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Office for Budget Responsibility

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Additional written evidence

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The Treasury Committee

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Written evidence

Written evidence submitted by Bonny St John

Hope you will not, not, take up George Osborne's offer to you to have a veto on the final candidate for the chairmanship of the OBR. Will you be perceived to be as honestly critical as you should be of someone whose appointment you had a hand in? I doubt it. In fact, I know that you won't.

And what about the Permanent Secretary of HMT? Would you also be allowed to take part in their selection? He or she is just as critical to the honest presentation of the nation's finances as the OBR's chairman. And in any event, you'd be simply rubber stamping a decision someone else had made, unless you interviewed the candidate(s) yourselves. Plus look at how politicise senior public appointments are in the USA because of the Congressional hearings into them. We don't want to go down that route, do we?

Please let HMT and the civil service appoint officials, and focus on scrutinising theirs and the government's performance and outcomes.

21 July 2010

Written evidence submitted by the Institute for Government

STATUS OF ARM'S LENGTH BODIES

EXECUTIVE SUMMARY

The current landscape for arm's length bodies is confused. A report published by the Institute for Government proposes a new way of classifying public bodies, based on needed freedom from ministerial control, which would put governance onto a sounder footing going forward. If that new system were adopted, it would make sense to treat the Office for Budget Responsibility as what we call an "Independent Public Interest Body".

1. In evidence to the Select Committee on 20 July, Sir Alan Budd referred to the Institute for Government's report, *Read Before Burning: arm's length government for a new administration*, published on 15 July 2010. Among other recommendations, that report proposes a new way of classifying arm's length bodies. This memorandum sets out the rationale for those proposals and the key criteria for differentiating between types of arm's length body which the Committee may find helpful in thinking through governance arrangements for the Office for Budget Responsibility.

2. The background to our report was the view that the current landscape of arm's length governance was confused. In particular there is no clear or systematic link between the form of a body to its function, to the freedom that body needs to perform that function. Like bodies had unlike forms—thus Ofcom, which regulates the communications industry is a public corporation while Ofgem, which regulates the gas and electricity industry is a non-ministerial department. The National Archive is both a non-ministerial department and an Executive Agency, as is the Central Office of Information, yet these two forms should imply very different governance arrangements. Our research found that the category of non-Ministerial department was particularly confusing, not least since a participant in one of our seminars said of running an NMD: "the first thing you have to know about being a non-Ministerial department is that you have a Minister and you are not a proper department". The term "non-departmental public body" also misrepresents the position—these bodies have Boards appointed by departments and are often wholly or largely funded by them. Our research also suggested that status decisions were often afterthoughts—the result of the way legislation was drafted, and driven by consideration such as impact on civil service headcount numbers.

3. Latest figures from the Cabinet Office suggest there are almost 800 ALBs, divided into at least 11 categories, but that the majority are small advisory committees with no independent budget or staff. The big budgets are held by the much less numerous executive agencies, executive NDPBs and non-ministerial departments, but even there, a few big bodies account for most of the spend (2008 figures showed that for executive NDPBs just 15 bodies accounted for over 75% of spend) and that most staff were in three big agencies. Even then, most of the executive NDPB spend is passed on in grants to third parties.

4. Our view is that effective relationships between the government, arm's length bodies and the public require greater clarity on roles and responsibilities and in particular the freedom from Ministerial/executive control a body needs to perform its function. One of the paradoxes of arm's length government is that while the general category of ALBs (or quangos) attracts a lot of political and public distrust and concern, the public can be reassured when individual functions are put at arm's length from government—whether it is the regulation of food standards or the integrity of official statistics or decisions on the distribution of arts funding.

5. Our report therefore suggests a new approach to classifying arm's length bodies. It would remove two of the most confusing categories where governance and relationships to ministers are most unclear—non-ministerial departments and executive non-departmental public bodies and stop treating advisory NDPBs as part of arm's length government, and recognise that they are no more than advisory committees to departments.

6. In place we propose a new categorisation which differentiates between:

(a) Constitutional bodies—answerable to Parliament, not ministers. This would include bodies like the Electoral Commission, the NAO and IPSA.

