examples but I think this is a much tougher regime than has existed before. I think the OBR is given considerable powers to comment, rightly within its remit, on certain what might appear to be evasive actions.

Q42 Michael Fallon: Because you also suggest that undertaking wider research and analysis is important to building up the OBR's reputation whereas the IFS in its Green Budget said it might undermine the credibility of the OBR if it ranges too widely.

Sir Alan Budd: Why do you say that Mr Fallon?

Q43 Michael Fallon: The IFS said that in its March budget. It said the cost of commenting on broader economic policy could be getting drawn unnecessarily into conflict with other parts of the policy-making process and thereby reducing the credibility of the OBR and its key function.

Sir Alan Budd: I think you have the privilege of Mr Chote appearing before you later this morning and you can ask him what he meant by that, but I assume he meant much wider into questions of whether cuts should come on spending or through increases in taxes and that a narrow focus for the OBR is highly desirable. I do not think he is disagreeing with us about that.

Q44 Michael Fallon: You also suggest that undertaking broader activities would make the OBR a more attractive place to work. Are you concerned that simply confining yourself to pure forecasting might make it rather difficult to attract people of the calibre you need?

Sir Alan Budd: I have said in public that no-one in their right mind would take on a job in which your success is going to be judged by your success in producing fiscal forecasts. Of course I was not in my right mind when I took on this job, but others will of course have learned from that experience! I do think that it is desirable that they should have other activities, but of course we cannot set up a body just to make life interesting for people who might take on public jobs, so again there is a balance between those two aspects.

Chair: And the *quid pro quo* is that we cannot do without a forecast even though nobody can succeed in the job.

Q45 Andrea Leadsom: I just wanted to know, Sir Alan, whether you consider that there is any chance the OBR could become as independent as the MPC is broadly considered to be?

Sir Alan Budd: I hope so. Of course I am an enormous admirer of the MPC. They do have the benefit of having a very simple task, and hitherto one instrument and now two instruments; simple in the sense that is simply defined, not simple to achieve, and that is a great advantage. The remit of the OBR is somewhat wider and pinned to an impossible task, namely producing correct fiscal forecasts, so it is going to be hard, but I would certainly hope that the OBR would achieve the type of reputation that the MPC has achieved.

Q46 John Thurso: I just want to pursue that theme particularly of your independence but can I ask one very quick technical question which I suspect is probably for Mr Dicks.

Sir Alan Budd: I hope so!

Q47 John Thurso: In paragraph 12 in your advice it states that the judgment that you are required to give on the Government's policy was consistent with a better than 50% chance of achieving the fiscal mandate. This may be the difference between business and economics but when I was in business I would not go for 50/50; I would be looking for 80/20 or 75/25. Is that not a very low probability?

Mr Dicks: I think that is the Chancellor's probability. He asked us to judge whether he was going to meet his mandate with a greater than 50% probability chance and that of course came out of our fan charts.

Q48 John Thurso: So you were simply responding to a question?

Mr Dicks: Yes.

Q49 John Thurso: Would you consider it part of your remit to suggest that the question might be slightly different?

Mr Dicks: I think the advantage of 50/50 is that it drops out of our median forecast. We adopted a median as opposed to the modal forecasts, say, that the Bank of England uses precisely because it balances the upside and downside risks and it does enable you to make that 50/50 judgment, and so our approach dovetailed into his request I think.

Q50 John Thurso: Coming to the main questions I wanted to ask, perhaps, Sir Alan, if I could start with you, the BBC summed up your evidence to us on the last occasion in respect of the independence of the OBR as: "Trust me, I am Sir Alan". The critical point about that of course is the quality and judgment and perception of the people who will be sitting in your three slots. To what extent does the credibility of the entire office rest on the credibility of the occupants of the chairs you are in?

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Sir Alan Budd: I think in its early days that may be inevitable because there is no track record and no history by which to judge the performance of the OBR, so it is perhaps inevitable, however undesirable it may be, that there is focus on the individuals who are doing it. However, I would hope through time that while one would still hope and assume that only excellent people are appointed to do this post (in future of course—I am not referring to myself!) that the names would matter less than the performance. That is how the credibility and the reputation will be built up

Q51 John Thurso: To that end you recommend in your advice that it should stick with a model of a committee of three with the relevant back-up and secretariat. Would it not be helpful to have four or five simply to give a breadth and depth on that issue of credibility?

Sir Alan Budd: Can I ask my colleagues what they think being a team of three?

Mr Dicks: We were put together because of the expertise we brought to it, as I said earlier, in economics and public finances. You are imagining another economist to keep a check on me and another public finance person to keep a check on Graham and thinking that a dialogue of four or five would improve the dialogue of two or three. It might: I do not think I have a strong view. We have worked well as a “hit squad”, in your Chairman’s words, but there is nothing written in stone that says only one of each should be on the OBR Committee.

Mr Parker: It is difficult to say. I think it was quite hard this time but largely because of short time. I think in future if there is a bit more time for the forecast that three people would be enough.

John Thurso: Can I just clarify, I do not for a moment doubt that the three hard-working people before us are capable of doing the work. I am talking about a governance issue and if you look at the MPC, for example, and the number of people it has, and you then read the minutes afterwards you can see the dynamics of the discussion, which of course enhances its credibility and its independence. That is my point.

Q52 Chair: While you are thinking about that question can I amplify it just by asking whether you think that the Chairman should speak for the OBR or do you think that you should have equal voting rights ultimately, as the MPC does for example?

Sir Alan Budd: The process we have followed, which has not ever involved a vote, has been three people. Certainly the Chairman does not provide the decision. It is a matter of consultation and discussion completely.

Mr Dicks: I think the MPC is different. They meet once a month and make one decision, or two now that there is QE as well. We met every day and every day we made a decision on some of the things that I have been talking about such as trend growth or the output gap or the outlook for credit availability. This is the forecasting process. It is an iterative step-by-step procedure and you make hundreds of decisions along the way.

Q53 John Thurso: The point that I am driving at, there is an interesting article by Danny Blanchflower in which he alleges that the Governor drove the forecasting process and that when he was in front of the US Senate version there was a whole range of Nobel laureates in front of him who gave the thing credibility, the suggestion being that if you have quality people at a certain number that of itself lends credibility and independence, so that is the point I am asking you to address.

Sir Alan Budd: Yes. This is a very interesting proposal and certainly I am not asserting that the ideal number is three or that a larger number would not be better. Three has worked extremely well during the process which Geoffrey Dicks has just described and a larger number might not have worked so well, so I think three has worked, but it has of course meant during the forecast process an enormous amount of work for all three of us.

Q54 John Thurso: Can I turn to another part of your independence which you have slightly touched on before and that is the relationship with Parliament. In one part of your advice, I think it is paragraph 65, you suggest that the OBR report to Parliament through the Chancellor and in another area there is a suggestion that it should be to Parliament direct. The reality is that you will come before this Committee and that will probably be the scrutiny. Is there not a danger that if you are seen to be reporting through the Chancellor that diminishes your independence and should you be like some of the other bodies we have talked about reporting direct to us rather than via?

Sir Alan Budd: Yes. The answer I gave earlier, as you heard me say, had to do with ministerial responsibility. We have thought and we have heard of proposals that we should report directly to Parliament in the way that the Congressional Budget Office reports directly to Congress. I think in this case reporting through the Chancellor is inevitable because it is the Chancellor who takes the budget decisions and who uses and publishes our forecasts. Of course, Parliament has a very legitimate interest in questioning us and in the forecasts that we produce, but these are an instrument of budgetary policy, as our earlier discussion revealed, and therefore I think it is appropriate that we are reporting through the Chancellor rather than directly and only to Parliament.

Q55 John Thurso: A last question, if I may, Dave Ramsden in his evidence to us was enthusiastic about you and the words he used, if I recall rightly, were that you had achieved more in eight weeks than he had achieved in 20 years.

Mr Dicks: In transparency.

Q56 John Thurso: In transparency. However, the heart of your success and your successors’ success will be around transparency. How will your successors ensure that all of the figures that this Committee has asked for for years, and been told either they did not exist or were not available and

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now appear to exist and be available, continues to be available to us? How can you get that into the DNA of the OBR?

Sir Alan Budd: I am a former Treasury official and one golden rule is never give a number because you may be asked for it again. In general, once you have produced a number you can never take it away again. We have already given a very, very large number of figures which, as you say, were not for some reason available beforehand and once we have done this the precedent has been set and there is no going back on that at all.

Mr Dicks: And our intention is to publish more rather than less.

Sir Alan Budd: Yes.

John Thurso: More power to your elbow. Thank you, Chairman.

Chair: We want to thank you for that increase in transparency which your hard work has brought in the space of those few weeks. Chuka?

Q57 Mr Umunna: I just want to ask a little bit more about independence before I touch on the appointments process and, in particular, this issue about the information upon which forecasts are based. I know you said that you had some reservations about the notion of a Treasury mindset when people are talking about this being provided. Perhaps I could put it another way. I cannot think of a better way than actually citing something that Stephanie Flanders said a couple of weeks ago. She started by saying that obviously it is important that the official Budget forecasts are based on the best information available because it forms the background for the Government's economic policy and she was saying that this would mean that information was only available deep inside the Treasury. Just to quote her, she says: "So to put it in a way that Bill Clinton would recognise, you need the OBR to smoke the same stuff as the Treasury but not inhale. Only Mr Clinton knows whether that was possible in his case but when it comes to the OBR I am beginning to have my doubts. After all, the closer the OBR is to the corridors of power the more it is going to know, but the more it knows the more its independence is going to be put under strain." Do you agree with Stephanie's analysis there?

Sir Alan Budd: I do not understand why knowledge threatens our independence. I do not see the connection between those two statements.

Q58 Mr Umunna: So you think it is possible to smoke but not inhale?

Sir Alan Budd: Without giving any impression that I have the slightest idea what Mr Clinton was talking about, then I think the answer is Yes.

Q59 Mr Umunna: Okay. Can I move to the appointments process and perhaps I could start by reciting back something you have just said which was "I was not in my right mind when I took on this job." You have already said that it has been quite a painful experience. Given that you are the only

occupant of this post to date, and this is what you are saying, how on earth are we going to attract somebody of similar quality to yourself to your post?

Sir Alan Budd: Of better quality one certainly hopes! As you know, the process has begun and I am full of hope that excellent candidates will apply. It is a challenging and interesting job and perhaps some of the experience that we have had will not be repeated. It also goes back to an earlier question that if the reputation of this body depends upon the first individuals who are appointed, the way to harm the reputation of this body is of course to harm the reputation of its members. That is a process of which I have been very conscious. The longer we go and the better work we do, the less exposed the individuals are and the more concern with the work that they do, and I hope that that will be the case, and I believe it will be the case, and I think we shall have excellent people applying for the post.

Q60 Mr Umunna: So despite your experience the message from Sir Alan today is "Everybody apply, please"?

Sir Alan Budd: Yes, please.

Q61 Mr Umunna: Obviously the Chancellor has proposed that we have a pre-appointment hearing here. What do you think the criteria are that we should use to judge whether we have the best candidate in front of us?

Sir Alan Budd: I may have mentioned that I am a member of the committee that will be interviewing candidates and making recommendations to the Chancellor, so already we are thinking about that process. Since one of the core activities is fiscal forecasting, it is essential that the people who have the three jobs are experienced in economic and fiscal forecasting, so that is possibly the first criterion, and I think really everything follows from that. These must be people who know about fiscal policy and cannot simply produce forecasts but also discuss issues of fiscal sustainability and so on, and those who can perform the tasks which have been allocated to OBR. My colleagues might also want to add their views.

Mr Parker: I have nothing to add.

Q62 Mr Umunna: Would you have been prepared to go through a pre-appointment yourself? Would you have enjoyed that experience?

Sir Alan Budd: I have once been through a post-appointment process when I was first appointed to the Monetary Policy Committee and I enjoyed it as I enjoy all appearances before the Treasury Committee.

Q63 Mr Umunna: I note in respect of the other two members of the Committee the proposal that we have pre-commencement hearings. Given there are only three of you on the Committee, do you think there is a case for perhaps doing the pre-appointment hearings for whoever the successors are of the other two members of the Committee whenever they decide they no longer wish to do the role or do you think that is going too far?

Sir Alan Budd: I am not sure.

Q64 Mr Umunna: If I just explain my motivation in asking the question which is that there is obviously a slight concern that the reputation will very much hang on the Chair and to spread out the burden perhaps you can achieve that by giving the same importance to the appointment of the other two members of the Committee as the Chair by having a pre-appointment hearing as well instead of a pre-commencement hearing.

Sir Alan Budd: I must admit I am assuming that the same process will apply. I may be wrong about that. If I am wrong I will be corrected. What did the Chancellor say to you?

Q65 Mr Umunna: I think he is proposing to have a pre-commencement type process in the same way as for MPC members.

Sir Alan Budd: Pre-appointment, that may be fine. Yes, sorry, then I misquoted the Chancellor.

Q66 Mr Umunna: I just wondered whether you think there is a case for having pre-appointment hearings for the other two members of the Committee as well given there are only three of you and you said it is very much a collaborative process.

Sir Alan Budd: That is a more difficult one. I can see it in the case of the Chairman. Again, I do not know whether my colleagues have views on this because people like them would be subject to it.

Mr Dicks: I am an economist and I think there are good arguments on both sides. I think the Chairman is key. The other members I do not have a strong view. I would love to have appeared before you of course!

Q67 Mr Umunna: I hope so. I suppose my final question is this: obviously amongst economists there are different views on, for example, the approach towards fiscal retrenchment and I just wonder whether there is a bit of an issue here in respect of economists who have taken a different view publicly to the Chancellor and the Treasury ministerial team on the extent to which we retrench fiscally, how quickly and how deep, and whether they will feel compromised in applying to take your role if they have sounded off about their views on that in the past and they do not necessarily fit with what the Treasury ministerial team have put forward? Do you think that is a problem or do you think that will not be a problem?

Sir Alan Budd: I hope it is not a problem because one would want the OBR generally to represent a wide range of views. Of course, we were not asked about the speed at which the deficit should be reduced, but, of course, I realise that our forecasts did implicitly provide some answer to that question, which is not the answer that everybody would give. Therefore, I would hope that the OBR would represent a wide range of views on this matter, and reach the best decision, as far as forecasting is concerned, as they could.

Mr Umunna: Thank you.

Q68 Mr Love: If the Chancellor goes through with his recommendations to our Committee last week then this Committee will have a veto on the appointment of the Chair. Do you think that will have any influence on, first of all, the people who apply for the job—recognising that that would be one of the tests—and, secondly, if you are a member of the appointments panel from the Treasury, any influence on you as to the qualities and skills of the person that you will appoint? Will it change the qualities and skills that you are looking for?

