



# The Office for Budget Responsibility

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This note provides information on the Office for Budget Responsibility (OBR). The OBR's function is to produce independent economic and fiscal forecasts for the Government and report on the 'fiscal mandate'.

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## 1 Summary

The Office for Budget Responsibility (OBR) was established within days of the Coalition Government coming to power with the aim of improving the credibility of fiscal policy. The body was initially established on an interim basis with Sir Alan Budd as chair. Robert Chote, a former director of the IFS, has been chair of the OBR since October 2010. The Treasury Committee has the power of veto over this appointment. The [Budget Responsibility and National Audit Act 2011](#) provides for the establishment of the OBR, and sets out its functions and broad governance structure.

The OBR's role is to produce forecasts for the economy and the public finances. These are produced independently of the government. In the past, the Treasury's forecasts have been based on the Chancellor's judgement. This has led to the suspicion that forecasts may be over-optimistic. It is hoped that any perception that the forecasts could be politically motivated is removed by an independent body producing them.

The OBR also comments on whether the Government's policies have a better than 50:50 chance of meeting the Chancellor's "fiscal mandates" (the target for the public finances). It also examines the public sector balance sheet (including PFI contracts, public sector pensions and the implications of an aging population) and spending on welfare.

The creation of the OBR has generally been welcomed, especially for the wider range of information it has published. A central issue is the extent to which the OBR can draw on expertise within government. Too much contact with government might harm the perception of independence. Too little could mean duplicating government expertise within the OBR which might be viewed as wasteful. Another issue is the extent of the OBR's remit. Should it, for example, be permitted to comment on the fiscal mandate set by the Chancellor or to run costings of Opposition parties' fiscal plans, as proposed by Labour's Shadow Chancellor in September 2013?

## 2 Interim establishment of OBR

The OBR was initially established on an interim basis on 17 May 2010.<sup>1</sup> Sir Alan Budd was appointed as chairman. Two other members were appointed to the Budget Responsibility Committee (BRC): Graham Parker and Geoffrey Dicks. The interim body also included a secretariat of eight Treasury employees on secondment. It had, therefore, to rely on the Treasury's expertise.<sup>2</sup>

The interim OBR published two sets of economic forecasts. The first was published before the June 2010 Budget and was based on the previous Government's economic policies.<sup>3</sup> The second forecast was published alongside the June 2010 Budget.<sup>4</sup>

The interim OBR did, however, become involved in political controversy over the release of employment forecasts. Some argued that this damaged its perceived independence. Sir Alan Budd expressed regret about this in evidence to the Treasury Committee:

Chair: You do understand, though, Sir Alan, do you not, that this has done quite a bit of damage to the early reputation of the OBR?

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<sup>1</sup> HM Treasury Press Notice, [Chancellor announces policies to enhance fiscal credibility](#), 17 May 2010

<sup>2</sup> [Establishing the Office for Budget Responsibility](#), Letter from the OBR to the Chancellor, 12 July 2010, para 47

<sup>3</sup> OBR, [Pre-Budget forecast](#), June 2010

<sup>4</sup> OBR, [Budget forecast](#), June 2010

Sir Alan Budd: And, as I have said, I regret that enormously, Chairman.<sup>5</sup>

### 3 Appointments to the permanent OBR

In October 2010, Robert Chote became chair of the OBR. This appointment was made by the Chancellor, subject to a veto by the Treasury Committee. Mr Chote was formerly director of the Institute for Fiscal Studies (IFS) and has frequently given evidence to the Treasury Committee. The IFS is well-known for its independent analysis of the public finances. An article in the *Independent* described Mr Chote as “widely respected” and said that his appointment was “likely to do much to restore faith in the integrity of the OBR”.<sup>6</sup> Mr Chote has commented widely on the OBR in the IFS’s 2010 *Green Budget*, evidence to the Treasury Committee and the 2009 Scottish Economic Society/RBS Annual Lecture (links to these are at the end of this note). This appointment is for an initial term of five years.

In October 2010, the Chancellor announced that Professor Stephen Nickell and Graham Parker were his preferred candidates as members of the Budget Responsibility Committee.<sup>7</sup> These appointments were also confirmed by the Treasury Committee.