(b) Independent Public Interest Bodies—which would be protected from ministerial interference by giving Parliament approval rights on appointments, budget and would involve Parliament in any cases where the minister wanted to override a decision. The body would account to Parliament for decisions made within its statutory framework, not to or through ministers.

(c) Departmental Sponsored Bodies—where the department would sign off the corporate strategy, make appointments and be allowed to attend Board meetings. These are bodies which would be expected to align with overall departmental objectives but have discretion on individual decisions.

(d) Executive Agencies—as now, effectively managerial business units of the department.

7. The determining consideration on how to treat an ALB is the degree of freedom it needs from ministerial control to perform its function credibly. So the bodies that we suggest should be made Independent Public Interest Bodies are the economic regulators, the guarantors of standards and bodies which act as watchdogs of government (particularly central government) activity. In our report we suggest this status could apply to bodies such as Ofcom, the Competition Commission, the Food Standards Agency (for its regulation activities), the Climate Change Committee and the UK Statistics Authority as the ability of all these bodies to perform their functions depends on them being seen to be distanced from ministerial control and interference.

8. We see the key issues for independence being:

(a) Appointment and dismissal process—is this ultimately for ministers (as regulated by the Office for the Commissioner for Public Appointments) or is there a Parliamentary veto on appointments? Can ministers dismiss appointees without recourse to Parliament?

(b) Budget—for the Minister to set or to agree the body's own proposal, with a potential role for Parliament in case of disagreement?

(c) Strategy—does the department have a role in approving the body's strategy or is it simply for its Board to determine.

(d) Accountability—for the Chair/CEO directly to Parliament or through Ministers (Ministers would remain accountable for the statutory framework in the case of IPIBs).

(e) Public profile—restricted or unrestricted.

9. A body that needs to have public credibility as being independent from government should, in our view, set its own strategy within its statutory remit and be directly accountable to Parliament for it, have no restrictions on public profile, and Parliament should both be engaged in the appointment process and Ministers should have to get Parliamentary approval before dismissing the Chair. It was these considerations that led us to the view in the report that the Office for Budget Responsibility might best be classified in the propose category of Independent Public Interest Body.

10. The current Cabinet Office review is an opportunity to look at these issues and establish a more robust and stable basis for arm's length governance going forward. The outcome of that review should inform decisions for new bodies like the Office for Budget Responsibility.

28 July 2010

Written evidence submitted by the Hansard Society

SUMMARY OF RECOMMENDATIONS

— The Treasury Committee should hold pre-appointment hearings and possess a veto power for the appointment of all members of the Budget Responsibility Committee, not just for the appointment of the Chair of the Office for Budget Responsibility.

— Consideration should be given to whether there is scope for broadening the OBR remit to enable Parliament itself (through perhaps the Treasury Committee or the Liaison Committee) to request/commission independent evaluations of government policy, within carefully agreed parameters, in respect of economic and public finance forecasting.

— Mechanisms should be established to ensure that OBR reports are debated annually in the House of Commons, in either government or backbench time.

Background and Context

1. Parliament has a unique and historic constitutional role in the authorisation and scrutiny of government expenditure. As such, financial scrutiny is a fundamental pillar of our political system and goes to the heart of the relationship between Parliament, government and the public. It ought to be considered one of the most important tasks facing MPs, but in reality Parliament has often been an acquiescent bystander: the Budget and legislation enacting taxation proposals receive limited debate; and on Estimate Days billions of pounds of public spending are authorised with only limited scrutiny.

2. In 2001 the Hansard Society's Commission on Parliamentary Scrutiny (the Newton Commission) noted that Parliament needed additional analytical capacity, enhanced research facilities and access to financial expertise if select committees were to adequately scrutinise financial matters.[1] Since 2002 the expertise available to committees has been significantly augmented by the work of the Scrutiny Unit. However, in 2005–06 the Hansard Society concluded that resources available in this area should be expanded either through augmentation of the Scrutiny Unit or the establishment of an independent Parliamentary Finance Office.[2] This would provide both committees and individual MPs with access to technical expertise and support to study financial data provided by the government, and check and evaluate the assumptions on which it is based.