Sir Alan Budd: On your first question, I hope it will not discourage anybody from applying, and I am not sure why it should do so. Anybody who believes that he or she is qualified to do this post should also feel that he or she is qualified to be interviewed by this Committee on a pre-appointment basis. As far as the appointment panel is concerned, I do not think we should be influenced either. We will recommend to the Chancellor of the Exchequer the two or three names of the people we think are best fitted to perform it and the Chancellor will choose one from those three. I think our process will continue exactly as it would have done, regardless of the role of the Treasury Select Committee.

Q69 Mr Love: In the Chancellor's letter to the Chairman of this Committee of 19 July he states, under "OBR Forecasts": "In the formulation of policy I will retain the right to disagree with the OBR's forecasts." What happens in those circumstances?

Sir Alan Budd: If he makes policy choices which are inconsistent with our forecasts, as the letter says, he will explain his actions to Parliament through this Committee. He will have to explain why he is behaving in the way that he is doing.

Q70 Mr Love: Clearly, the Chancellor has said that and we would, of course, ask him anyway when he comes before the Committee. I was really asking what would be the OBR response, to stress its independence, should the Chancellor decide that as a policy option he will reject the forecasts that you have just made?

Sir Alan Budd: I think they would repeat that the Chancellor's actions, which he is of course completely free to take, are inconsistent with the best judgment of the OBR. Of course, that would be public knowledge.

Q71 Mr Love: We have a Statistics Commission, the Chairman of which is endorsed by this Parliament and when somebody abuses, misuses or takes advantage, shall we say, of statistics he will comment publicly. How far will you go in commenting on the decisions of the Chancellor when they rest on rejecting your forecasts? How far do you think you need to go to make sure that you are maintaining your independence?

Sir Alan Budd: I can only repeat that the OBR will make it completely clear that the Chancellor's actions are inconsistent with the OBR's view of prospects for the economy. This will be completely public; no one can hide it, and the OBR would not

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attempt to hide it. It may not be completely parallel to the type of task which Sir Michael Scholar performs, but it would be very public and completely independent. There would be no one who was not aware that this disagreement had occurred.

Mr Dicks: Would it not add to the OBR's independence? You certainly could not say an OBR with which the Chancellor disagreed was his poodle, could you? If their view of the world was very different, that would be a demonstration, I would have thought, of their independence.

Q72 Mr Love: The point I am trying to make is would you comment on the policy options that he had decided to undertake in rejecting the OBR's forecast, or would you just stick to the mantra—if I can put it that way—that he has rejected your forecast and, therefore, you reject the totality of what he is doing?

Sir Alan Budd: I think the form it would take would, for example, be as follows: if there is still a mandate and the Chancellor says: "My actions are consistent with achieving this mandate," the OBR will say: "On our best judgment his actions are not consistent with achieving this mandate." I do not think we would not comment on individual decisions or individual parts of these decisions; we would just point out that the OBR disagreed with his claims to be acting in accordance with his mandate.

Q73 Mr Love: Let me ask you one final question. You mentioned earlier on, when asked, about where the OBR should be located—and I do not know about non-departmental public bodies and all the rest of it; that is above my pay grade as well—and I would thought that you would be looking for equidistance. However, you seem to suggest that because you were taking over functions from the Treasury and you were answering questions that were necessary for the Treasury to make its Budget and other statements during the year you would be closer. Do you not see in relation to where you may find yourself in dispute with the Chancellor and the Treasury that having a little more distance between you and the Treasury would be a good thing? If you do, how would we reflect that in the way that you are structured?

Sir Alan Budd: This is psychological distance rather than fiscal distance that you are talking about?

Q74 Mr Love: Yes. Distance in terms of public perception.

Sir Alan Budd: Again, I will ask my colleagues to add comments. What is essential is that the structure is such that the OBR's independence in the role it has been asked to perform is absolutely clear, and this can be enshrined in the legislation and it can be demonstrated in action. That is what matters. The psychological closeness to the Treasury only arises out of their close involvement in the Budget process. However, that can be performed—as I believe we

completely performed it—in a way that is independent and, in particular, is independent of ministerial involvement in the forecasts that we produce. That is what matters and it is essential that that is achieved and demonstrated to be achieved.

Q75 Mr Love: Let me just press you a little on that. We have talked about personnel, and I think this Committee accepts that there will be a small number of personnel in OBR and that you will need to tap into resources of various government departments and, indeed, the Treasury as well. We understand that there will be a close relationship because you are producing forecasts for the Treasury. Do you not think in order to ensure that the public perception is one of independence that you should naturally look for the three members of the Committee, as a minimum, to be endorsed in a way that gives them the public view of independence from the Treasury? In other words, what I am saying is: should you actually be appointed by Parliament?

Sir Alan Budd: With respect, my answer to that is no. I think even in the case of Sir Michael Scholar, although Parliament approved that appointment, it was not, in fact, a statutory requirement that they do so. I think the parliamentary process in terms of the Chairman has been strengthened in an unprecedented way by giving this Committee the veto over that appointment.

Q76 Mr Love: Absolutely.

Sir Alan Budd: And it is given strength under the present proposals by the post-appointment scrutiny of the other two members of the Budget Responsibility Committee. I do believe that goes a very, very long way indeed to help ensure the independence of this body.

Q77 Chair: Sir Alan, thank you very much for coming today. Thank you, all three of you. You have taken on an onerous role at relatively short notice—clearly, out of a sense of public duty—and everybody should be grateful to you. We will close for now this session. We may have further questions we might want to bring to you in writing. We hope that you will be prepared to work with us in coming to a view about how this institution should be put on a statutory basis.

Sir Alan Budd: Of course.

Q78 Chair: Thanks for coming today.

Sir Alan Budd: You allowed me a last word last time, so may I have a last word this time? You also allowed me a first word, which I know will never be allowed again! I am assuming that this is the last time that I shall appear before this Committee as a Chairman of the Interim OBR. You referred to the "bumpy ride", and I have other words for it, as far as comment is concerned, but what I hope the Interim OBR will be judged by is not the bumpy ride but by these two documents, the pre-Budget forecast and our part of the Red Book, of which I personally think that we

20 July 2010 Sir Alan Budd, Mr Geoffrey Dicks and Mr Graham Parker CBE

and all those involved in it can be immensely proud. As has been mentioned in questioning, there was a leap forward here in terms of clarity and transparency and, of course, as we have discovered, clarity and transparency themselves give rise to difficulties. Maybe that explains why this

Committee has been so little burdened with those particular qualities for the last 30 years. I hope the Committee does appreciate what we have done.

Chair: I will not add to those last words. Thank you very much for coming, Sir Alan, and thank you all three of you.

Thursday 22 July 2010

Members present

Mr Andrew Tyrie, in the Chair

John Cryer
Michael Fallon
Mr Mark Garnier
Stewart Hosie
Andrea Leadsom
Mr Andrew Love

Mr George Mudie
Jesse Norman
David Rutley
John Thurso
Mr Chuka Umunna

Witnesses: **Professor Simon Wren-Lewis**, Professor of Economics, Oxford University; **Professor Tim Besley**, Professor of Economics, London School of Economics; and **Mr Robert Chote**, Director, Institute for Fiscal Studies, gave evidence.

Q79 Chair: Welcome to this, our third evidence session on the OBR. Thank you very much for coming along, and it is much appreciated. I think we have an opportunity, all of us, to influence the structure and statutory basis of this body by making timely remarks now. We have a troika here in front of us of people who have thought very deeply about these issues over many years. I wondered if I could begin by asking each of you to comment in turn on what you see as the principal challenges there are to creating an independent OBR and in particular perhaps to orientate comments on two types of point: firstly, how to reconcile the appearance of independence with the fact that a large number of the forecasters, unless we have huge duplication, will have to remain in the Treasury when they are doing this work at forecasting time, a point which we explored with Alan, and secondly, how far, if at all, beyond the forecast we would expect the Chairman or the three people running the OBR to go in commenting on the overall fiscal stance and whether that will help or hinder the good conduct of fiscal policy and overall financial policy in Britain. Who would like to begin?

Mr Chote: You have clearly answered the question as to what the biggest challenges are by identifying in particular the first one, which is the question of how you first have the reality and the appearance of independence, and yet you do not weaken the analytical capacity of the system as a whole, comprising officials and the independent body too. I think it certainly is possible to combine those two things. In some of the debate we have had so far there is a tendency to see officials as part of the problem rather than as part of the solution. In fact, one of the attractions of this reform is that it potentially offers greater encouragement, greater—not quite endorsement but it will help officials speak truth to power, as we would wish them to be doing anyway, with the knowledge that the OBR is an equally important customer for their analysis as the Chancellor is. So I actually see this as being quite positive in terms of independence, not just for this body itself but also about providing a reinforcement to what we would hope would be the role of Treasury officials anyway. I certainly do not think that the options of either taking everybody who has any involvement with the forecast out of the Treasury

and putting it into the OBR is a practical one, for all the reasons you have talked about—the number of people who spend a relatively small amount of their time on the harvest—and completely duplicating would both be a waste of taxpayers' money and you would have people duplicating the policy expertise as well. In a way, it is a slightly stepped up version of the New Zealand model, where you have the officials taking responsibility. In that system it is the Permanent Secretary who signs off the forecast and sometimes the Finance Minister publicly disagrees with it after the event. I do not think in the country that invented “Yes, Minister” we could ever get away with having Sir Nicholas signing off a forecast and that being deemed independent, but having this combination, although it is clearly a difficulty, does present possible benefits for both sides of the relationship, for the OBR having access to good analysis and for officials feeling more empowered to speak truth to power, to Ministers.

Q80 Chair: Before we leave that subject, it is very interesting: are you leaning therefore strongly towards what is known in the trade as the validation model?

Mr Chote: The model as I understand at the moment is the idea that you take those officials who are spending the majority of their time on the forecast out and put them into the OBR. That seems to me to be a reasonable one. I was slightly surprised when Alan said he thought that would only be three people; I would have thought there would be rather more people than that who would come under the category of owing their primary loyalty to that sort of area but, essentially speaking, you are having something where you want to make the most of the knowledge that is within the system to obviously demonstrate independence. At the core, you demonstrate independence through the quality, the explanation and the presentation of the analysis you do. You could locate this institution in the Isle of Skye and staff it with Benedictine monks and people would still be concerned about its independence if they look at its outputs and say, “Why did they say that?” Explain your working, be transparent about it and that at the end of the day is the greatest source of credibility for a body such as this.

Q81 Chair: Can I take up your suggestion and move along the line on the first of the two points I raised and then we will come back to the second.

Professor Besley: I can probably agree with what Robert has said. The only thing I would really add is I think the independence of this organisation really resides at the top of the organisation. I am perfectly relaxed about the idea of having analysts and others interacting with people from the Bank, from the Treasury, from wherever, to try and come up with the best technocratic solution to the forecasting problem without thinking that that is going to compromise in any deep sense the independence of this organisation. It is really a co-operative relationship to make sure that we make best use of expertise wherever it resides and to make sure that is brought into the process. What really counts is that the individuals at the top are able to have a staff of critical mass who they can use as a task force to interrogate, to provide that really independent perspective on what is happening in Treasury or wherever else is relevant, and that that body ultimately signs off on the reports of the organisation and signs off on the forecasts and is the core at the level of which independence really resides. I think we need to separate independence at that point from the way the staff operate on a daily basis, which I could imagine really is not compromising independence that much. I have seen the way it operates, for example, at the Bank of England, where the staff will spend quite a bit of time talking to wherever the expertise resides without in any sense compromising the independence of the Bank.

Professor Wren-Lewis: Yes, I would probably agree with what has been said. I think the model that we seem to be moving to, where there is a core staff from the OBR—and I think it certainly has to be more than three—which is responsible for the forecasting, which taps into the resources of the Treasury in terms of detailed information, is tenable, and I think that model can work, but it does raise a public perception of independence problem which I think one needs to address and think about whether there are things one can do as well to, in a sense, counteract that impression that maybe the OBR is too close to government. Certainly, if you look around similar bodies around the world, fiscal councils in other countries do not have a major problem of independence but they are also perhaps a little less involved in government than the OBR is planned to be. They tend to be watchdogs which comment on what government does rather than replace an existing activity of government. What the OBR has done is replace an existing activity of government and that makes it more vulnerable to the accusation of lack of independence. In a sense, we need to think about active ways in which we can promote the independence of the OBR, given that there is this perception problem.

Q82 Chair: And on the wide remit versus the narrow remit point?

Mr Chote: The focus as it has been set out so far is really in terms of the mandate that the Chancellor has currently set, which is really looking over a five-

year view, and sustainability, which is clearly looking over a much longer time horizon, so you are looking at the prospective paths over 50 years or beyond, which essentially are the sort of issues you are looking at. For example, on the issue about whether the OBR should comment on the merits of the mandate per se in the short term, I think the way it should do that is by looking at its consistency with sustainability in the longer term. So it has responsibilities to judge on and it would certainly be reasonable to say if you just achieve the mandate that you have set out, that does not deliver you sustainability on whatever analytical approach you want to go at that with. That would seem to me to be a perfectly reasonable thing. You have then the issue of, for example, pace of consolidation: should the OBR comment on the merits of achieving the fiscal consolidation that is aimed for over five years or over eight or whatever that may be? That I do not think should necessarily be recommended on but, clearly, the fact that it is now responsible for both macro-economic forecasting and fiscal forecasting means that you are, by producing forecasts of both, implicitly reaching a judgment on whether you think that action to achieve the mandate with the degree of caution that the Government is aiming for is consistent with sustaining a reasonable path for the economy or not. In doing that, it would certainly be sensible to look at the enormous uncertainties that lie both around the path of the economy and around the public finances in commenting on that. I think by doing that, you are getting quite a lot of information and analysis which others would easily use in reaching those sorts of judgments. I think the body should be wary about saying, “Well, actually, we think five years is crackers to try to achieve this. You ought to do it over eight” or “you ought to do it over two.” The fact that it has this twin responsibility on forecasting means that it is inevitably going to be commenting on that mix.