In its report on the OBR, the Treasury Committee recommended that it should have a small number of non-executive directors. Their role would be to safeguard the independence of the OBR. The non-executives would not be involved in the OBR’s forecasts.<sup>8</sup> In the second reading debate on the Budget Responsibility Bill in the House of Lords, Lord Sassoon, the Commercial Secretary to the Treasury, said that there would be “at least two” non-executives.<sup>9</sup> The OBR currently has two non-executive members.<sup>10</sup>

### 4 The OBR’s role

The [Budget Responsibility and National Audit Act 2011](#) provides for the establishment of the OBR, and sets out its functions and broad governance structure. Before the Act came into force, the OBR was governed by terms of reference published by the Chancellor.<sup>11</sup> Further details of the OBR’s governance and management arrangements are set out in a [Framework document](#).<sup>12</sup>

The OBR produces forecasts for the economy and the public finances at least twice every financial year.<sup>13</sup> Previously, these forecasts had been produced by the Treasury. The OBR also reports on whether, in its judgement, the Government’s policies have a better than 50:50 chance of meeting the fiscal mandate set by the Chancellor. The fiscal mandate is laid out in the Charter for Budget Responsibility:<sup>14</sup>

3.2 The Treasury’s mandate for fiscal policy for this Parliament, announced in the Budget on 22 June 2010, is:

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<sup>5</sup> Treasury Committee, *June 2010 Budget*, HC 350, 20 July 2010, Q14

<sup>6</sup> “Osborne appoints critic to top job at Treasury watchdog”, *Independent*, 10 September 2010

<sup>7</sup> HM Treasury Press Release, *Chancellor announces Professor Stephen Nickell and Graham Parker as his preferred candidates for members of the Budget Responsibility Committee*, 12 October 2010

<sup>8</sup> Treasury Committee, *Office for Budget Responsibility*, HC 385 21 September 2010 paras 96-97

<sup>9</sup> HL Deb 8 November 2010 c14

<sup>10</sup> <http://budgetresponsibility.org.uk/about-the-obr/who-we-are/>

<sup>11</sup> Letter from the Chancellor to Robert Chote 12 October 2010

<sup>12</sup> HM Treasury. *Office for Budget Responsibility and HM Treasury: Framework Document*, May 2014

<sup>13</sup> The latest forecasts are available on the OBR’s website: <http://budgetresponsibility.org.uk/>

<sup>14</sup> HM Treasury. *Charter for Budget Responsibility: March 2014 update*, March 2014

- a forward-looking target to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period.

3.3 At this time of rapidly rising debt, the Treasury's mandate for fiscal policy is supplemented by:

- a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16, ensuring the public finances are restored to a sustainable path.

Budget 2014 introduced a further measure to supplement the 'fiscal mandate'; a measure commonly known as the welfare cap:<sup>15</sup>

3.4 To ensure that expenditure on welfare remains sustainable, the Treasury's mandate for fiscal policy is further supplemented by:

- the cap on welfare spending, at a level set out by the Treasury in the most recently published Budget report, over the rolling five-year forecast period, to ensure that expenditure on welfare is contained within a predetermined ceiling.

The OBR also assesses the health of the public sector balance sheet looking at the costs of an ageing society, PFI contracts and public service pensions.

While the Chancellor has used the OBR, the legislation does not require him to do so. When formulating policy, the Government has the right to disagree with the OBR's forecasts, but must explain the reasons if it does so.<sup>16</sup>

It is worth noting that similar institutions in other countries have, in some cases, been given a quite different role. The Treasury Committee noted that "most fiscal councils do not themselves produce the forecast which the government uses in making its fiscal judgements". Often the role of the council is to assess the official forecast, or provide an alternative, after it has been published.<sup>17</sup> Lars Calmfors, Chair of Sweden's Fiscal Policy Council, contrasted the OBR's arrangements with those in Sweden where there is less on-going contact between the fiscal council and the finance ministry. He argued that requiring the OBR to publish a forecast with the Budget makes it very difficult to "avoid behind the scenes 'negotiations' ... with the Treasury". He concluded:

And the most important lesson is this: one cannot have it both ways – the OBR cannot be both an independent watchdog and an in-house provider of input into the Treasury's work.<sup>18</sup>