3. In the intervening years there have been a few, albeit modest, improvements in financial scrutiny (for example, the Treasury Alignment Project) and Parliament has more opportunities and greater resources than previously to undertake its scrutiny role. However, there remains considerable scope for MPs to foster a greater culture of detailed financial scrutiny in order to hold the government to account in this crucial area of work.

4. More broadly the Hansard Society's work on legislative and procedural reform has led us to regularly call for improvements in the role and function of select committees, including revisions to the scope, purpose and impact of public appointment hearings.

5. It is in the context of these areas of our work that we comment on the proposals regarding the future arrangements for and accountability of the new Office for Budget Responsibility (OBR).

Appointment Hearings

6. The Chancellor has proposed that the Treasury Select Committee should hold a pre-appointment hearing and possess a veto over the appointment of the Chair of the OBR. We welcome this important development. It will serve to enhance the independent reputation of the OBR and set an important precedent with regard to future parliamentary scrutiny of the appointment of chairs of similar independent bodies in the future.

7. However, the Chancellor has suggested that the Treasury Select Committee hold only pre-commencement hearings with regard to the other two members of the Budget Responsibility Committee (BRC). We contend that the same arrangements for the appointment of the Chair should be applied to the appointment of the other members of the BRC. The Chair is of course the most important post, particularly as the public, ambassadorial face of the OBR. However, the other members of the BRC will have critical roles to play in delivering different aspects of the work of the OBR and members of the Treasury Select Committee should therefore be able to reflect on the broad skill set required of the BRC as a collective body.

Accountability to Parliament

8. If Members were so minded, the OBR legislation might present Parliament with an opportunity to enhance its financial scrutiny work by broadening the remit of the OBR to include areas where Parliament itself has an interest in securing/commissioning an independent evaluation of government policy in respect of economic and public finance forecasting. This would have the additional advantage of underscoring the independence of the OBR, reinforcing its role as acting independently in the public interest. Any broadening of its remit to allow Parliament (eg through the Treasury Select Committee or the Liaison Committee) to request forecast information must be achieved within clearly defined parameters. The OBR is not and should not be seen as an alternative to a fully functioning Parliamentary Finance Office serving Members and committees direct. And any broadening of the OBR's remit in this way would only be justified, and be effective in practice, if such work requests were properly resourced and the OBR were asked to provide Parliament with an independent assessment of an issue within a reasonable timeframe for the work required.

9. There are also important lessons in relation to parliamentary accountability to be learnt from the experience with the Bank of England since its independence was enshrined in the 1998 legislation. In setting out the advantages of independence, the then Chancellor of the Exchequer made clear that not only would the Treasury Committee be able to scrutinise appointments to the Monetary Policy Committee but that Parliament should have the opportunity to debate the Bank's annual report. This was endorsed by the members of the Treasury Committee who made clear in their first report on the subject that they expected

[1] Hansard Society (2001), *The Challenge for Parliament: Making Government Accountable: The Report of the Hansard Society Commission on Parliamentary Scrutiny* (London: Hansard Society), pp 60–69.

[2] A Brazier and V Ram (2006), *The Fiscal Maze: Parliament, Government and Public Money* (London: Hansard Society), pp 69–71.

a debate on the Bank of England to take place each year in government time within a month of the Committee having taken evidence on the Bank's annual report.[3] The Modernisation Committee was asked to consider how to facilitate this. In practice, a yearly debate on the Bank of England annual report has not happened with any regularity; the idea fell by the wayside. Publication of the OBR forecasts will similarly provide an important opportunity for all members of the House of Commons to debate its work and thus to augment current scrutiny of aspects of the government's economic policy and approach to public finances. The Committee might thus give some thought to how it will ensure that such regular debates take place, and whether that should be in government or backbench time, liaising with the new House Backbench Business Committee, the Liaison Committee and the Usual Channels as required.

August 2010

Written evidence submitted by the UK Statistics Authority

Summary

The UK Statistics Authority regards its statutory independence to be reinforced by the following:

- provisions of the Statistics and Registration Service Act 2007;
- responsibility for preparing, adopting and publishing a statutory Code of Practice for (Official) Statistics;
- statutory objective to promote and safeguard official statistics to ensure they "serve the public good";
- independently-appointed Chair (Crown appointment), subject to a pre-appointment confirmation hearing before a parliamentary committee and a formal motion debated on the floor of the House of Commons;
- a non-executive majority on governing Board, appointed through open competition;
- direct reporting to Parliament and the devolved legislatures, not to Ministers;
- operating transparently, for example through the publication of minutes and papers, correspondence, and issues investigated; and
- recognition of the Code of Practice for Official Statistics in the Ministerial Code, including requirements on Ministers in respect of statistical propriety.