Professor Besley: I am strongly of the view that if the broad object of the organisation is to safeguard fiscal sustainability in the UK, it has to have a remit that allows it to range over the entire set of issues that are germane to that. Taking an example from the past, had the OBR existed since, say, 2000, I would hope it would have produced commentary on some of the risks around fiscal policy with respect to the taxation that was being raised from the financial sector and that it would have felt perfectly justified to raise such an issue independently because it felt it was an important part of the outlook. To constrain artificially in any way the ability of this body to comment on what is germane to that broad objective I think would compromise its independence and compromise its institutional integrity. I feel pretty strongly that some aspect of a commentary function has to be accepted within its remit under the broad heading of achieving fiscal sustainability. In terms of its other two functions—I always always thought of it having three functions: a commentary function on issues germane to the outlook, the short-term to medium-term forecasting function and then the long-term forecasting function, and I would have thought functionally the organisation would have

groups more or less devoted to each of those things. The problem with putting too much weight on the short- and medium-term forecasting is that this organisation is bound to fail if that is the way in which we judge it, because we know that the success of short-term economic forecasting is extremely limited, and for good reasons; it is just not a science, if you want to call it a science, or an art, that is fully developed to a point where we can rely wholly . . . It does not mean forecasts are unintelligent or based on deliberately misleading data. It is just the nature of the exercise, and so if this organisation is judged on the basis of whether it happens to forecast well over a two-year horizon and we come back in two years and say, "Oh, you got it wrong and therefore this organisation is not serving an important social purpose," I think that would be the wrong way to look at it. What matters is the quality of the commentary around fiscal risks and fiscal sustainability that will make this organisation useful in the public debate, and we have to firmly put that at the centre of what we are trying to achieve with OBR, in my view.

Professor Wren-Lewis: I could not agree with that more. I think the dangers to the credibility of the organisation of focusing on the short-term forecasting role are very large because forecasts are always wrong. Also, I think it would be unfortunate because it puts the focus on the short term, whereas issues to do with fiscal policy much more medium- and long-run in nature. So I think it is essential for the OBR to not just provide that role but also to look at issues of long-run sustainability, doing medium- to long-run forecasts as well, in a sense possibly putting that at least on an equal footing with its role in producing the pre- and post-budget forecast. The website of the Central Planning Bureau in the Netherlands is indicative here because the Central Planning Bureau in the Netherlands is probably closest to the OBR-type role in that it produces the Government's forecast but on their website they say that the surest way of demonstrating independence is in the quality of your analysis. The OBR needs to have the resources to produce good-quality analysis as well as producing forecasts.

Q83 Mr Garnier: You have half-answered my first question, which is really: what do you think the primary purpose is of the OBR? Within that question there are a range of arguments that have been advanced for an independent fiscal body, and one of the things I find myself questioning over and over again is that we have here three representatives of genuinely independent bodies who analyse the economy and fiscal practice; what is the OBR going to add to what you are already doing?

Mr Chote: I would make some distinction there between macro-economic forecasting and fiscal forecasting, where in a sense the OBR, as a newly created body, does not have an informational advantage in doing macro-economic forecasting over anybody else. The information that you use to do that is pretty much in the public domain. You have a resource advantage in terms of most people the equivalent of ourselves who do do macro

forecasting—we do not—have less resources to do it, so there is clearly a value there. The difference is with fiscal forecasting, where any external person is at an informational disadvantage. For example, we do not have access to an awful lot of the information on tax receipts and spending patterns that the Treasury does, and therefore there is always a suspicion when we say, as for example we did during the second term of the last Government, that we think that the Treasury is being over-optimistic in its forecasts over a five-year time horizon because we are not as confident as they are that revenues will come in quickly. There is always the suspicion in people's minds that the Treasury must know something that you do not, and that is why you have this credibility issue of the fact that Ministers can get away with politically inspired wishful thinking from time to time because they know that from outside people might well assume that they know something that everybody else does not know. Over time, if the forecasts are repeatedly wrong, obviously that is eroded, and that happened over that period. I think the value there is partly this informational asymmetry and it is more pronounced on the fiscal side than it is on the macro-economic side.

Professor Besley: I agree with that and, just building on that comment, I think one key role of OBR will be to decide how to present and disseminate data, obviously subject to suitable confidentiality wherever that applies, in order to increase transparency in debates about fiscal policy and it can only do that if it has access to the full array of potential statistics and data that are available to government and it can make a judgment about the best way to present that so that it is useful to you, to whoever is reading that. Equally, I would hope over time—it is a small point but I will make it—that OBR would be given a role in assessing how well fiscal data is being generated in the UK, much as, as I say, the Bank of England plays a role in assessing whether ONS is producing data appropriate to the conduct of monetary policy. I think there is a similar role for OBR to comment annually or some period on the quality of the fiscal statistics that we have and potential improvements in that. It can only do that from an official standpoint. So while it is true that there are independent bodies that perhaps have the analytical capacity, and I would hope the OBR would draw on that freely because there is much expertise out there that can be drawn on, it is only by having it as an official body that it can perform the role Robert that was describing.

Professor Wren-Lewis: I would like to add two points. First of all, I do not think we should over-emphasize how much analytical capacity is already there. There is some. What Robert does is extremely useful and well informed but the IFS looks across a range of issues to do with taxation. It is not focused on the issue of the medium- to long-run budgetary position. The National Institute does many other things as well. So I do not think it is as if there is an over-crowded field already there. I think there is plenty of space for additional expertise. That is the first point I would make. The second point I think is that inevitably a fiscal council that is set up by the

Government, an OBR, does have additional authority and additional political clout so that if the OBR says you are doing something wrong, it is much more difficult for the Government to shrug it off and say, "Oh, that is just one view and there is another view over there" because it is a body that it itself has set up. It is interesting to look at this historically. Both the IFS and the National Institute did quite clearly say that the previous Government were making over-optimistic assumptions on the Budget and what you have to ask yourself as a thought experiment is "Well, OK, that didn't seem to have that much effect but if an OBR had been in existence, maybe that might have had a little bit more clout."

Q84 Mr Garnier: Professor Wren-Lewis, I gather you proposed an institution similar to the OBR in 2006 in order to help stabilise national debt. How do you think the OBR matches up to your original plan and your expectation?

Professor Wren-Lewis: Actually, I think I wrote my first article proposing something like the OBR 14 years ago, so it is something I have been banging on about for some time. No, you are right; in 2007 I did put forward a fairly detailed proposal and there are a lot of similarities between the OBR and that. The major difference is I did not see the OBR as actually replacing what the Treasury does in terms of producing the post-Budget forecast; I saw it as producing an alternative or commenting on that forecast but not replacing it. So the OBR has almost gone a little bit further than my proposal.

Q85 Mr Garnier: A much wider point, as we are going back, if you like, to the General Election when everybody was rushing around making promises, George Osborne, when we announced our Manifesto, and I quote, "promised today that by the time of our first Budget we would have set up and be running an Office for Budget Responsibility", which we have done, "that will hold a Conservative Government to account for the promises it makes to the British people." Do you think that the OBR is doing that already and will it be able to do that in the future?

Mr Chote: In terms of some of the promises, in terms of the fiscal mandate that was set out. What was slightly odd at the election was that you did not actually have the mandate formalised until the time of the Budget, so you had this slightly odd arrangement where you had the initial pre-Budget forecast and then mandate and the policy measures together there, and crucially, at that stage, the Government decides in seeking to achieve the mandate with what caution it wishes to do so, i.e. it has not set policy so as to achieve the 50-50 probability of achieving the mandate that the OBR is tasked with saying what it is necessary to do, but has said more than that. One difficulty in terms of holding to account, not an insuperable one, is that we have now moved to a forward-looking target. The idea, I think, is that this mandate rolls forward, although the Chancellor has also mentioned the possibility that the time horizon could be shortened, so quite where we end up with that I do not know.

The previous Conservative Government had a series of policies aimed at achieving balance in the medium term, or words to that effect, and when Labour came in they made for a fiscal rule that was defined in a way that you could judge it as pass or fail by actually saying it has to be achieved between two points, points which elasticated entertainingly over that period, but, nonetheless, you could after the event say whether this had been met or not. In assessing and describing the success of the Government in achieving what it is seeking to do will depend on how the mandate is, as it were, redefined as we move forward and to what extent you say, "This is what they set out to do in five years' time. Five years on, obviously, a lot has changed and that is no longer the target that you are aiming for." If you have, for example, fiscal drag in the system, there is always a built-in fiscal tightening over five years on unchanged policy because the average tax rate rises, so you can always be running a roughly 1% of GDP deficit and say with hand on heart that on unchanged policy in five years' time you will be in balance, and you can keep doing that every year and you just put off the year and you just never actually get there. So it is quite complicated given this rule to actually have a pass/fail test but that in no way would prevent the institution saying whether policy has been set consistently with the objectives the Government has set out for itself.

Professor Besley: That discussion just illustrates, I think, why it is important that the OBR have a wide enough mandate to comment on exactly that set of issues, because if they feel that the way in which the mandate is proposed is not actually suitable to the task, they really ought to be saying that, and I would hope the Director of OBR would say that.

Chair: We have quite a bit of business to get through this morning, so if witnesses feel they have not been given a fair crack of the whip on a particular question, please do write in. Written responses will be treated as of equal value. I know there are a lot of colleagues who want to come in.

Q86 David Rutley: There seems to me some consensus amongst you that there needs to be a wider commentary function for the OBR going forward. Just to test the outer limits though, you have mentioned the fiscal council in the Netherlands, which has gained a reputation for costing government policies and also opposition policies. Would the OBR or should the OBR go that far, just, again, trying to test what the outer limit should be, in the commentary function?

Professor Wren-Lewis: Can I start by a simple answer, and that is "yes". I think that is a good thing to do anyway because I think it will raise the level of public debate around elections, it would stop opposition parties promising to do everything without costing it properly. I also think it would foster independence, the notion of independence, because you would start a dialogue not just between the OBR and the Government, which is a necessary dialogue and is always going to be there, but you also start a dialogue with the Opposition. I think that would be useful for independence as well. So my

answer to that is a definite “yes”. I mentioned the parallel between the OBR and the Central Planning Bureau before and I think it is no accident that it also does this role of costing Opposition policies. I think that is a very good idea.

Professor Besley: I would sound one note of caution on that general idea though: if the OBR—perhaps this would be relevant only around election time—was constantly having to respond to requests to do analysis of different programmes from all comers, the level of resource it would need would be enormous to be able to service such requests. Provided there is a resource that is consistent with being able to do this, it is a fine idea but my worry is it would really stretch an organisation to suddenly find every new policy from any place in the political spectrum was being put to OBR for a proper analysis and costing at any point in the political cycle.

Mr Chote: There is clearly a problem here that the costings are going to have to be done in most cases, for example, a welfare package or a corporate tax package, by exactly the people that we have described in the Treasury, who are only spending a relatively small amount of their time on the forecasting, so it really is as much a question about whether Treasury resources should be used in that way or not, because if the OBR was asked to cost a proposal to equalise the CGT rate with income tax, for example, that is not something that its 10-15 people would have the capacity to do. That is the team with the expertise in that area within the Treasury. So actually finessing that would be quite difficult. You can think of this role of the opposition parties, and there are a number of elements to this. Simon has mentioned the Dutch model, the Central Planning Bureau. There basically the parties submit their plans prior to the election and, God help them, there are nine parties that the CPB has to actually run the slide rule over, and that is clearly a very resource-intensive piece of work.

Q87 Mr Mudie: It will be easier: we are now down to two!

Mr Chote: We cannot guarantee that that will always be the case. There is a sustainability issue perhaps there. The other issue which we have at the moment with the costing of Opposition policies—and I do not know whether this has happened under this Government, as it did under the last one—is that you have this odd model whereby Ministers would ask Treasury officials to cost Opposition policies privately and from outside there occasionally seemed to be a suggestion that if the answer was disobliging, a conveniently timed Freedom of Information request would ask for that information and then that came into the public domain. If that sort of process continues, there is an interesting question there as to whether that should be done, because if that policy was actually enacted, the OBR, as it did in the Budget, would have to sign off the costing as reasonable. If the Government is going to release its costing of somebody else’s policy, should the OBR be signing that off? I think there are several dimensions to this area but it is certainly worth

considering. There may be an issue in terms of going to the full Dutch model of the body needing to establish its credibility before going all that distance.

David Rutley: Just coming on to structures, obviously, it is key to establish independence. I just wondered what your thoughts were about the optimal organisational or institutional structure that should be developed for the OBR. Sir Alan pointed to a category from the Institute of Governance view on this that there should be an independent public interest body or such body. Do we need to look at something like the National Audit Office as a model? Where would you see this body being created? The other question which perhaps in the interests of time you could answer is, should there be three members of the Budget Responsibility Committee or should it be five? Should that be a review body or should it be, as it is at the moment, a roll-your-sleeves-up, do-it body?

Q88 Chair: Can I ask the witnesses to keep their answers brief and if they want to amplify what they say in writing, please do.

Professor Wren-Lewis: I do not really have that much expertise on the general issue of different quangos and how they are structured but on the point about the Budgetary Responsibility Committee I do have a clear view, and that is that I think it would be a very good idea if that body had what I think Sir Alan has called non-executive members, such that it became a much wider board where you had the three members as at present but you also had people who were not on the staff, who were not drawing a salary, but had expertise in the area of fiscal policy and macro-economic forecasting, who could play a supervisory role at a professional level. I think that would be very good both for the quality of the work that the OBR did, for the internal governance, and also for the protection of independence as well; I think it would help there.

Q89 Jesse Norman: I would like to pick up on some of the questions raised earlier and just take the situation, for example, after the year 2000 and look at where the scope of the OBR might have fallen. Presumably, your view is that it should have been able, given your commentary function, to comment on the rise in public spending and public indebtedness. Should it have been able to comment on the fiscal implications of, for example, the housing bubble or personal indebtedness, or is that the other side of a line? How do you draw the line as to commentary on the current economic situation?

Mr Chote: I think those sorts of issues about what is going on in asset markets are more to bring together the long-term sustainability, the fiscal analysis and the macro-economic forecasting elements. If you believed that the future expected income from the financial sector, for example, looked implausible on the basis of the analysis you did of the likely or possible paths of that, that would certainly be something that is reasonable to talk about. You described a spending problem, that that was a

spending problem, there was too much spending; you could equally of course describe it as a not-enough-taxing problem, that actually, the errors showed up not because the Government was spending more than it had expected to, except when it did so deliberately, but that it did not raise as much revenue as it had hoped to do. So arguably it is two blades to the scissors and you could say it is an under-taxing policy as well as an over-spending one. I would be wary—we have certainly taken this approach at the IFS—that it is not for us to comment on whether we should be a high-taxing, high-spending or a low-taxing, low-spending economy. You can say that but, of course, at the same time, if you take a very broad view of the sustainability issues, you may say that the individual details of particular policy measures, those sorts of judgments, will affect the long-term productive potential of the economy and, arguably, anything which affects that in some senses impinges on sustainability and you can draw your remit as widely as possible. The line is clearly blurred here and you have to take a sensible approach as to how far you push it but I would certainly be happier with looking at the implications of what is going on in asset markets for the macro-economic and fiscal outlook than I would be on reaching a judgment about whether we are together spending and taxing too much or spending and taxing too little. The focus is on the gap between the two: famously, if you go for Swedish levels of public service and American tax rates, that is not sustainable.