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<sup>15</sup> Further detail of the Welfare Cap is available in the Library note [Budget 2014: a summary \(updated\)](#) (SN/EP/06848)

<sup>16</sup> HM Treasury, *Government response to the House of Commons Treasury Committee 4<sup>th</sup> Report of Session 2010-11: Office for Budget Responsibility*, Cm 7962, November 2010, para 2.6

<sup>17</sup> Treasury Committee, *Office for Budget Responsibility*, HC 385, 21 September 2010 para 20

<sup>18</sup> "How it's done in Sweden", *Guardian*, 29 July 2010

## 5 Accountability to Parliament

The Treasury Committee has the right of veto over both the appointment and dismissal of all three members of the BRC. The Chancellor gave the Committee this power for the appointment of the three current members of the BRC. The Act contains statutory provisions to this effect.

The OBR lays its reports directly before Parliament and members of the Budget Responsibility Committee appear before the Treasury Committee to be questioned about their forecasts.<sup>19</sup>

The OBR is a non-departmental public body (NDPB). Prior to its establishment there was some discussion over the institutional form the OBR should take. One possible model would have introduced the OBR as a Parliamentary body, similar to the National Audit Office (NAO). Some fiscal councils overseas, such as the Congressional Budget Office and the Parliamentary Budget Office in Canada, have close links with their legislatures. The Treasury Committee recommended that this arrangement should be considered as part of the five year review suggested by the Committee.<sup>20</sup>

However, the Treasury Committee also noted that such arrangements might be more suited to an OBR whose function was to validate official forecasts, rather than producing them itself.<sup>21</sup> As Lord Turnbull said in the second reading debate on the Bill in the Lords, the OBR has an “executive role” in supplying forecasts used by the Government:

The real choice is between an OBR that is on the executive side of the fence and one that is an emanation of Parliament, like the NAO. Both the Treasury Select Committee and the Government have opted for the former, which I believe is right. The OBR is not just a commentator or expert auditor. It has an executive function: it supplies the Treasury with the basis for its projections.<sup>22</sup>

The Treasury Committee recommended that the OBR should be a Non Ministerial Department similar to the UK Statistics Authority. The Government disagreed with this recommendation and proposed establishment of the OBR as a grant-funded NDPB. This was because of concerns over whether the OBR’s establishment as a Non Ministerial Department would provide value for money.<sup>23</sup>

## 6 Rationale

In recent years, governments in a number of countries have sought to improve their fiscal policies by the introduction of fiscal rules or by strengthening fiscal institutions. These measures can improve the credibility of fiscal policy. Governments may be tempted to adopt short-term policies, such as cutting taxes or increasing public spending in an unsustainable way, which may be harmful to the economy in the long-term. By adopting fiscal rules or frameworks, which constrain their behaviour, governments can signal that they will not adopt these short-term policies and can thereby give their fiscal policy increased credibility.

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<sup>19</sup> HM Treasury, [Office for Budget Responsibility and HM Treasury: Framework Document](#), May 2014

<sup>20</sup> Treasury Committee, [Office for Budget Responsibility](#), HC 385, 21 September 2010 p4

<sup>21</sup> Treasury Committee, [Office for Budget Responsibility](#), HC 385, 21 September 2010 para 91

<sup>22</sup> HL Deb 8 November 2010 c22

<sup>23</sup> HM Treasury, [Government response to the House of Commons Treasury Committee 4<sup>th</sup> Report of Session 2010-11: Office for Budget Responsibility](#), Cm 7962, November 2010, paras 4.4 – 4.6

A number of attempts have been made in the UK to gain credibility in this way. These include the fiscal rules adopted by the last government and the [Fiscal Responsibility Act 2010](#) which placed a legal obligation on the Treasury to reduce borrowing and debt by specified amounts. The fiscal frameworks must find a balance between placing constraints on policy with the need for flexibility in response to unanticipated economic events. This point was made by Lord Burns in the second reading in the Lords debate on the Bill:

The challenge is to have a framework that both constrains fiscal behaviour in a responsible way and is capable of dealing with the range of surprises and unexpected events that inevitably occur. All attempts to frame budget responsibility in this way have at some stage met that particular problem-some have dealt with it better than others.<sup>24</sup>