Legislative Provisions

1. The UK Statistics Authority was established by the Statistics and Registration Service Act 2007 which came into force on 1 April 2008. The Statistics Authority is a non-ministerial department reporting directly to the UK Parliament and the devolved legislatures on the exercise of its functions. The Act requires the Authority to promote and safeguard the production and publication of official statistics that serve the public good.

2. The Act sets out the status of the Authority, its membership and staff; its functions in relation to official statistics and National Statistics; organisation and administration; and specific provisions relating to registration services. The territorial extent of the Act (with the exception of provisions relating to registration services) is to England and Wales, Scotland, and Northern Ireland.

3. The Act gives the Authority a statutory responsibility to prepare, adopt and publish a Code of Practice for Statistics, although the Act sets out that the Code may not deal with any matter relating to the granting of pre-release access to official statistics. Pre-release access arrangements are proposed by Ministers and determined in separate, secondary legislation. The Statistics Authority has requested the government to give it, by administrative action, responsibility for independently determining the arrangements for pre-release access; the government has not acceded to this request.

Establishment, Membership and Staffing

4. The Authority operated in shadow capacity between the appointment of the Chair in July 2007 and 1 April 2008. The non-executive members of the Board were appointed in February 2008.

5. The Chair of the UK Statistics Authority is a Crown appointment, appointed by Her Majesty on the advice of the Prime Minister. The appointment of the Chair was subject to a pre-appointment confirmation hearing by the Treasury Select Committee, followed by a formal motion debated on the floor of the House of Commons in July 2007.

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[3] House of Commons Treasury Committee (1997–98), *First Report: Accountability of the Bank of England*, HC 282, section IV; See also the House of Commons Treasury Committee (1997–98), *Accountability of the Bank of England: The Response of the Government and the Bank of England to the First Report from the Committee in Session 1997–98*, HC 502.

6. The Board of the Authority has a majority of non-executives who are all appointed through open competition. The current non-executive members have a range of professional experience in business, academia, and public service.

7. Membership of the Authority Board includes three executive members, the National Statistician and currently also the Head of Assessment and Director General of the Office for National Statistics.

8. The Authority Board is supported by a small secretariat.

9. The National Statistician is a Crown appointment, as Head of the Government Statistical Service and chief executive of the Authority. The National Statistician reports to the Chair of the Authority as chief executive, and also to the Cabinet Secretary as a member of the Permanent Secretaries group. The National Statistician is, by statute, the Board's principal adviser on the quality of, comprehensiveness of, and good practice in relation to, official statistics.

10. The Head of Assessment is a statutory postholder who reports to the Chair and the non-executive members of the Board. The Head of Assessment is, by statute, the Board's principal adviser on the scrutiny of official statistics. The Head of Assessment is supported by a small team of statistical assessors who undertake the Authority's monitoring and assessment work independent of the National Statistician, Office for National Statistics, and other producers of official statistics.

11. All permanent members of staff are civil servants.

Reporting Directly to Parliament

12. The Statistics Authority reports directly to the UK Parliament and the devolved legislatures. The Authority most routinely reports to the House of Commons Public Administration Select Committee, and other committees as required. The Authority values the constructive and engaging relationship that has been built with the Public Administration Select Committee since April 2008. Direct reporting to Parliament is regarded by the Authority as a visible instrument of its independence from government.

Ministerial Oversight and Statistical Propriety

13. The 2010 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 also places a duty on Ministers to have regard to the Pre-Release Access to Official Statistics Order 2008, and advises Ministers that the Order places strict conditions on access to official statistics in their final form, including limiting access ahead of publication and prohibiting any statement or comment to the press ahead of release of the statistics.