Professor Besley: Your question really underlines why it is important to have somebody as a Chair of OBR who has good judgment about how to interpret the mandate. I would have been very disappointed if the Head of OBR had not been proactive in debating the issues that you raise. For this to be an independent body, it has to be something that the body itself makes a judgment on where the line lies, because I do not think it would be possible to legislate or to write down a domain in which this is on limits and this is off limits. If the broad goal of the body is to maintain fiscal sustainability, then the judgment of the Chair of OBR, I assume in consultation with other members, has to be the arbiter of where that domain is and hopefully it will exercise it judiciously.

Q90 Jesse Norman: Can I just ask a supplementary on that question? Obviously, many economists believe that having a lot of debt is itself an impediment to long-term growth, so the line that you are talking about threatens to pull someone who is running the OBR into a political judgment on those kinds of grounds in that situation: it seems to me inevitably, because they will have to either accept or reject a body of academic work which bears on that question, which has in itself political implications.

Professor Besley: Yes, these issues arise, for example, with governors of central banks as to at what point they are drawn into discussions or what is the domain in which they are able to comment. This is an issue we are used to dealing with. We hope to deal

with it by having people in those positions who have good judgment and show it in relation to these tricky grey areas, but I cannot see that we can deal with it any other way than to hope we have somebody sitting in the Chair who has good judgment over those particular issues.

Professor Wren-Lewis: Just very quickly, it seems to me that the question of the general size of the state is not one that you would want OBR to discuss. The question of whether it is detrimental to run a very high but sustainable debt level is, I think, one that you would want the OBR to certainly look at the evidence on.

Q91 Jesse Norman: Is it therefore the case that none of you can really see circumstances under which there would be criticism by the OBR of government policy? Just to draw out some alternatives, you might say there will not be criticism of policy but there might be a view of the economic forecast which implies a criticism, or you might say that actually, a policy which is clearly fiscally unsustainable and detrimental for growth would be a fit subject for criticism, or you might say, as it were, there is a separate category, which is that abuse of statistics, or a misuse of the Treasury function for political purposes, was in and of itself a subject for criticism. Could you just touch on those different categories.

Professor Besley: Since, using the phrase of Alan Budd, bringing the economics back into fiscal policy is the key role of this organisation, I think provided that the Head of OBR believes that there is sound economic reasoning behind a particular position that is germane to its mandate, fiscal sustainability, they would speak out but with respect for the fact that there is a political process, and one does not want to speak out of turn, influencing a political process at certain crucial moments. We know that these are very difficult things when they happen. I would have thought that, were there a serious difference of judgment over the economy between, say, the Chancellor and the Head of OBR, that could be under certain conditions put into the public domain and debated, and that is the role of transparency in the process, to have all views aired, aired intelligently, and hopefully we can be grown up enough to have a proper debate, not a debate that is too much inflamed over that and pointing at different people in different seats having different views. We know that is how the world really looks and hopefully they can conduct themselves appropriately.

Q92 Jesse Norman: So all three categories would be, as it were, commentable?

Professor Besley: In my view, yes, but maybe others disagree.

Mr Chote: Certainly, for example, I do not know whether you mean misusing the OBR's analysis and interpreting it in a way it should not be interpreted—that is clearly something that the OBR would want to respond swiftly to. So if somebody were basically taking some analysis, misinterpreting it and drawing a conclusion that they should not have drawn from it, then I think you would respond to that very

quickly. Clearly, there are issues over whether the person doing that knew or understood, so you have clearly had the debate over recent weeks with the interim body and what was said at PMQs about the employment numbers, for example. On the issue of disagreement, I know you had a discussion with Alan on the issue about what happens if the Chancellor just disagrees with the fiscal projections and whether you just say, "Our view is that he is not going to achieve his goal if he does what he is going to do," I think you inevitably end up being rather more nuanced in response to that because of the wide range of uncertainties around any central forecast. The interim OBR is producing a fan chart of outcomes based on past forecast errors from the Treasury, which is the same way we present ours, and so it is not as though the Chancellor is either definitely going to hit the target if he follows the OBR's advice and definitely not if he does not. You can look at that in the context of the uncertainties around it. So at the moment he has set policy in such a way that if the interim OBR's forecast is as accurate as previous ones, you think he probably has a roughly 60-and-a-bit % chance of achieving the mandate in 2015-16 and a very slightly higher than 50% chance of achieving it in 2014-15 and there are clearly big uncertainties around there. So you could say, "Look, on our best judgment, he probably has a 40-50% chance of hitting it." You are not necessarily going to say, "Well, he has not taken our views and we wash our hands of the whole process"; you put it into the context of the rhetorical weight that the analysis will bear.

Q93 Michael Fallon: Professor Wren-Lewis, the IFS said that the cost of commenting on broader economic policy could be getting drawn unnecessarily into conflict with other parts of the policy-making process and therefore reduce the OBR's credibility. Do you agree with that?

Professor Wren-Lewis: You can certainly imagine a situation where the new Director of the OBR got carried away and started commenting on things which it would be much wiser not to comment on, so it is conceivable it could happen but I would hope it would not happen, and I think any sensible Director would make sure it did not. The problem with the fiscal remit is that a lot of things touch on it, so potentially your field for commentary is very large but any sensible Director will realise that you have to be sparing in your commentary and you have to focus on the things that you have particular expertise about, that are particularly in your remit, rather than discuss everything under the sun.

Q94 Michael Fallon: I understand that but it is clear that your earlier proposals for the OBR as more of a watchdog role, perhaps even a whistle blowing role, but supposing the Government started stretching its fiscal rule, tweaking or bending the rule, and the Director was uncomfortable with it, should he not say so?

Professor Wren-Lewis: Absolutely he should say; that is a clear example where he should.

Q95 Michael Fallon: So he should be able to comment on aspects of fiscal policy that are not directly related to forecasting or sustainability?

Professor Wren-Lewis: I think it is related to sustainability. Certainly he should be able to comment on things beyond the forecast itself and its production, yes. He should be able to comment on issues that impinge on fiscal sustainability. An absolutely clear-cut example is, supposing that because of some new event, the Government proposes redefining or defining in a particular way particular bits of public expenditure so they do not appear in the accounts, fiddling the figures in that sense, we would certainly want the Chairman of the OBR to say technically the mandate has been hit but only because of this rather underhand fiddling with the figures.

Q96 Michael Fallon: Supposing the Government proposed to adjust its forward-looking fiscal rule, for example, would the Director of the OBR be able to say openly that it was unhappy with the way that was being promulgated?

Professor Wren-Lewis: If he was. I think it goes both ways. You can imagine situations where, say, a couple of years before the end of the Parliament the economy is hit by some shock which means that unless the Government does something drastic, they will not hit their target. In that position, there is a judgment to be made: should the Government do something about it, or is it sensible to take a longer-term view and think this is just a temporary shock and it does not undermine the overall sustainability of the public accounts? I would have thought the Director of the OBR should comment on that.

Q97 Michael Fallon: Finally, how wide a research function do you think the OBR should have? Should it have a research analysis department that is separate from the forecasting division? Should it build up a research expertise?

Professor Wren-Lewis: It certainly should build up research expertise. Whether you need a separate department, I think probably not because there is a periodicity involved in its activities. You would probably want everyone involved in the forecast while it is going on, because it is a very intensive activity, and then you have a more fallow time when pretty well everyone can embark on research. So in a sense, I think having a separate research department would be unnecessary.

Q98 Michael Fallon: You have looked at these equivalent fiscal councils around the world. What would be the size you would envisage of the total establishment here?

Professor Wren-Lewis: Alan has mentioned 15-20. Looking at what is done around the world, something more like 20-30 I would have thought was reasonable. You are never going to match the resources which the Congressional Budget Office have; I think they have between 200 and 250 personnel, but they do a lot more than we are thinking the OBR will do. So I would have thought 20-30 is a reasonable number.

Q99 Mr Mudie: I just want to emphasize that we have not seen the Bill and all we are talking about is the Chancellor's agreement with Sir Alan. I want you to put yourselves in our position, which is that this is a very good move in terms of setting this up but if you were sitting at this end of the table, as backbench Members of Parliament, what would you be saying? Would you be seeing this as a very limited arrangement between the Treasury and the Office, where the question of freedom in the range is a matter for how brave the Chairman of the Office is, rather than a dual mandate where that could be one. Would you be satisfied with this relationship if you were at this side of the table? We have a blank piece of paper, the principle of having this office being set up, it is a very big moment for Parliament—would you be happy with it?

Mr Chote: There is what sort of relationship the body should have with this Committee, with Parliament, and there are all the issues around appointment—

Q100 Mr Mudie: Robert, the agreement is between the Treasury and the Office for Budget Responsibility. There it is there. Should we be satisfied that we have no relationship? In fact, Sir Alan pretty patronisingly said we have a very legitimate interest in questioning him. Is that the extent, when we set up this body, that a group of politicians should be satisfied with questioning? Should that role not be a more active part of this relationship?

Mr Chote: I think anybody running this body would see their primary and ultimate responsibility being to the general public, to improve the quality and trustworthiness of the analysis upon which the Chancellor was basing his decisions and you are basing your analysis and comment, favourable or unfavourable as it might be. Clearly, the fact that the Chancellor has said that this body is going to be producing the forecast means that there is a particular relationship there with the Chancellor and with officials, in the sense that you have to iterate during the process of the Chancellor coming up with a Budget, i.e., you will be talking to them—

Q101 Mr Mudie: No, that is forecasting, but we are commenting on and hoping for a broadening out. That is a matter between the Chancellor and the courage of the Chairman. We have no part to play in that. We can only hope that it develops. Would you be satisfied with that if you were sitting this side of the table?

Mr Chote: I think you come back to Tim's point about how much of this you can spell out in advance. You all find it hard to predict now what questions you think will be the most important to us in three or four years' time.

Q102 Mr Mudie: But we do not have an opportunity in four or five years' time to say, "We think you should look at this, we think you should look at that." We cannot ask that. Well, we could ask it but

we cannot get any agreement because the agreement on what they do is with the Chancellor. You seem pretty satisfied with that. What about the other two?

Professor Besley: You are raising an important and constitutional question about the role of Parliament in the scrutiny of public finances. You are better placed than I am to judge whether you think sufficient resources are devoted to Parliament's efforts to do so, and that Parliament has what it needs to do the job it is doing. If you say to me that there is a need for a parliamentary body, to which you have direct access in both its role and function, that on behalf of Parliament scrutinises the state of UK public finances, you are better placed to make that judgment than I am, and whether that is OBR or not. I think we are at a moment where you have to make that decision from your side of the table too, but I do take the point very seriously that Parliament is ultimately the body to whom the Government is responsible and whatever you need to do that job better, whether OBR can assist you in that, that has got to be built into the structure.

Q103 Mr Mudie: Do you not think this is a time where we should take a decisive step to say, "No, no, this is not a private agreement between the Treasury and you. We are Parliament. It should be with Parliament and the Treasury, and we can both ask the Office to do certain things"?

Mr Chote: You can focus on the legislation; presumably, you can amend it.

Q104 Mr Mudie: That is what I am saying. We are looking for your very wise, comprehensive advice. This is the moment. Would you suggest we take it? You are pretty doubtful and you are not so sure. What about you, Simon?

Professor Wren-Lewis: I partly answered your question with this issue about whether the OBR should be allowed to cost Opposition policies before an election. I would certainly want the OBR to have the freedom to do what it thinks is important in fulfilling its remit, not just what the Chancellor might think. I would perhaps draw a line between the setting up of a body, which, given the historical way it has happened, is very much the Chancellor's idea of what he wants to do, and so he is in that sense involved, but he is setting up what I would call a public interest body, and so once that process of setting up is over, the OBR should be serving the public interest, not the Treasury's interest.

Q105 Chair: Presumably, the logical position is to give the body a statutory duty to cost policies if they are presented by a political party to them, and if that is then triggered, their responsibility would be to comment on all aspects of them, not just any particular little package that is handed to them. Do people agree with that?

Mr Chote: The resource implications of that could be considerable. We are often asked by Opposition parties to assist in tax policy design, for example, or welfare policy design. They come to us with ideas and say, "Look, we are thinking about doing this. Does that sound right and what would the cost be?"

et cetera, and occasionally you get it from bits of government that do not want to talk to other bits of government, who ask all sorts of questions. That is a resource-intensive activity. It would be particularly resource-intensive in the run-up to an election period and, as I say, the expertise on doing those sorts of things, unless you want to have the OBR with a sort of independent group of tax benefit modellers, welfare analysts, et cetera, as well, you are back to using the same resource that the Government does to look at those same sorts of policies, i.e. the people in the Treasury, and that further complicates the relationship which you described to begin with about the role of Treasury officials versus this body. I think it would be very desirable for the OBR to have that sort of role. It would help independence, as I said, and it would lead to a more informed debate. Having tried to do some of that from the position where we are sitting, I am conscious of how much time and flexibility you need to be able to do that.

Q106 Stewart Hosie: Can I just go back to the forecasting? You made the point earlier that the OBR is responsible for macro-economic forecasting as well as fiscal forecasting but the macro-economic outcomes are not only determined by fiscal policy; they are also determined by monetary policy. Given there is general agreement, without the Chairman getting carried away, that there should be this commentary role, would you seek to comment on monetary policy in the way that you might seek to comment on fiscal policy?

Professor Besley: I could answer that partly from my experience on the other side from the Bank of England. Of course, there we would produce a macro-economic forecast taking the fiscal forecast as given. There were sort of rules of engagement that suggested you were fed those forecasts, you put them through, you did not comment on them as best as possible, and conducted a forecast for the outlook for monetary policy, taking fiscal policy as given. One could say that is a very odd thing to do but it has been done for a period of time, I think, with a measure of success. Would it be better to have one single joined-up forecast? There are merits to getting everyone around the table involved in all aspects of policy and trying to agree on a grand proposition. I suspect that is rather unrealistic given that we want to have independent institutions and they serve sensible functions. So I can see the merits in having a joined-up forecast but I do not think it is a particular Achilles' heel of this process that it would have to make assumptions about the conduct of monetary policy and simply take those as given. Of course, the Bank of England does not announce what it is going to do in the future, unlike fiscal forecasts, which tend to be pre-announced, so it is somewhat more difficult to do forecasts when you are trying to guess what the path of monetary policy is going to be because it is unannounced, but I think it could be done; I do not think it is an insurmountable problem.