In the past, attempts were made to add caution to the Treasury's fiscal forecasts. For example, the NAO examined the assumptions used in the projections of the public finances to ensure that they were reasonable and cautious. The NAO will no longer audit the assumptions used in the Budget forecast under the Government's proposed framework. In addition, the Budget and Pre-Budget Reports used a cautious assumption for trend GDP growth in making projections for the public finances. For example, the March 2010 Budget assumed that trend GDP growth was ¼% lower than the Treasury's main economic forecast. The OBR does not use "cautious" assumptions in this way. It presents a central case and seeks to emphasise the inevitable uncertainties involved in economic forecasting.

The aim of the OBR is to make the Government's forecasts for the economy and public finances independent. Until now, the Treasury's forecasts were based on the Chancellor's judgements. This could lead to the suspicion that the forecasts were over-optimistic, and potentially to a loss of credibility in fiscal plans. By giving the forecasting role to the OBR, the danger that the forecasts could be politically motivated is removed and the credibility of the fiscal framework enhanced.

In the second reading debate in the Lords, Lord Sassoon said:

Now, through the Bill, the Government are strengthening the framework of the UK's fiscal institutions.

The greatest single step forward is the establishment of the independent Office for Budget Responsibility, which will make independent assessments of the public finances and the economy. Up until the new Government's first Budget, the responsibility for producing the official forecasts had rested with the Chancellor. The key judgments were made by Ministers, but the possible incentive to forecast optimistically, whether on lower borrowing or higher growth, led to scepticism over the credibility of the forecasts. Budget forecasts over the past decade consistently underestimated borrowing, compared to both its actual level and to what other independent forecasters expected at the time. The coalition Government intend to take a different approach.<sup>25</sup>

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<sup>24</sup> HL Deb 8 November 2010 c34

<sup>25</sup> HL Deb 8 November 2010 c12



## 7 Reaction

The creation of the OBR has generally been welcomed, especially for the increase in transparency it has brought to forecasting the economy and the public finances. The IFS described the decision to move forecasting to an independent body as “a very welcome one” and praised the publication of more detail on the assumptions underlying the forecasts.<sup>26</sup> A leader in the *Financial Times* described the OBR as “a welcome innovation” but said that it should answer to Parliament rather than the Treasury.<sup>27</sup>

The IMF welcomed the establishment of the OBR:

Directors commended the creation of an independent Office for Budget Responsibility and encouraged the authorities to strengthen the fiscal framework further by eventually replacing the current fiscal mandate, an appropriate guide for the consolidation process, with more permanent fiscal rules.<sup>28</sup>

The OECD said:

One of the key measures announced by the new government is the creation of the Office for Budget Responsibility (OBR). This is clearly an important initiative in terms of strengthening government management of public spending and improving public confidence in the government’s fiscal policy. The experience of OECD with establishing similar bodies in Canada, Korea, Austria, Hungary, and Sweden suggests that in such bodies clear signals of impartiality are important.<sup>29</sup>

Writing in the *Independent*, Stephen King (managing director of economics at HSBC) gave the OBR a more cautious welcome:

The formation of the OBR cannot possibly be a panacea for the UK’s underlying economic difficulties. It’s important for investors, the public at large and, indeed, the new Government to understand the Office’s limitations. Nevertheless, even allowing for the constraints imposed by economic “group think”, the OBR should be able to deliver modest improvements in economic policy-making in the years ahead (which, with any institutional innovation, is about the best we should be hoping for).

The Treasury will no longer have the opportunity to redefine the economic cycle or fiddle the economic forecasts to suit its own purposes. With the Government subject to independent fiscal inspection, the risk of a sovereign downgrade should be reduced, thereby protecting the interests of UK taxpayers. And, if the OBR really has teeth, any fiscal misdemeanours should lead to welcome parliamentary scrutiny at a relatively early stage.