14. The Minister for the Cabinet Office exercises certain residual responsibilities in respect of the Government's statistical policy, including those in relation to Census legislation, and to the statutory provisions for pre-release access to official statistics. The Minister also acts as a conduit for the answering of parliamentary questions and laying reports before Parliament. Similar residual responsibilities exist in respect of devolved statistics and the business of the devolved legislatures.

15. The parliamentary stages of the Statistics and Registration Service Bill concluded that residual ministerial oversight of the Statistics Authority should be exercised by the Cabinet Office rather than HM Treasury. Previously, Treasury Ministers had oversight of the Office for National Statistics.

Operating Transparently and Openly

16. Because the Statistics Authority is an independent body with a statutory objective to serve the public good, it operates transparently and openly. The Authority is required under the 2007 Act to produce an annual report each year setting out what the Authority has done during that year, what it has found, and what it intends to do in the following year. The annual report is laid before the UK Parliament and the devolved legislatures, and published on the Authority's website.

17. The minutes and papers of the meetings of the Authority Board are published each month on the Authority's website. Correspondence with the Authority is published, together with summary lists of those statistical issues raised with, and considered by, the Authority. The Authority holds open meetings with users of official statistics and other interested parties to discuss issues of particular importance, and to discuss the findings of interim reports before final publication.

Accommodation, Services and Communications

18. Staff working in the Board Secretariat and undertaking monitoring and assessment work are co-located with staff in the Office for National Statistics at its sites in London and Newport for reasons of economy. The Authority has a small office in Edinburgh which is involved in the assessment of devolved statistics. Where staff are co-located with ONS staff, office accommodation is physically separate.

19. Also on grounds of financial economy and efficiency, the Authority shares various IT, finance, procurement and human resource systems with the ONS.

20. All external communications by Authority staff (email, postal address etc) are distinct from those of the ONS. The Statistics Authority manages its own press office, corporate website, www.statisticsauthority.gov.uk, and it has its own branding. The Authority regards distinctive communications as an essential feature of its independence.

August 2010

Written evidence submitted by the National Institute of Economic and Social Research (NIESR)[4]

1. The Treasury Select Committee has asked for written evidence on the role and responsibility of the Office for Budget Responsibility (OBR). The enquiry will consider alternatives and international experience, and has asked for evidence on the remit, the resources and the means for ensuring the independence of the OBR. The Chancellor intends that the OBR take on responsibility for undertaking independent forecasts and auditing the ability of the government to fulfil its *Fiscal Mandate*. The *Fiscal Mandate* and the tax and spending decisions associated with it are to be left to politicians.

2. The *Fiscal Mandate* at present involves a plan for fiscal consolidation and a target for the budget deficit. The *Mandate* embeds a concept of sustainability, and the OBR needs to assess this concept. Sustainability is not a unique concept. Fairness between generations and a commitment to pay back debts that are raised may be seen as the core of sustainability, but fairness gives a wide range of possible levels of borrowing, and there are a large number of paths for the deficit that involve repaying debts. The *Fiscal Mandate* can be changed by a new government, and the OBR would be best set up to manage such a change. Given this structure, its role should perhaps be reserved to producing independent forecasts and comments on and analysis of government policy. As such its role would be closer to the long-standing Netherlands Bureau for Economic Policy Analysis (or CPB) than to the recently established Fiscal Policy Council in Sweden. Indeed we would caution against copying small countries such as Sweden and New Zealand as their institutions in this area may reflect the size of the relevant profession rather than the optimal structure for the UK.

3. The major remit of the OBR will be to produce an independent forecast from within the public sector. This has been difficult in the last 40 years because Chancellors and their advisors have often had strong views on both how the economy operates and what the prospects for growth will be. Both Gordon Brown and Nigel Lawson believed that their policies had changed the way the economy would operate, and were convinced growth going forward would be stronger than an analysis of the past would suggest. These views coloured their Budget forecasts. It would be wise if this link were broken. However, complete separation from the Treasury would be unwise. The OBR suggests that links with the public sector forecasting groups at the Treasury, HMRC and DWP should be maintained. In our view this is essential if the macroeconomic forecast is to be well founded. The degree of expertise and the scale of effort in these bodies would be impossible to replicate. However, it has always been possible to build a technical wall between the inputs of the public sector forecasters and the overall macro economic forecast, and this link will not endanger independence.