Professor Wren-Lewis: There is a distinction here between having to work out the implications of monetary policy for fiscal forecasting, which it clearly has to do, and commenting on whether you

think monetary policy is appropriate or not, and that clearly is not a role for the OBR. I think on the more general point about forecasting and, in a sense, it is one of the more unfortunate by-products of having the OBR very much in this role of producing the post-Budget forecast, I would try to devote as little resources as possible at the OBR to the short-term forecast. I would want the short-term forecast to be pretty close to a kind of consensus forecast because there are a lot of people doing this activity and I do not think the OBR is going to have any particular expertise—probably less expertise than the Bank—at producing the short-term macro forecast. Its expertise is in working out the fiscal implications of that and also looking at more medium-term to long-run trends in the economy, which currently is not done that much. That is where I think the resources should be, not in terms of the short-term forecast.

Q107 Stewart Hosie: The OBR does these forecasts in terms of the Budget and Government policy. You are all agreed on this commentary role. I am intrigued at the resistance. If monetary policy is too tight and it squeezes credit or if it is too loose and it fuels inflation, or even risks it, if it is behaving in a procyclical way, which is dangerous, surely it would damage the forecast and there would be an obligation to comment.

Mr Chote: What you have assumed the monetary response to a fiscal policy change to be was clearly a difficult issue for the interim OBR to deal with in the pre-Budget and the Budget forecast. You had some combination of saying, "Well we have taken into account the fact that the Bank of England will be responding" and in other areas you may say, "We will take market expectations for interest rates." That clearly needs thinking hard about and there are no easy answers to it. The obvious question now is, if you have this change in fiscal policy, is that imperilling the economic recovery? Is it threatening a seriously sub-optimal performance on that front? If you are producing a macro-economic forecast at the same time as you are producing the fiscal forecast, you have to have some sort of assumption as to how the monetary policy is going to respond. You could just simply make the assumption that monetary policy will not respond, in which case, clearly, that is an unrealistic assumption and it would mean that a fiscal consolidation is likely to look more dangerous to the recovery path than it in fact would be, because you would expect the Bank of England to adjust monetary policy so that it is sticking with the path of nominal GDP, nominal activity in the economy, that it believes is consistent with the inflation target that it has been given. So you need some sort of balance whereby the OBR can make a sensible judgment about the way in which monetary policy might respond, given the fact that it knows that the Bank of England is going to pursue an inflation target based on a changed set of fiscal inputs, while at the same time not being seen overtly to either predict or to recommend what should happen. That is a difficult balance, and if there is some sort of way of having a relatively simple rule as

an assumption for how you think monetary policy might respond, that might be one way there but it is a difficult issue.

Q108 Stewart Hosie: I take what you are saying is a rule-based system like that would be preferable to a close relationship with the MPC in the way there is a close relationship with the Treasury?

Mr Chote: Yes. You do not want to be going along and having unattributable assumptions about “The chaps tell us that they are likely to respond in this sort of way.”

Q109 Stewart Hosie: Can I just move away from that completely to something a little more mundane. What are the lessons that you have learned already from the interim OBR of things that were good, and the things that you would want to do differently?

Mr Chote: What we have just discussed is one of them, thinking about how you analyse and describe the inter-relationship between monetary and fiscal policy. I think the most gratifying thing to have emerged out of the interim OBR is the enormous increase in the transparency, the amount of information that is produced on the assumptions that underpin the forecasts, and so having a forecast for average earnings; apparently it was inconceivable that the world could survive if we had that published before. We now have official assumptions for that and the world has not ended, so that is great. The budget costings document, I think, the online one, and held by the OBR, is particularly valuable. The degree to which there is just much more analysis of why you think a particular policy is going to cost or raise what it does, which requires you to talk systematically about how you think it will affect people’s behaviour, that is great and I think much to be welcomed. I think in both those areas you could go further. As a consumer of Red Books in the past, the most useful thing you can do is to have a clear presentation of why the forecast has changed from the last time it was produced to this, which will reflect a whole variety of factors. It will reflect the fact that the macro economy has changed, policy has changed, your assessment of the impact of past policy will have changed, you may have changed views on the amount of spare capacity in the economy or view of long-term trend growth, et cetera. As I say, the key to the credibility of this body in the long term is—Simon calls it commentary—explaining your working, why you have said what you have said, what is the empirical and analytical basis for the judgments you have reached, because people will disagree with those, and that is fine, but they need to be able to see how you have got to where you have got, and the more you can do through transparency and a culture of an assumption of publication and an assumption of transparency should be hard-wired in the institution. There will be cases where you cannot make the full amount of information available, as the HMRC does not make it fully available to the Treasury, but having that presumption in the heart of whoever is involved in this would be a good thing.

Q110 Andrea Leadsom: Bearing in mind the forecasting problems that there are, particularly in the short-term, is there not a risk that in the fullness of time an unintended consequence of the OBR being the sole forecaster is that government starts to blame the OBR for its failed policies?

Professor Besley: In a way, that is another way of putting a point I made earlier, that if this is judged by the success of its forecasts, I think we are setting up an organisation that is bound ultimately to fail, because even if it has a run of good luck, it will eventually run out of luck because a lot of economic forecasting is about luck. It is not about knowing the future. If we knew the future, the world would be a very different place and we would be engaged in many different things. The question is unpacking the idea that the OBR got it wrong when the OBR gets it wrong, understanding why, and whether it is taking steps to correct its error, because presumably something has been learned about how the world works that has changed its judgment. Being both transparent and changing its judgment for good reasons, that we have learned and moved on and incorporated whatever we learned into the forward-looking component, is what makes a successful organisation. It is not finger-pointing around “You got it wrong.” I assume there will be some other random forecaster at the time who got it right and there will be attention put on “Oh, X got it right whereas OBR got it wrong” but they will have equally got it wrong for the random reason, so I think we need to have a dynamic process of learning from mistakes.

Q111 Andrea Leadsom: I think the key point here is the implication that government could somehow abdicate responsibility for its own policy because of the fact that the OBR is the sole forecaster. What I am getting at refers to Professor Wren-Lewis’s earlier point where he recommended that this body was a watchdog or a sort of critical friend as opposed to the only forecaster. Would that not surely be a better solution, to have a watchdog or a critical friend rather than this sole forecaster, with all the potential for government to therefore blame it when things go wrong?

Professor Wren-Lewis: I certainly think that is an argument, and is certainly one reason why I did not in my own proposal have this very close relationship in terms of forecasting. Given that we appear to have got that role, you can protect the OBR in various ways, one of which, as I have already said, is to make sure that the OBR is producing a consensus forecast in the short term, so that if the Government say, “You got it wrong”, the OBR can say, “Well, yes, everyone did.” The other thing in your scenario would be that the OBR would also be saying “We got it wrong.” It would be saying, “Things haven’t turned out right partly because we got our forecast wrong,” but if it was also turning out differently because the Government had done some things that perhaps it should not have done, it would also be saying that. So it would say, “Look, we made mistakes but actually it isn’t just our responsibility; the Government reneged on some of its

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commitments.” I think transparency there will help the credibility of the OBR and not allow the Government to avoid responsibility when it is due.

Q112 Andrea Leadsom: With recent experience, where there has already been a lot of finger-pointing, do you not see that this structure, where the OBR is the sole forecaster, has the potential to just be an endless round of finger-pointing?

Professor Besley: I am slightly surprised that you say the OBR is the sole forecaster. There are lots of forecasts out there from different bodies. You mean the sole forecaster in a Treasury forum?

Q113 Andrea Leadsom: For the Treasury, yes.

Professor Besley: I have some sympathy with the idea that one would not necessarily want to completely transfer the forecasting function to OBR rather than to have the possibility that Treasury and OBR have competing forecasts. I do not have a problem with that personally.

Q114 Andrea Leadsom: I would like to know whether you would prefer that. Sir Alan said in his evidence that they had had about 100 meetings with Treasury officials, and I asked him, “How many did you have with independent forecasters?” “None.” That, to me, leaves a big potential for finger-pointing as a sort of institutional issue.

Mr Chote: I think partly that reflects the timescale over which they had to produce these particular forecasts, because some of the information that they were dealing with they obviously could not share with that sort of environment. I think this raises the fact that one of the issues is what happens between harvests. I am no agricultural expert but I think the success of a harvest depends on a lot of hard work put in place in between harvest times, and one of those would be to engage with independent forecasters and to explore their thinking and see how that could inform your own. So, for example, something we have all been involved in: the Bank of England has monetary policy roundtables twice a year at which independent forecasters and City people, academics, are invited in and there is discussion focused on particular issues of importance at the time: impact of quantitative easing, likely path of external demand, et cetera. Having that sort of relationship and drawing upon the expertise that is outside—you cannot do all of that and be checking with 40 forecasters whether you think you are right on the growth forecast at exactly the same time as you are producing the final outlook. But that sort of engagement of stakeholders—dreaded word—should be an important part of what it does outside harvest time, and of course, that is also the source of wider analysis that we think is appropriate. On a big issue that will remain the case, are we right about the judgments that we have on trend growth in the future and the extent of spare capacity at the moment? That is the sort of thing upon which any sensible OBR is going to want to canvass a wide variety of views. There is also the potential, I think—I have argued this in the past—that some of the OBR’s resource should be used to

bring in people from outside to focus on particular areas of interest for a while, so it is not just entirely a permanent staff. You might say, “We think now is a particularly good time to dig into our forecasting of the financial sector and the feed through into fiscal policy,” and I think the budget should have some room to bring people in on that. A related issue is whether you might want to do that with the arrangements for forecasting as a whole. The Bank of England, when it had its medium-term macro model, commissioned Adrian Pagan to do a review in 2003, to basically say, “Is the modelling work we are doing state of the art?” and some of the conclusions he came up with were reflected when the Bank moved to BEQM, the quarterly model which succeeded that. It is very important to be drawing on that sort of outside expertise both structurally and in looking at the conjuncture but there is a limit to how much you can do that in the three weeks when the Chancellor wanders down with a new tax policy that needs to be put in and you are dealing in that very concentrated harvest period.

Professor Wren-Lewis: If I can answer your question, would the OBR be my preferred model because of its production of Treasury forecasts? No, because it was not my model that I proposed. Can it be made to work? Yes, I think it can.

Q115 Andrea Leadsom: Can I ask one very quick question: if each of you you had a clone, would your clone’s application form be in right now for this job and, if so, why?

Mr Chote: You want pre-application hearings now!
Andrea Leadsom: Absolutely. I did say “clone”, not you.

Q116 Mr Love: Anything you say will be taken down and used in evidence.

Mr Chote: I note what Sir Alan said about whether he was in a right mind when he agreed, and that is something I think anybody contemplating this should reflect on in the still of the night.

Professor Besley: I have recently returned to Civvy Street, so I think . . .

Chair: Treasury Committee fast delivery. Anything to say, Professor Wren-Lewis? No? Good.

Q117 John Cryer: Transparency has been mentioned quite a few times, understandably. How do you practically make the OBR processes transparent?

Mr Chote: There is the issue of processes and outputs. I think on the outputs, explaining your working is the key point. You do not want people looking at the conclusions that you have reached and saying, “Why on earth have they reached that?” because that creates all the suspicions about independence that you want to avoid. The more you can do to spell out the analytical basis, the empirical basis, upon which you have reached the judgments that you have had and, as I say, a presumption of transparency, levelling the playing field as much as possible, so other people can look at the same data and reach conclusions, which may differ and therefore inform how you want to think about these things in the future, is a good thing. As I say, the

notion of engaging with other people who have an interest in the same sorts of analysis, so that they also will get a sense of ongoing communication, so that they think you are going at this in an open-minded way and that you are responsive to a wide range of views, is an important element as well.

Professor Wren-Lewis: I have used the phrase in a similar context of talking about “active transparency”. I think it is important not just to have somewhere laid out all the details but to be actively protective of that information such that, if someone misuses that information, misinterprets it, then you very quickly and publicly say so. I think it is important to be actively transparent in that way.

Professor Besley: I would certainly caution against having too many of the inner workings of this body revealed—not because I think there is anything to hide but simply because one important part of the process, having been part of many forecast processes when I was at the Bank, is that that process is a complicated process in which people make fools of themselves willingly by trying out ideas on each other. You would not want that full process that led up to the forecast to become part of the public record but eventually converging on and reaching an agreement about a reasoned position, the argument behind that, the way it was reached broadly, should be spelled out very clearly.

Q118 John Cryer: I think one of the reasons that the MPC has been a success is that it has been very open. The voting records of the members have been published as opposed, for example, to the European Central Bank, which is a very closed institution, and I think it is perceived as that by the public. On the basis that the virtue of the MPC has been its openness, should not the OBR be open as well so that it can face the same sort of scrutiny?

Professor Besley: I think the OBR should be as open as the Bank of England in the sense that the Bank is very clear in its monetary policy briefings, et cetera, minutes and so forth, and similar things could be brought forth, but what the minutes are not is a verbatim account of who said what to whom. They are an attempt to capture the essence of what was said at a meeting and to pull together the different themes in the discussion. Perhaps there could be minutes of the meeting of the committee that drew this up. Because of the nature of the exercise here, I cannot see how that could be done effectively but yes, I think it should be as open as possible, subject to the constraints of not just putting out loads of material that people do not want to read.

Q119 Chair: Let us be clear. You want the OBR to publish minutes of its exchanges with the Treasury in relation to forecast?

Professor Besley: No, I backed off from that idea. I said I do not think that is appropriate.

Q120 John Cryer: Sorry. What you seemed to be saying is what you did not think was a good idea was to publish a verbatim report. What you seemed to be saying originally was that a broader report like we get from the MPC would be more appropriate.

Professor Besley: Yes. That would be effectively the fiscal policy report of the OBR. In effect, it would be the reasoned product of the discussions that the OBR had had. I would not see a need to have another product that was a separate set of discussions that were summarised, because it would all, I would hope, find its way into the document that was the public face of OBR.

Mr Chote: I think you have to distinguish because with the MPC, the Committee meets once a month to take one decision, previously on one instrument, now on two, possibly on three in the future, and therefore having that sort of person by person transparency, and that individual giving speeches may be clear about this, and it is clear to some extent—it is how they balance those factors in reaching the decision that they have which is an easily describable decision. That is quite easy to be transparent about. You also, of course, have the Bank producing a quarterly forecast and the inflation report, which is a combination of a forecast, discussion of uncertainties, lots of analysis, lots of description, and that is something to which the Committee as a whole signs up, although clearly some people are not going to agree with every “i” and “t” in it. You do not necessarily want to open up the process of how you actually got to the inflation report. That is somewhat different from how people have decided to vote on a particular monetary policy decision.

Q121 John Cryer: Who do you think should appoint the Chair?