The really big challenge for the OBR, however, is finding a way to escape from group think. Good policy-making depends not on adherence to a central forecast but, instead, on the risks around that central projection. Even the Bank of England, which routinely publishes fan charts designed to capture both upside and downside economic risks, failed to capture the catastrophic meltdown associated with the credit crunch. The OBR will need to think the unthinkable and explain to sceptical politicians why they need to

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<sup>26</sup> IFS Press Release, *OBR sets the scene for a painful Budget*, 14 June 2010

<sup>27</sup> “A welcome check on the chancellor”, *Financial Times* [leader], 18 May 2010

<sup>28</sup> IMF, *IMF Executive Board Concludes 2010 Article IV Consultation with the UK*, 9 November 2010

<sup>29</sup> OECD, *United Kingdom: Policies for a Sustainable Recovery*, July 2010, p26

pay attention to events which, while seemingly unlikely, present an existential challenge to our economic well-being.<sup>30</sup>

Speaking for the Opposition, Lord Eatwell described the OBR as “a very good idea” but criticised the arrangements for making the OBR independent.<sup>31</sup> In a speech in November 2010, the Shadow Chancellor, Alan Johnson called for the OBR to look at the resilience of the tax base:

A proper understanding of how reliant our tax base had become on certain sectors should have made clear that our economy was too narrowly focused.

To put it another way – the tax base provides a lens through which to recognise distortions of this kind and signal that the government should do more to promote economic diversity.

The Office of Budget Responsibility provides an opportunity to deal with this issue.

Its responsibility for forecasting tax receipts should be extended to require a regular assessment of the resilience of the tax base. This should form part of its annual analysis of the sustainability of public finances.

We need to be sure that the OBR is truly independent and genuinely transparent before we attempt to amend the Bill currently in the Lords to extend its remit in this way.<sup>32</sup>

## **8 Issues**

### **8.1 Independence**

A key issue is how to ensure that the OBR is truly independent of the Treasury. As noted above, the Treasury Committee has a veto over appointments to the BRC. However, the OBR's remit means it will have to work closely with government departments.

Central to the issue of independence is the extent to which the OBR makes use of expertise within the civil service. Civil servants in the Treasury, HM Revenue and Customs and the Department for Work and Pensions have considerable expertise in fiscal forecasting and the implications for the forecast of changes in taxes and benefits. How far should the OBR make use of this knowledge? There are advantages if the OBR could use this knowledge but too close contact could damage the perception of independence. The alternative would be to build up knowledge within the OBR but this could lead to wasteful duplication of resources.

The Treasury Committee described this problem as follows:

In the run up to the Budget it [the OBR] 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?<sup>33</sup>

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<sup>30</sup> [“The Office for Budget Responsibility must be prepared to defy the fiscal consensus”](#), *Independent*, 31 May 2010

<sup>31</sup> HL Deb 8 November 2010 cc15-19

<sup>32</sup> [The real debate about our economic future](#), Speech by Alan Johnson MP at Royal Society of Arts, 11 November 2010

<sup>33</sup> Treasury Committee, [Office for Budget Responsibility](#), Fourth Report of Session 2010-11, HC 385, 21 September 2010, para 68



It went on to say:

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.<sup>34</sup>

In its advice on setting up the permanent body, the interim OBR favoured using departmental resources but also called for those at the “core of the forecasting process” to be moved to the OBR:

The question of the use of departmental, especially Treasury, resources is more difficult. The scepticism this process produced is unfortunate since, in our view, this is the best way for us to perform our task. Detailed forecasts of receipts and expenditure are necessary for the Budget and few outsiders appreciate the complexity of fiscal forecasting. At its peak the process involves more than 100 people in the Treasury, HMRC and DWP. It is not a full-time job for most of those involved. Between forecasts, the officials are engaged in such tasks as policy analysis and advice and monitoring of fiscal flows. It would not be practical to duplicate the forecasting activities within the OBR. The cost would be unacceptably high and there would be a severe peak-flow problem, given that forecasting is an intermittent activity. Further, those currently engaged in forecasting use the skills and knowledge they gain on their other activities: there are synergies in developing expertise that can be applied to both forecasting and other analysis.

For these reasons we rule out wholesale duplication. That means that either the OBR continues to rely on official resources as now, while accepting full responsibility for all judgements and scrutinising all policy costings, or its forecasting task is changed. For example, it might just produce aggregate fiscal forecasts without taking responsibility for the full details of revenue and expenditure as published with the Budget. This could lead to consistency issues with policy costings and other problems. We do not believe that this approach would be consistent with your expressed wish to use the OBR as the source of the Budget forecasts.