Mr Chote: I think the dual lock seems a good idea, the Chancellor appointing, and I think this brings us back to the models of non-ministerial departments versus NDPB, as somebody said in that report you referred to, the thing about a non-ministerial department is you have a Minister and you are not really a Department. I do not think you can really get away with having the Chancellor not having a key role in this, but having the Committee playing that role too in the dual lock seems to be a very sensible one, although it has to be said that this body should no more be telling this Committee what it thinks this Committee wants to hear than it should be telling the Chancellor what it thinks the Chancellor wants to hear.

Q122 John Thurso: Can I ask a couple of questions on data and models, and perhaps come to you first, Professor Wren-Lewis. At the moment a great deal of the discussion is broadly around independence and if it is independent, it is right but of course, actually, once that independence is established, its track record will depend on the quality of the work, modelling and data. How easy is it to fiddle the model to achieve an outcome?

Professor Wren-Lewis: Extremely. I have spent a large part of my life doing things like that. In a sense, a model is a means to an end. A model is a way of ensuring that your forecast is consistent and that it has various relationships in it that you want. It never dictates a forecast and never should.

Q123 John Thurso: I was struck by an article in *Bloomberg* that Danny Blanchflower wrote basically suggesting that how the Bank arrived at conclusions—I am not saying I agree with it—how he said you could alter the end result by the way in which you have created the model. To what extent is it therefore important that there is complete transparency in the model and that it is broadly seen by external critics to be one that is robust, even if it leads inevitably to the wrong answer?

Professor Wren-Lewis: I think is extremely important. This is an example where I think transparency can only be good. You would expect the OBR to be completely transparent about certainly the core model it uses. There may be some details with particular taxation where there are some sensitivities but, in terms of the core models you use, you want it to be completely transparent, yes.

Q124 John Thurso: Robert, can I come to you next? Should the OBR accept the data from Departments or should it be actively obsessing and criticising that before accepting it?

Mr Chote: I think it should be deciding what data it needs to do the job it is tasked with doing. There is an iterative process there about looking at what you have through the normal channels and then saying, “Well, actually, this could be done better. We need more, different information,” or “Is this really being approached in the right way?” That sort of relationship you have seen in the past with the Bank of England interacting with the Office for National Statistics, raising any concerns they may have there, and I think the OBR would presumably raise similar sorts of concerns if it found, for example, that it was not getting the information it thought it needed to be able to validate the social security spending forecast, to take one example. The OBR should not be at all afraid of saying, “We want more or different information,” if it is available.

Q125 John Thurso: But it is important that the OBR should be able to request in the anticipation of receiving what it wants rather than being the recipient of what people may wish to give it? It needs to be able to drive the data collection that it desires.

Mr Chote: Yes. I am presuming that happens to a degree with the people who are responsible at the Treasury now for doing it. Over time they will see that their need for data changes. I presume there has been a requirement for much more data and analysis of credit availability than there would have been if you go back X years, and presumably you then identify the new sorts of information that you need and you push for that. To what extent you can define, for example, in legislation the fact that it has a right to particular data—you, as drafters of legislation, would be more expert than I would be.

Q126 John Thurso: Would that be a sensible recommendation, that there should be something in the Bill that gives them some degree of right?

Mr Chote: Yes: the access to the same information that the Treasury has available to it. You have issues there with, for example, the fact that HMRC will not provide all the taxpayer data it has to the Treasury because of taxpayer confidentiality issues.

Q127 John Thurso: Once it loses it, it probably could not anyway.

Mr Chote: I do not think you could give the OBR a right to avoid that requirement, for example. That is probably spelt out in legislation for HMRC as well.

Q128 John Thurso: To any of you: what happens if the Treasury disagreed with the changes in the modelling, if there was a fundamental disagreement between the guys in the Treasury and the guys at the OBR? We know that there are disagreements between people involved in forecasting and modelling. How should that be dealt with, and what happens if they end up using different models, or is that not something that you foresee?

Professor Wren-Lewis: I think the OBR has to be in charge of the model it uses. Obviously, it wants to be open to criticism and can respond to criticism but it should not be negotiating with somebody else about what model it uses.

Q129 John Thurso: So the decision on the model must be with the OBR?

Professor Wren-Lewis: Absolutely. The situation that you posit whereby the Treasury decides that the OBR model is wrong in some sense, I think basically then it is up to the Treasury to decide whether it wants to move to an alternative model or an alternative way of doing things whereby it produces its own forecast and does not rely on the OBR. In a sense that is a Treasury decision. The OBR position I think is clear.

Q130 John Thurso: You could actually have quite a benign situation where the OBR had its chosen, open, published model which it thought was right and the Treasury, for its own reasons, had another open, published model which it thought was right and there would be a healthy and dynamic tension between the two. There would be nothing wrong with that?

Professor Wren-Lewis: Nothing wrong with that.

Q131 John Thurso: Finally, Tim, the Bank of England publishes the quarterly model and it gives details that it has used to produce the MPC’s economic projections. Should the OBR take the same approach and publish everything at the appropriate moment?

Professor Besley: The answer is yes. On the other hand, coming back to a question you directed at Simon, I think one cannot exaggerate how much of this is just the model, reading off numbers and then just writing them down and publishing them. There is a jolt of judgment that goes into the model. It is important that the modelling tool is there and available and people can see it, but I do not think anyone should be under any illusions that that is the sole arbiter or the sole determinant of the forecast

that they reach, any more than Formula 1 cars that are tested in wind tunnels operate on the track in exactly the same way.

Q132 John Thurso: If it is independent and there is transparency and everybody understands it, then the robustness of the analysis is underscored by those two facts. That is the point I am making.

Mr Chote: It is, but justifying the judgments that have been applied to it is at least as important, if not more so, than the precise structure of the model. The Bank of England has a very nice—and I am sure you have all read it—£10 book on the Bank of England quarterly model, which describes the sort of onion structure: “Here is the core theoretically coherent model, there is then an additional layer around that, and then we apply judgment on top of that,” and it explains how that process works. I do not know whether the Treasury has ever published anything similar.

Q133 John Thurso: Not willingly, as far as I am aware.

Mr Chote: That would be a very nice thing to have, in a user-friendly fashion. This book is not widely read amongst the general public. Again, this is something to do between harvests, to be setting out in a reasonably user-friendly way how you approach the task of thinking about economic forecasting and economic analysis, and to make that available would be very desirable.

Q134 Mr Umunna: I would like to go back to the appointment process and pick up where I think John Cryer left off. Obviously, independence and competence are absolutely key and the Chancellor has put forward a process whereby he puts forward people, in particular the Chair, and the Chair in particular is subject to confirmation by this Committee now, and Professor Wren-Lewis, you have said that you would prefer to have a broader OBR Committee and for the members of it to be appointed by a board of the Committee, if I am right, once it is greater in number. I am struck by something Mr Chote said about people not coming before this Committee and telling us stuff that we want to hear. My question to you in particular, Professor Wren-Lewis, is why do you not think we are up to it, if indeed that is the case?

Professor Wren-Lewis: No, no, it is not. I think, as I have already said, having a wider committee which has three executive members but which has people with a lot of experience, people like Sir Alan is going to become, who would sit on this more general board, which would not meet that often but would provide general guidance and certainly not get involved in the nitty-gritty but would provide that overall general guidance, would be a very good thing. Once you have got that wider committee in place, then the question arises whether those non-executive members of the committee could play a role in the appointment process for a new Chair, and I think that potential does arise. You can imagine therefore those non-executive members doing some of the things which senior Treasury officials are

going to do in terms of the appointment process, doing the initial selection and possibly the interviewing but I would still want the Treasury Select Committee to have its veto role. I think that is an important thing. I think you are very up to that role and I hope I never said anything otherwise.

Q135 Mr Umunna: You are not just saying that because that is what we want to hear?

Professor Wren-Lewis: Absolutely not. What I think would be difficult would be for you as a Committee to actually do the whole appointment process, from getting in the applications and sifting through them. I am not sure that is something you would want to do.

Q136 Mr Umunna: One of the things that I am struck by, and in particular I was watching your almost physical reaction to George Mudie’s question about actually whether the relationship between the OBR should be one between the OBR and Parliament as opposed to it just being one with the Treasury, which by its nature was taking you into a political arena, and I could see you all slightly recoiling at this as you were being drawn into the political arena. Do you think that is going to compromise the volume of people who are likely to put themselves forward for this role, the prospect of being drawn into the political arena in the way that, frankly, Sir Alan has since the birth of the OBR? There has been a lot of talk about it being set up in May and, of course, actually it was set up in shadow form and was born by press release from the Conservative Party in December of last year. Do you think there is going to be a problem here in terms of the quality of candidate you have coming forward? You all see yourselves as economists, and do not really see yourselves as political operators, but I am not sure how possible it is for anybody to avoid being drawn into the political arena when they hold such a sensitive and important role. That is actually a question to all of you.

Mr Chote: An awful lot of the judgments that are made are going to inform very politically sensitive debates and discussions, the pace of fiscal consolidation being perhaps the most obvious amongst them. If it does deter anybody from being involved because of the knowledge that they will get in those sorts of areas, it is probably a good thing. If people are going to engage in these sorts of debates, you really want them to be doing so intentionally rather than unintentionally, and it is clearly one of the attributes that you will be looking for in the team. I think there is an interesting point about the mix of people in the three-person Budget Responsibility Committee. You do not want three identical people; you want a mix of skills there, and obviously those people, as has been graphically demonstrated over the last few weeks, are going to need to feel comfortable working in a potentially politically difficult environment. It is not impossible; you have to be very clear about what you see as the appropriate role and what is not, and explaining why you have reached the judgments that you have. In the IFS we hope and believe that our analysis is

based upon good rigour, good evidence. Clearly, people will disagree with it, perhaps because they disagree with the analysis or because it does not come up with answers that are particularly politically convenient, but that does not absolve you of reaching those sorts of judgments and presenting them and explaining them and defending them to anybody who, perfectly reasonably, takes a different view.

Professor Besley: In some ways I think it is helpful that the difficulty that Alan Budd had recently come into the public domain so quickly, because I think anyone who takes on this job now is going to be aware of the kinds of issues they may be drawn on to deal with but I think one possibility—and this is something on which I will present some written evidence—I would stress is to have some kind of small *pro bono* board, a little bit along the lines of what Simon was saying, that in a way helps to protect the Chair when independence is under threat, to give a small body of advisers.

Q137 Mr Umunna: Advisers to the Chancellor, if you like?

Professor Besley: Yes, and some kind of protection. I am sure if, for example, Robert were ever under fire, there is a very distinguished board of trustees of the IFS that would come to his aid.

Q138 Mr Umunna: Do I take it that you think the current Chair has been left exposed? Do you think he has not necessarily been provided with the support that somebody in such a sensitive new role should have been provided with?

Professor Besley: I would say he was a victim of circumstance. This was a job that he was thrust into, he was asked to do many things under a very tight timetable, and I would not especially describe him as having been exposed. My colleagues may think differently.

Mr Umunna: Do you think he was wise to accept the appointment before the general election? I suppose I just think of the way the MPC was set up and actually nobody really knew that was going to exist until just after the election in 1997. I wonder whether it was wise to have got involved with a body in shadow form.

Q139 Chair: We are concentrating on the new body now so if we could have one-word answers, or written answers if you want to provide one. I would like to concentrate on the structure of the new body.

Professor Wren-Lewis: Not to answer that last question but in terms of would the very public role of the Chair of the OBR deter some people, I think the answer is probably yes, but part of the role of the Chair of the OBR is to be a very public figure, and you want someone who is comfortable with that and comfortable about making political, with a very small “p”, judgments about when to intervene and when not, and I think that is inevitable.

Q140 Mr Umunna: What do you think in terms of the actual technical attributes of the person? What do you think we should be looking for when the prospective new Chair is put before us and we are asked to confirm their appointment?

Mr Chote: As I say, I think you should be thinking about it in terms of the three people and the mix of skills that you have there. The first three—and I think this is quite a sensible structure—you clearly have somebody of the two deputies who is relatively focused on the macro side and somebody who has had in-depth experience of the fiscal forecasting, conditional on the macro forecast. You can imagine you want lots of expertise in those sorts of areas. You need demonstrable independence, you need a focus on effective communication, et cetera. Quite how you mix that in terms of whether you look for three people who combine all of those attributes or where you see the most important bits of those lying I think is one entanglement of having a pre-appointment hearing for one and commencement for the other. In a sense, in an ideal world you would take a view on the group of people as a whole and whether they bring that right sort of mix together rather than putting all the emphasis on who happens to be the Chairman.

Q141 Mr Love: Earlier on you mentioned engagement and you gave us an illustration of the twice yearly meetings that the Bank of England hold. Currently the Treasury has an observer on the MPC. It is a formal role. Do you see the Office having that sort of structured role in the Civil Service or do you think they need to stay a little disengaged?

Mr Chote: Should they have a representative on the MPC?

Q142 Mr Love: I am only using that as an illustration. You can comment if you like on whether they should have a role there but I was really just thinking about whether they should be in the formal structures of the Civil Service in that way or whether they need to draw back and show a little independence from the Civil Service.

Mr Chote: I think in terms of many of the staff, you are going to want to have Civil Service contracts because people are not going to make a life’s career in the OBR; they are going to move, I presume, from different economic functions across government, and that is a good thing and it constantly refreshes the human capital of the organisation. So I think in some sense you need to have some members of staff who are civil servants but, at the same time, as I say, you want to be bringing in outside expertise. There will be people who want to work for this body, and maybe they have come from the private sector or the academic sector and they are working for this and they are not intending to go into government at all, so a mix of people I think would be right. I guess in terms of a formal role in the Civil Service, again, you are taking me out of my comfort zone on whether a non-ministerial department is headed by somebody who is automatically part of the Whitehall machine of Wednesday Permanent Secretary meetings, et cetera. I presume that is not something that this

person would want to get involved with but I do not know whether it is a requirement if this thing is set up as a non-ministerial department, which seemed to be Alan's preference, and judging from the other bodies that are NMDs, it looks like the most obvious match to me, but I claim no expertise on that. Whether that necessitates some involvement in the Civil Service more broadly, ideally, I think, in terms of independence, that would not be the case but I do not think it would be a life or death issue.

Q143 Mr Love: Professor Besley, what do you think? You have sat on the Monetary Policy Committee. Just taking that as an example, would there be benefits to the OBR from having that observer function or do you think it would compromise their independence to be that closely involved with other parts of the forecasting machinery, if I can put it that way?

Professor Besley: The piece of it where I imagine there is more fruitful ground for co-operation between OBR and the Bank is during the forecast round but actually, during the forecast round is the time where the Bank does not have Treasury input; it is only at the formal MPC meetings, and actually, contrary to something that came up in one of your earlier hearings, in fact, where it was suggested that even during forecast rounds members of the MPC only meet for the meeting, just as I think the OBR has been meeting intensively during its forecast, the MPC meets much more intensively during the forecast round and has a number of sessions, but they are not part of the formal process, meaning they do not have Treasury representation there. Whether the level of co-operation there should be between staff of the Bank and staff of the OBR or members of the OBR Committee and members of the MPC, it is not entirely clear to me would be most fruitful at the level of OBR Committee members and MPC members but my guess is that there would be some fruitful communication that takes place around that time, depending on how synchronous was the process of the forecast round at the Bank and the forecast round that the OBR was doing, because a lot of the same issues are going to be debated and discussed—the comparison with outside forecasters which has come up gets discussed during the forecast round at the Bank and so forth. So I would have thought there ought to be a good level of co-operation that takes advantage of the fact that they are engaged in similar processes, but I would not formalise it particularly in any legislative sense myself.

Q144 Mr Love: We have talked a lot about the scope for the membership of the Committee, in particular the Chair who is appointed. How prescriptive should we be in terms of setting down what it is the Committee and the Chairman are allowed to do? Should we be very prescriptive or should we leave it entirely, only saying that fiscal sustainability is your objective and leave the Chairman and the Committee to make that judgment about what they get involved in and what they do not?

Professor Wren-Lewis: I think the post has to have some broad outlines of what it is meant to achieve but I think there is a danger of being too prescriptive in preventing the Chair of the OBR from doing things which allow him to fulfil that remit. So I would not be too prescriptive. I think you would want to give the organisation sufficient clout that it is able to do what it wants to do. We have already talked about being able to go to the Treasury and say, "We want to see all this information" and have a right to see information. You want to make sure that it has those rights but I think it would be dangerous to go too far. Take the issue of sustainability. We certainly know what is not sustainable, which is a path of debt which is just getting bigger and bigger over time. That is clear but going beyond that is much less clear, and so in a sense the concept is sufficiently vague that it is very difficult to be too prescriptive about it and probably a mistake to try and be too prescriptive about it.

Q145 Mr Love: Mr Chote, in terms of how prescriptive we should be, of course, the argument could be used that it is an unequal relationship between OBR and the Treasury, and that if the Treasury gets very heavy with the new Chairman, it would be helpful to him or her to be able to look and say, "This is what my role is intended to do," so being prescriptive might actually help. Is that an argument for being more prescriptive?

Mr Chote: It is an argument for being very clear, as clear as you can be about what you see the task to be. The difficulty, as we have discussed, is actually being able to define in advance exactly what it is you think you are going to need to know and to look at in order to reach the judgments that are necessary to reach the judgment on what you are finally left with. I think I would agree with Simon. I think it is hard to be too prescriptive. You want to be clear about what this body is there to do but it is very hard to spell out in detail to begin with what in all future states you think it will need to think about and to analyse in order to fulfil that core function.

Q146 Jesse Norman: Going back to the question of disagreement between the Chancellor and the OBR, is it really a good idea to have the Chancellor able to draw on a lot of additional expertise directly within the Treasury? Does that not simply replicate the problem we have at the moment? Is not the point that the OBR is his creation and he is going with it or he is reaching a political judgment or another judgment but not one based on Treasury expertise as such?

Professor Besley: I would sort of hope there is sufficient dialogue across institutions to help to resolve the vast majority of cases where this could be an issue. I think it is hard to think in the abstract and view what the nature of the disagreement was and getting to the bottom of that would hopefully resolve many of the issues. I find it quite difficult to respond without thinking of the concrete example that would be at stake in a particular case, how easily it could be done.

22 July 2010 Professor Simon Wren-Lewis, Professor Tim Besley and Mr Robert Chote

Chair: Thank you very much, all three of you, for your oral evidence today and also for the written evidence. If you want to put more in, please do. This body and its structure is clearly in a state of flux and we have an opportunity to influence it. If you want to add a CV for a job application, we are fully prepared to consider it. Thank you very much indeed.

Written evidence

Written evidence submitted by the Chancellor of the Exchequer

You asked me to set out some more of my thinking on the arrangements for the permanent Office for Budget Responsibility.

Before I do so, I would like, first, to put on record my gratitude to Alan Budd, and his colleagues Geoffrey Dicks and Graham Parker, in agreeing to lead this new venture. I believe that the OBR marks a step change in the transparency and openness of economic and fiscal policy making. International reaction has been very positive. The OECD described the advent of the OBR as “clearly an important initiative in terms of strengthening government management of public spending and improving public confidence in the government’s fiscal policy”. The IMF noted that the OBR’s proposed mandate is “broadly consistent with established best practice for independent fiscal councils.” Sir Alan and his colleagues have been central to this innovation.

I was under no illusion at the scale of the challenge in establishing an interim body to deliver two forecasts in time for a June Budget just 42 days after the General Election. Sir Alan and his colleagues met this challenge head-on and have made an important, and I hope very long-lasting, contribution to the development of economic policy-making in this country.

Sir Alan’s own recommendations on the arrangements for the permanent OBR mirror many of my own thoughts. The arrangements under which the OBR currently works reflect its status as an interim body, prior to the introduction of legislation. It is, and has always been, my intention that the OBR should evolve from its interim status.

The interim OBR was, of necessity, located within the Treasury building, and staffed by redeployed Treasury officials. Sir Alan said that at no point has there been any ministerial interference in any of the interim OBR’s work, and I am comfortable that the OBR has been functionally independent in its interim status. But it is important not just to be independent, but to be clearly seen to be independent. The legislation that we will be bringing forward shortly will allow us to take steps to meet those perceptions. I expect that the OBR will be legislated for in the autumn.

I will listen to the evidence put before the Treasury Select Committee before making more detailed proposals in the legislation, but it may be helpful for your considerations to note my initial thinking.

THE APPOINTMENTS TO THE BUDGET RESPONSIBILITY COMMITTEE

I agree with Sir Alan that Parliament will play a prominent role in preserving the independence and accountability of the OBR. As I told the Committee on Thursday, I intend to provide in the legislation for the TSC to have the power of veto over the appointment of the Chair of the OBR. A statutory veto bestows upon the TSC more power over the appointment than they currently have over any public appointment. I propose to take this unprecedented step because I want there to be absolutely no doubt that the individual leading the OBR is independent and has the support and approval of the TSC.

An advertisement for the permanent Members of the BRC was placed in The Economist newspaper on Friday 16 July and is on the OBR’s website, and it is expected that an appointment will be made in September. In order to ensure that the TSC has an effective power of veto over this appointment prior to the enactment of the Bill, I propose that the TSC conduct a pre-appointment hearing of the proposed candidate and I will not appoint a candidate who is judged unsuitable by the TSC.

My intention is for the two other positions on the Budget Responsibility Committee, currently occupied on an interim basis by Graham Parker and Geoffrey Dicks, to be subject to pre-commencement hearings before the TSC. This is a well established and well understood process for other public appointments, such as those for external members of the MPC.

REAPPOINTMENT AND REMOVAL OF THE CHAIR OF THE BRC

The Bill will set out fixed five-year terms for the BRC members, including the Chair of the OBR. These will be renewable once, and renewal will again be subject to the recommendation of the Chancellor and agreement of the TSC.

I also wish to ensure that the Chair cannot be removed at the whim of the Chancellor. The Bill will contain provisions to the effect that the Chair may be removed by the Chancellor only under exceptional circumstances and with the express agreement of the TSC. These arrangements are the appropriate converse to the appointments process outlined above, in which the Chancellor is accountable for the appointment of the Chair of the OBR, and the TSC has formal power of veto.

LOCATION OF THE OBR

The interim OBR is located in the Treasury. This was necessary given the time constraints placed upon the production of its first forecast: the OBR began work a matter of days after the Government was elected. While this in no way affected the real independence of the OBR, I will ask my officials to take forward the

relocation of the permanent body outside the Treasury. It is worth noting two points. First, changing the OBR's physical location will not be instant. For example, it will be necessary to provide the OBR with secure information technology systems for holding government data. Some of the OBR's ongoing work may therefore happen while it is still in the Treasury. Second, given the need for close working with the Treasury around fiscal events, there will be occasions when OBR officials may spend extended periods of time inside the Treasury. I hope that, with the other measures I introduce, this practical necessity will be accepted and understood.

THE OBR'S FORECASTS

Sir Alan made a series of recommendations about the substance and process of producing forecasts. Discharging this function in a transparent and independent way will remain central to the credibility of the Government's fiscal framework. I therefore make the following observations:

- I wish to reiterate the statement I made when I announced the establishment of the OBR: I want us to be one of the few advanced economies with an independent fiscal agency that produces official fiscal and economic forecasts. In the formulation of policy, I will retain the right to disagree with the OBR's forecast. However, if I do so, I will have to explain my actions to Parliament, through the TSC. This will further enhance parliamentary accountability. I further expect that the OBR will lay its reports directly before Parliament, and that the BRC Members will appear before the TSC on the publication of its forecasts, as the interim members have done this year.
- I agree with Sir Alan that a minimum two forecasts, spread evenly over the year, represent a sensible approach for the OBR in its steady state. It is in line with international best practice.
- I agree with Sir Alan that steps should be taken to enhance the technical independence of the OBR. I will ensure that those working at the heart of the forecasting process are clearly part of the OBR. Given the complexity and large amount of detail upon which the fiscal forecasts depend, much of which only exists within Government, there will continue to be close working with the Treasury and other Government departments.
- On the process of publication, I think it is important that the OBR follow a transparent, regular and predictable process for the publication of information, for either future forecasts or supplementary information on existing forecasts, with release dates set out well in advance.

July 2010

Letter from Sir Alan Budd to the Chairman of the Committee

At the Treasury Select Committee meeting on 13 July, where I and my colleagues on the Budget Responsibility Committee gave evidence on the interim Office of Budget Responsibility's Budget forecasts, you asked me about the terms of my departure from the interim Office for Budget Responsibility (OBR). In particular, you asked whether there would be an interval between my departure from the OBR and the resumption of my former employments.

I have enclosed here an exchange of letters between myself and Sir Nick Macpherson, the Treasury Permanent Secretary, on this issue. The letters set out the conditions of my departure and, I hope, will reassure you that all necessary steps have been taken to ensure full propriety in relation to my future employment.

I would like to take the opportunity to thank you again for the courteous way you and your members have treated us in the OBR's first appearances before your Committee.

26 July 2010

Letter from Sir Alan Budd to Sir Nicholas Macpherson, Permanent Secretary, HM Treasury

I am writing to place on record the arrangements relating to my departure.

We have agreed that I should step down as Chairman of the interim Office for Budget Responsibility (OBR) when my contract ends on 13 August. Up to that point I shall continue to be available for advice regarding the permanent OBR, the appointment of my successor and any other OBR-related issues that might arise.

We also discussed the timing of my return to work in relation to the three consultancies that had been suspended—Credit-Suisse, Brevan Howard and the Observatory Group. My arrangement with them was that the consultancies would be suspended for a short period during my engagement with the OBR. We agreed that all the market-sensitive information to which I had access before the Budget became public knowledge on 22 June. I visited the Bank of England on 5 July, alongside Treasury officials, to provide the MPC with their usual briefing on the Budget, but I have not had access to any market sensitive information held within the Bank or the Treasury in relation to the financial sector.

We had agreed that I could properly restart my consultancies at the beginning of September. I have considered this matter further and, in order to rule out any suspicion of impropriety, I have decided to postpone the re-start of my consultancies to 1 October and bear the cost of the resulting unpaid period.

As a consultant to HM Treasury, I am not subject to the Advisory Committee on Business Appointments requirements. But I hope you will agree that these arrangements are within the spirit of those rules, and similar to any recommendation you would have made to the Committee were I subject to its requirements.

During the period between 13 August and 1 October I shall have the following engagements:

- meetings related to the appointment of my successor; and
- a meeting of the Tax Law Review Committee (of which I am chairman) on 20 September.

The Tax Law Review work is pro bono and is only concerned with information in the public domain.

Prior to my departure the OBR will publish its report on the effect on the public finances of changes in oil prices. I do not believe it uses any market-sensitive information.

I hope that you agree that these arrangements are satisfactory.

26 July 2010

Letter from Sir Nicholas Macpherson to Sir Alan Budd

Thank you for your letter earlier today, about the arrangements you have put in place for your departure from the interim Office for Budget Responsibility (OBR).

I can confirm that I am satisfied that the arrangements you propose are sufficient to ensure no risk of impropriety with regard to your return to work in the private sector.

In particular, I agree that members of the Budget Responsibility Committee no-longer hold market sensitive information; any such information that you had access to during your role on the BRC interim OBR is now a matter of public record.

While you are not subject to the requirements of the Advisory Committee on Public Appointments, your intention not to return to your consultancy roles until 1 October is certainly within the spirit of those requirements, and therefore I welcome it.

May I take this opportunity to thank you for the significant contribution you have made, as Chairman, to the success of the interim OBR, and to the establishment of the OBR itself, and to wish you well in the future.

26 July 2010

Supplementary written evidence submitted by Professor Tim Besley, Kuwait Professor of Economics and Political Science, London School of Economics

FUTURE STRUCTURE OF OBR

Further to my comments at the hearing, I would like to offer a few supplementary written comments.

WHAT SHOULD OBR DO?

Broad mandate: I would prefer a broad overarching mission -- something broad like “safe-guarding fiscal sustainability for the UK”. Within that, one could have narrower and specific mandates which could evolve depending on circumstances. It would be the broad mandate that could give OBR (given its independence) scope to tackle issues that it felt were germane to its broad mandate in its commentary role.

I see three distinct outputs of OBR which could be written into the structure:

- Short/medium term forecasting
- Long-term forecasting
- Commentary

The reasons why I separate out 1 and 2 is that the type of model and considerations needed in each case are probably quite different. For example, judgements on the economic cycle are important for 1, while long-term growth and demographics are important for 2. So I would personally think in terms of having two models—one for each task (albeit with some common components). As came up at the seminar, there is probably an important role in 1 for trying to match up findings with consensus etc. And I could see a role for the OBR to hold a regular (six-monthly) event at which a range of public and private forecasters could come and present their views and compare notes in an open and public way. In organizational terms, I would probably link the team working on 2 to the team producing work on the public sector balance sheet. I think that 3 is an essential part of what OBR does and that it should in this role commission specific pieces of work on issues that affect its mandate, becoming an influential non-partisan commentator on fiscal issues (to complement but not displace the IFS). Commissioning some of the work by outsiders in collaboration

with OBR staff would help to keep the organization lean. This commentary function should not be seen as separate to 1 and 2, but integral to it. The OBR needs to develop its own in-house competence on 1 and 2 in my view even at the risk of some duplication of activities with what others are doing.