The way forward therefore would appear to be to build on the system used for the pre-Budget and Budget forecasts but to reinforce the OBR's technical independence. Since the OBR is responsible for producing the forecasts it would be reasonable for those at the core of the forecasting process to be part of it. That can be achieved by moving a number of posts from the Treasury to the OBR such that core tasks can be fully controlled and coordinated within the OBR.<sup>35</sup>

The OBR has around 20 staff, civil servants who have in the main transferred from HM Treasury.<sup>36</sup> The Act gives the OBR the right of access to government information which it may reasonably require for the performance of its duty. The Government has published frameworks for co-operation between the OBR and its main Government partners in formal memoranda of understanding.<sup>37</sup>

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<sup>34</sup> Treasury Committee, [Office for Budget Responsibility](#), Fourth Report of Session 2010-11, HC 385, 21 September 2010, para 72

<sup>35</sup> [Establishing the Office for Budget Responsibility](#), Letter from interim OBR to Chancellor, 12 July 2010, paras 44-46

<sup>36</sup> HM Treasury, [Government response to the House of Commons Treasury Committee 4<sup>th</sup> Report of Session 2010-11: Office for Budget Responsibility](#), Cm 7962, November 2010, para 3.6

<sup>37</sup> HM Treasury. [Memorandum of Understanding between Office for Budget Responsibility, HM Treasury, Department for Work and Pensions and HM Revenue & Customs](#), April 2011; OBR. [Memorandum of Understanding between the Office for Budget Responsibility and HM Treasury – the macroeconomic model](#)

The OBR is currently located in the Attorney General's Office on Victoria Street.<sup>38</sup> The interim body had been located in the Treasury.<sup>39</sup> In its advice on setting up the permanent body, the OBR recommended that it be located outside the Treasury while noting that it would be difficult to have a close working relationship with the Treasury if it was located too far away.<sup>40</sup>

## 8.2 Costing Opposition policies

The issue of whether the OBR should cost Opposition parties' fiscal proposals was discussed when the office was being established.

The issue re-emerged in 2013 when Labour's Shadow Chancellor Ed Balls MP proposed that the OBR should independently audit the costings of the spending and tax measures contained in Labour's manifesto for the 2015 election. This additional role for the OBR was proposed in Mr Balls' speech to the 2013 Labour Party Annual Conference,<sup>41</sup> which was followed up with a letter laying out the proposal to the OBR's Chairman, Robert Chote:

The reform I am proposing would mean the Opposition would submit costings for proposed manifesto commitments on spending and tax – obtained for example, from the House of Commons Library, Parliamentary Questions or the Institute for Fiscal Studies – and the OBR would 'provide independent scrutiny and certification' of these costing.<sup>42</sup>

Robert Chote has provided some support for the idea in principle, but has suggested that practical issues may stand in the way of the OBR performing such a role for the 2015 general election:

As I have discussed [in oral evidence to the Treasury Select Committee] I believe that independent scrutiny of preelection policy proposals could contribute to better policy making, to a more informed public debate, and could help facilitate coalition formation when party programmes need to be reconciled. But we should not underestimate the significant practical issues that would need to be addressed - issues that would affect the political parties and the civil service at least as much as the OBR.

First and foremost, it would be essential to establish clear 'rules of the game' for all involved, well before the election, and to ensure that adequate resources were in place to do the job properly. To embark on this exercise in a rush, or with insufficient resources, could be very disruptive for the parties and very damaging to the OBR.