The commentary function has to allow some scope to comment on the structure of taxation and spending where it is germane to fiscal sustainability. For example, the degree to which specific spending commitments on the future retired impact on long-term sustainability or how particularly tax structures (eg taxation of the financial sector) expose the public finances to cyclical risk have to be considered.

In terms of effectiveness, I would suggest that the OBR be given some guaranteed statutory access to certain specified data and information from key sources—where necessary on a privileged basis. This could be built into its statutes with appropriate riders. Some kind of ink to ONS would be useful—the Bank as you know is asked every year to comment on ONS’s performance and OBR could be given the same status both in relation to ONS statistics relevant to the conduct of fiscal policy.

There are areas where I feel that OBR could contribute to policy-relevant knowledge. For example, how to model and deal with shocks, especially low probability, high cost events. It should be able to commission work from outside experts.

HOW SHOULD THE OBR WORK?

Independence is paramount. I can see the logic of five year appointments. However, in the inception period, it would make sense to stagger these so that not all members would step down at the same time.

I would advocate creating a small (pro-bono) oversight/advisory board that could meet infrequently and help to produce an annual report on OBR activities. Such a board could be very useful if the OBR’s independence were ever under threat.

I am relaxed about the structure of the organisation in terms of links across government and other institutions and organizations. It would make a lot of sense to bring in staff (possibly on secondment) from HMT, B of E, NIESR, IFS, academic and the IMF for periods of time. It would be an important career enhancement and would guarantee that a good cooperative relationship. I view the “top” of the organization as where the independence resides—it is less important at the more operational level. There would have to be an agreement though, in relation to all commentary whether it would have to be an official view of OBR or in the case of commissioned work whether it was simply to move the debate forward. It may be essential to make a distinction between official OBR papers endorsed by the three members versus “discussion papers” with a suitable disclaimer.

I could see a role for OBR in bringing together applied macro research relevant to its mandate in the UK, with meetings that bring government, researchers and government bodies together on a regular basis for open discussion. This would raise the quality of debate around the issues. The OBR should hold evidence sessions to seek feedback on its work.

In terms of staffing, a team of six to eight good economists assigned to each of the three functions above would be adequate in my view. One could manage with fewer if the commentary function were outsourced to a significant extent. A team of around 20 economists in total would be enough to establish an esprit de corps, to cover relevant expertise etc. This would mean having an experienced team leader for each group. I would hope that a number of the staff would have at least a masters level training in economics and the salaries would be set to make them competitive with GES and the Bank of England. (I would not personally have a problem in the staff of OBR were affiliated to GES, but some might see this as compromising independence.) It would be useful to have someone in the organization to advise on communications as this is an important role.

The OBR should be in a position to communicate key international bodies such as the IMF, EU, and OECD. It would be good to think about how the government will promote the OBR in this respect and whether this would be built into statutes governing OBR.

TIMING/NATURE OF FORECASTS

One thing that we have learned from the experience so far is the difficulty of producing two forecasts in quick succession before and after a budget. This was done, of course, in exceptional circumstances. However, there is a question of whether the OBR should do the budget day forecast. An alternative would be to have OBR produce a forecast and commentary a significant period after the budget. This would give it more time to digest the implications for the budget for the medium term outlook and diffuse the prospect of short term

conflicts. It makes sense to me that published forecasts would be in October and March. I do not believe that OBR should displace the forecasting function of the Treasury and that the Treasury team should produce the budget day forecast.

31 July 2010

Supplementary written evidence submitted by the Office for Budget Responsibility

The inter-relationship between productivity, income tax receipts and employment and different wage rates between government and market sector

1. Wages and salaries are the key economic determinant of the forecast for Pay-as-you-earn (PAYE) and national insurance contributions (NICs). This determinant consists of two main components:

$$\text{Wages \& salaries growth} = \text{employment growth} + \text{average earnings growth}$$

2. The path for whole economy wages and salaries is determined at the macroeconomic level. It is not constructed “bottom-up” via a simple aggregation of its components, but “top-down” ie with reference to other whole economy indicators such as inflation and the output gap.

3. This is because (in the medium term) the Bank of England is assumed to be able to control the aggregate (and only the aggregate) level of nominal demand in the economy. The Bank will therefore target the level of nominal demand judged to be consistent with meeting the inflation target. The forecast for wages and salaries growth will be the path consistent with this level of demand in the economy.

4. In the medium term, when the economy is at its potential level of output and inflation is at target, whole economy average earnings can be expected to grow at around 4½%, (representing growth of 1.7% p.a. in productivity per worker and 2.8% growth in RPIX inflation).

5. Although the overall forecast is determined at the whole economy level, forecasts are also produced and published for its individual components. There are separate forecasts for the government and market sector.¹

6. The government sector forecasts for employment and earnings are determined exogenously. They are projected as set out in the OBR document “General Government Employment Growth Forecasts” released on the OBR website on 13 July.

7. The market sector forecasts are then determined by whole economy factors such as the output gap and inflation, given the path of the government sector forecasts.

8. There is no explicit modelling of the characteristics of those workers flowing between the government and market sector. Workers leaving government sector employment are implicitly assumed to have the same average earnings as those remaining.

9. The level of employment also depends upon population. The forecast for population is a combination of the contribution of natural demographic change and an assumption that net migration to the UK is 140,000 per year. No attempt is made to model, at the microeconomic level, which sectors of the economy migrant workers flow into, if they become employed.

10. The whole economy forecast for wages and salaries growth is then used to construct the PAYE and NICs forecasts, although the split between growth due employment and to earnings is important. The PAYE and NIC forecasts apply an average marginal tax rate to changes stemming from higher earnings, while the average tax rate is applied to changes resulting from higher employment.

19 July 2010

Letter from the Chief Economic Adviser, HM Treasury, to the Clerk of the Committee

In your letter of 29 July you asked for an organogram of the forecasting process and more information on the resources involved as input to your Inquiry into the Permanent OBR.

I have attached two documents that I hope meet your requests.

The first document is an organogram of the forecast process, which sets out the key stages and staff involved in producing the OBR’s economic and fiscal forecast at the June Budget.

The Budget Responsibility Committee’s (BRC) advice to the Chancellor on the arrangements for establishing the OBR on a permanent basis set out that the OBR’s Budget forecasts were produced using the full forecasting resources of the Treasury, HMRC and DWP. And the OBR June Budget forecast document explains that the BRC “made or agreed all judgements in the forecasts”.

The forecast process itself included three main elements: economy forecast, fiscal forecast and policy effects.

¹ Private sector plus public corporations.

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- The BRC made or agreed all judgement in the economy forecast. The overall economy forecast numbers were co-ordinated and compiled by part of a central Treasury team.
 - The OBR economy forecast was sent to fiscal forecast suppliers for them to use as the economic determinants in their individual fiscal forecasting models. These individual fiscal forecasts were provided to the BRC for them to challenge and the BRC made or agreed all final judgements in these forecasts. These forecasts were compiled into fiscal aggregates by the Treasury's central fiscal forecasting team.
 - As the OBR's Budget forecast document explains the BRC scrutinised the Government's assessment of the direct costs or yield of Budget policy decisions that affect the economy and public finances forecast. The OBR's economy and fiscal forecasts also reflect the OBR's judgement of the effects of Budget policy measures on the forecasts.

The elements of the OBR forecasts were compiled into overall aggregates and considered in the round by the BRC to produce the OBR's June Budget economic and fiscal forecast.

The second document is a table that gives more information on the resources involved in producing the forecast, which shows approximate numbers of people involved in the forecast process and the approximate amounts of time that they spend on producing the forecasts for the Budget. There are over 100 staff involved in the forecast. A small proportion of these staff spend the vast majority of their time working on the forecast. However, for most of these staff the forecast is only one component of their role. The majority of the resource deployed on the forecast is also heavily deployed in other departmental work, even at times of the year when forecast and Budget processes are in train.

23 August 2010

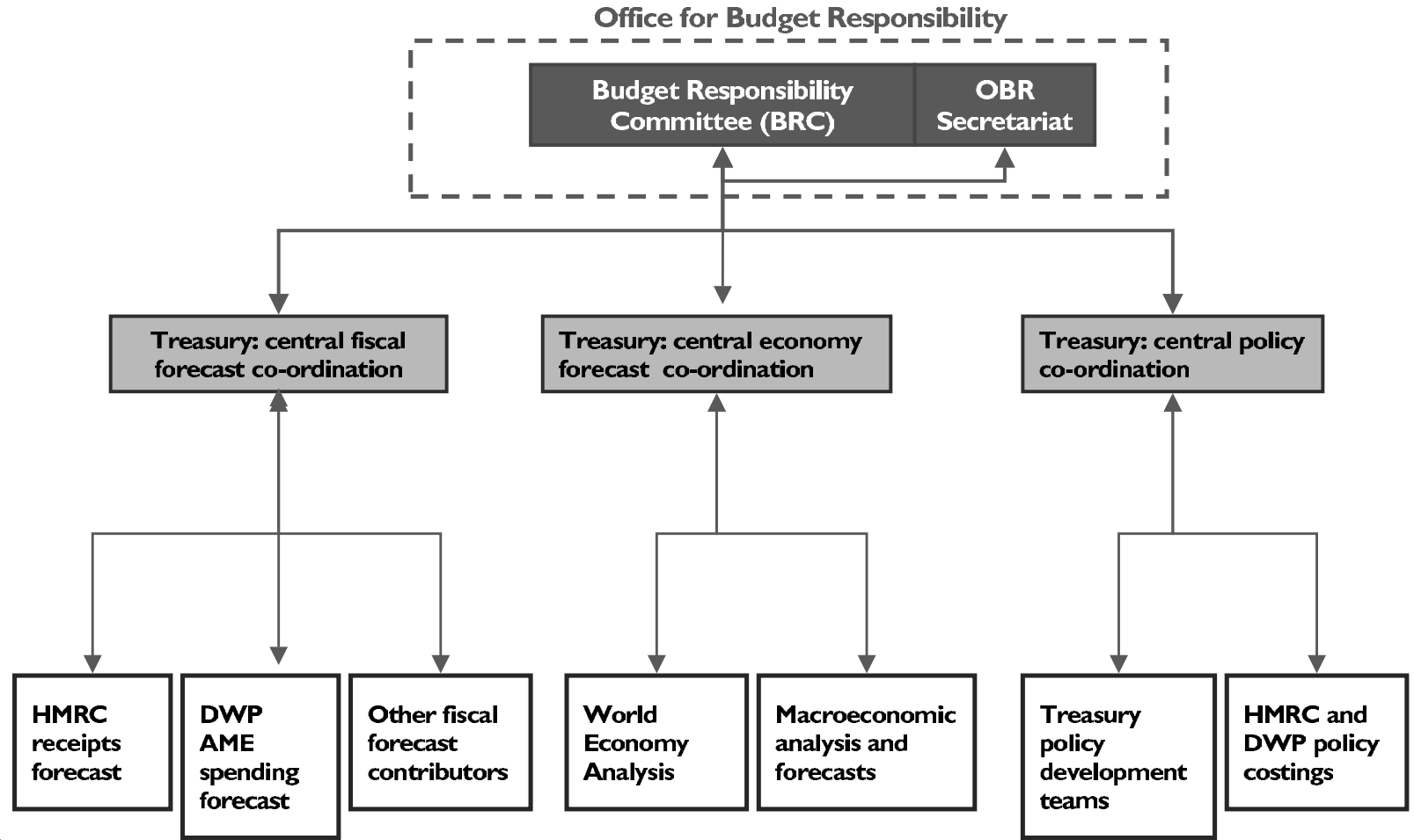
ECONOMIC AND FISCAL FORECAST RESOURCES AT THE JUNE BUDGET

The Committee asked for a breakdown by grade of the resources used as part of the forecasting process. The below tables set out approximate numbers of staff at grade ranges and an approximate amount of time spent on producing the forecast over the period from Monday 17 May to Monday 21 June.

<i>Area/Dept</i>	<i>Role in OBR forecast</i>	<i>Role in other departmental work</i>	<i>Approx number of people</i>	<i>Approx number of people in each grade range (approx average percentage of time spent on producing the forecast)</i>
Interim OBR Secretariat	Scrutiny, challenge and presentation of OBR forecasts	N/a	8	Grade 5: 1 (100%) Grade 6-7: 4 (100%) Grade SEO-AA: 3 (100%)
HMT central forecast co-ordination	Co-ordination and collation of economy and fiscal forecasts to produce the aggregate economy and fiscal forecast numbers.	Analysis and centre of expertise on economy and fiscal forecast.	10	Grade 5: 1 (Approx 60%) Grade 6-7: 4 (Approx 95%) Grade SEO-AA: 5 (Approx 95%)
HMT economic analysis and forecasts	Producing economic analysis and parts of the economy forecast.	At least 50% of time both during and outside of forecast rounds spent producing economic analysis of economic issues, briefing on latest data.	20	Grade 5: 2 (Approx 40%) Grade 6-7: 7 (Approx 50%) Grade SEO-AA: 10 (Approx 50%)
DWP/DWP benefits forecast	DWP provide the DWP benefits spending forecast, assess in-year trends and produce longer-term analysis.	At least 50% of time providing forecasts and analysis of the numbers of benefit claimants and expenditure for departmental policy making and departmental financial and staff planning, which can also be required at same time as forecast rounds. Provision of briefing and analysis of benefit expenditure (including for PQs).	30	Grade 5: 1 (Approx 50%) Grade 6-7: 9 (Approx 50%) Grade SEO-AA: 20 (Approx 50%)
HMRC/tax receipts forecast	Provide HMRC receipts forecasts, producing the in-year forecasts and HMRC co-ordination.	Monitoring receipts, analysing receipts trends and costing policy options for HMT and HMRC policy development. Analysis and policy costing work is often required during Budget/forecast process.	25	Grade 5: 1 (Approx 10%) Grade 6-7: 11 (Approx 25%) Grade SEO-AA: 13 (Approx 50%)

<i>Area/Dept</i>	<i>Role in OBR forecast</i>	<i>Role in other departmental work</i>	<i>Approx number of people</i>	<i>Approx number of people in each grade range (approx average percentage of time spent on producing the forecast)</i>
Other HMT and departmental resource which contributes to the forecast	Providing elements of the receipts, spending and financial transactions forecast. Depts contributing include HMT, CLG, GAD, each public service pension scheme, DCMS, DMO, NIE, BIS and DECC.	Large majority of time spent on a range of functions for departments, including operational and policy analysis. This work can also be needed during forecasting rounds.	Approx 20–40	Typically a small proportion of time spent on forecast work (ie less than 20%)

Process organogram for producing the OBR economic and fiscal forecast at the June Budget



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