Putting it bluntly, if Parliament wished us to play this role in the 2015 election, we would need a clear steer in the very near future to have any hope of putting the necessary practical arrangements in place in time to deliver a smooth process. Indeed advocates of the reform may now feel that it would be better to consider these issues at the beginning of the next parliament- with a view to being fully prepared before the subsequent election- rather than rush into it for 2015 and risk undermining support for the idea in the longer term.<sup>43</sup>

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<sup>38</sup> [Letter](#) from Robert Chote to Andrew Tyrie, Chairman of the Treasury Committee, 12 October 2010

<sup>39</sup> HL Deb 17 June 2010 c133WA

<sup>40</sup> [Establishing the Office for Budget Responsibility](#), Letter from interim OBR to Chancellor, 12 July 2010, para 57

<sup>41</sup> [Ed Balls MP's speech to Labour Party Annual Conference 2013](#)

<sup>42</sup> Letter from Ed Balls MP to Robert Chote, Chairman of the OBR, 22<sup>nd</sup> September 2013. A copy of the letter is available from <http://budgetresponsibility.org.uk/transparency/letters/>

<sup>43</sup> [Letter](#) from Robert Chote to Andrew Tyrie, Chairman of the Treasury Committee, 12 March 2014. A copy of the letter is available from <http://budgetresponsibility.org.uk/transparency/letters/>

Legal advice provided to the OBR suggests that primary legislation would be required for the OBR's role to include the costing of Opposition parties' fiscal proposals.<sup>44</sup>

The costing of Opposition parties' fiscal proposals happens, for example, in the Netherlands, and was discussed when the OBR was being introduced. Professor Simon Wren-Lewis of Oxford University was in favour of this model:

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.<sup>45</sup>

In October 2010, the Chancellor said that the House should debate and decide whether the OBR should cost Opposition parties' policies:

this is genuinely a matter that should be debated in the House in a non-partisan way, because it does not affect just this Parliament. There is a question of whether we want the OBR to be able to cost Opposition policies at the time of a general election. I propose to have discussions with Opposition party leaders about whether that is the appropriate thing to do, and it would be a legitimate matter for the House to debate and decide.<sup>46</sup>

In its response to the Treasury Committee report, however, the Government rejected this idea, saying that the OBR "should not examine alternative fiscal or other policy scenarios, including those proposed by political parties."<sup>47</sup> This was because the Civil Service Code tightly controls the degree to which civil servants may examine Opposition parties' policies and that the principle of political impartiality should also apply to the OBR. The Government has re-iterated this view in the light of Labour's September 2013 proposal.<sup>48</sup>

### 8.3 A commentary role

Another issue is the extent of the OBR's remit. In particular, to what extent should the OBR be permitted to have a wider "commentary" role in addition to its fiscal forecasting duties? Tim Besley, Professor of Economics at the LSE, and a former member of the Bank of England Monetary Policy Committee, has argued that the OBR should be able to look at all issues relating to fiscal sustainability:

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<sup>44</sup> As discussed in a letter from Robert Chote to Ed Balls MP on 23<sup>rd</sup> September 2013, available from <http://budgetresponsibility.org.uk/transparency/letters/>

<sup>45</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, Q86

<sup>46</sup> HC Deb 12 October 2010 c142

<sup>47</sup> *Government response to the House of Commons Treasury Committee 4<sup>th</sup> Report of Session 2010-11, Office for Budget Responsibility*, Cm 7962, November 2010, para 2.23

<sup>48</sup> For instance see: [HC Deb 29 April 2014:c693](#); [HC Deb 11 March 2014:c165](#); [HC Deb 10 December 2013:c118](#)

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.<sup>49</sup>

The IFS has argued that while it is sensible for the fiscal target to be set by the Government, it would be appropriate for the OBR to make a public assessment of whether “any changes to the rules it is tasked with policing are consistent with the ultimate objective of long-term sustainability”. The IFS warned against the OBR advising on broader economic policy issues.<sup>50</sup>

The Government decided, however, to limit the OBR’s “commentary” role. The Charter for Budget Responsibility states that the OBR:

The OBR should not provide normative commentary on the particular merits of Government policies.<sup>51</sup>

The Treasury Committee is in agreement with this arguing that it would be inappropriate for the OBR to play a role in setting the fiscal mandate and that comment should not be made on individual measures.<sup>52</sup>

## **8.4 Establishing credibility**

It is clearly important that the OBR establishes credibility. However, fiscal forecasting is notoriously difficult. For example, government borrowing is the difference between revenue and expenditure – both very large numbers. Small errors in forecasting these can make a large difference to the forecast for borrowing.<sup>53</sup> There is a danger that if the OBR is judged solely by the accuracy of its short-term forecasting it will lose credibility. The issue was raised by Tim Besley in evidence to the Treasury Committee:

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,

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<sup>49</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, Q82

<sup>50</sup> Institute for Fiscal Studies, *The IFS Green Budget: February 2010*, pp257-58

<sup>51</sup> HM Treasury, Charter for Budget Responsibility March 2014 update, [para 4.12](#)

<sup>52</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, para 64

<sup>53</sup> For example, in its June 2010 Budget forecast the OBR forecast receipts of £548 billion and spending of £697 billion in 2010/11, giving a deficit of £149 billion (Table C7 p90). If receipts were 1% higher and spending 1% lower, the deficit would be £137 billion – a difference of £12 billion or over 8%.

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.<sup>54</sup>

Professor Wren-Lewis agreed with this point:

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.<sup>55</sup>

In its report on the OBR, the Treasury Committee argued that while there should be scrutiny of the OBR’s forecasts, “absolute accuracy is not a useful criterion.” Their quality could be assessed relative to other forecasts.<sup>56</sup>

## 8.5 Review

The Treasury Committee recommended that the OBR be subject to a comprehensive review after five years, reporting to both the Chancellor and the Committee. This review “should include an assessment of the OBR’s performance, remit and institutional accountability arrangements”, and in particular, whether the OBR should become a Parliamentary body.<sup>57</sup> In its response, the Government said that it was best practice for all public bodies to be subject to regular review, as set out in Cabinet Office guidance. It was not, therefore, necessary to include provision for this in legislation.<sup>58</sup>

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<sup>54</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, Q82

<sup>55</sup> Ibid

<sup>56</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, para 39

<sup>57</sup> Treasury Committee, *Office for Budget Responsibility*, Fourth Report of Session 2010-11, HC 385, 21 September 2010, para 33

<sup>58</sup> *Government response to the House of Commons Treasury Committee 4<sup>th</sup> Report of Session 2010-11, Office for Budget Responsibility*, Cm 7962, November 2010, para 1.25

## **9 Annex 1: International examples of fiscal councils**

A number of countries have fiscal councils, although their role and structure differ. The following list is taken from the [website](#) of Simon Wren-Lewis, Professor of Economics at Oxford University.

### **Austria**

The Public Debt Committee was established in 2002, and 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 (see below). 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 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**

In 2007 the Swedish Fiscal Council was established. The Council 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. Its director, Lars Calmfors, has a paper describing the experience of the council so far.

## **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.

## 10 Annex 2: Links to further information

### The Act

[Budget Responsibility and National Audit Act 2011](#)

Parliament [webpage](#) for the Act

### The Bill

[Budget Responsibility and National Audit Bill \[HL\]](#)

[Explanatory notes to the Bill](#)

### OBR

[OBR website](#)

[Establishing the Office for Budget Responsibility](#), Letter from interim OBR to Chancellor, 12 July 2010

### Treasury

HM Treasury Press Notice, [Chancellor announces policies to enhance fiscal credibility](#), 17 May 2010

[Letter](#) from the Chancellor to Robert Chote, Chair of the OBR, setting out terms of reference for the OBR, 12 October 2010

### Treasury Committee

Treasury Committee, [Office for Budget Responsibility](#), HC 385, 21 September 2010

HM Treasury, [Government response to the House of Commons Treasury Committee 4th Report of Session 2010-11: Office for Budget Responsibility](#), Cm 7962, November 2010

### IFS

IFS *Green Budget 2010*, Chapter 11, [“Reforming UK fiscal institutions”](#)

IFS Press Release, [Keeping official fiscal forecasts honest](#), 12 November 2009. This contains the text of the section on the OBR of Robert Chote’s November 2009 Scottish Economic Society/Royal Bank of Scotland Annual Lecture

### Other

IMF, [Fiscal Rules – Anchoring Expectations for Sustainable Public Finances](#), 16 December 2009. This gives an overview of the theory of fiscal rules and international experience. There is a table on p14 showing fiscal rules in other countries.

[How it’s done in Sweden](#), *Guardian*, 29 July 2010, Lars Calmfors (chair of Sweden’s [Fiscal Policy Council](#))