4. The remit of the OBR should reflect that use of resources over time during a forecasting exercise. Given there is a structure in place in order to produce a forecast it should take no more than six weeks from setting the starting point to publishing a finished document.[5] This leaves a good amount of time outside the forecast for background analysis, improvements to tools and writing papers on policy related in particular to the public finances. Such activities should be included in its remit. However, the remit should be flexible enough to ensure the OBR can set its own research agenda while remaining focused upon the Fiscal Mandate of that particular time. These activities can be supplemented by commissioning background work from the relevant academic community. The choice of tools to use should be under scrutiny from parliament, but not prescribed in the remit. The Treasury model is itself an adequate tool for forecasting, but it provides neither a wider perspective on the global economy nor an ability to undertake a variety of policy-related scenario analyses. These are not needed in the Budget forecast, but they are central to making decisions. There are flexible independent tools available for this purpose.

5. The independence of the OBR will depend in part on the structure of its management committee of three councillors. At least one should have experience of the detailed process of forecasting, much as Geoffrey Dicks has, otherwise independence from Treasury influence would be more difficult. This knowledge is common among Treasury officials even at the highest grades, but it is not common outside the public sector. Most City forecasts are small scale operations, and very few academics understand what a large scale macro-economic forecast involves.

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[4] Professor Barrell was an Economic Advisor involved in the forecast team at the Treasury in the 1980s, and has been in his current post since 1990. He is currently Director of Forecasting at NIESR, and President of the AIECE, the European Association of Foresting Institutes. Simon Kirby is the lead UK forecaster at NIESR.

[5] The Institute forecast published in our Review in July 2010, for instance, took a team of eight five weeks to produce. This included writing the forecast material from page F2 to F65.

6. The perception of independence is vital to the effective operation of the OBR. As such the permanent OBR should be established in a building that is separate any from government departments. The relatively transparent approach to the appointment of the three permanent members of the Budget Responsibility Committee (BRC) is a welcome innovation. Clearly much has been learned from the evolution of the process of appointing Monetary Policy Committee (MPC) members. The policy of MPC members commenting on the current and future state of the UK economy should also be undertaken by BRC members, as this would enable them to enhance the public understanding of their role. Expert commentary on the state of the public finances should not be left to twice-yearly forecasting rounds.

7. Interaction with the Treasury is inevitable, in part because forecasters have to be involved in the process of policy making by advising on the consequences of actions taken in the Budget. However, this process should be managed with care. An extra degree of openness about contacts with special advisors is perhaps essential to ensure independence. It is not that they should be absent, but that they should be noted and reported on to Parliament.

12 August 2010

Written evidence submitted by the Social Market Foundation (SMF)

SUMMARY

1. Appropriate design of the OBR will be essential to its credibility, longevity and capacity to provide the best possible fiscal forecasts to guide policy. But in order to determine that design, a full analysis of the reasons for the failure of the old fiscal framework is needed.

2. Consistently over-optimistic revenue projections over the past decade indicate a systemic bias in the way that projections were assembled. This is commonly attributed to political interference—a form of "top-down" bias. But given the nature of the forecasting process—based on myriad finely balanced judgements and assumptions made at all levels of the process—it is all but inevitable that it is vulnerable also to pervasive, if unintentional, organisational bias. It would be nave to imagine that the judgements exercised by civil servants sitting within an organisation whose role is to serve the chancellor could be immune from such bias. A small OBR with minimal manpower will be unable to scrutinize the components of the forecast in sufficient detail to truly own the output and safe-guard against this, less visible, form of bias.

3. The need to separate inherently political fiscal policymaking from essentially a-political forecasting is clear. But splitting the functions is further complicated by the fact that policymaking and forecasting are closely interconnected. Those Treasury officials responsible for feeding into the forecast are simultaneously needed in HM Treasury for their policymaking expertise during the budget exercise. Those making the forecast need to have a good grasp of policy and, currently, those making policy are the only ones who can make the forecast.

4. The only effective and practical solution to the problems of eliminating bias from the fiscal projections is therefore to ensure that the OBR is sufficiently well resourced for its officials to:

— take on the forecasting role of officials at an early stage in the process, thus owning the forecast and eliminating the potential for bias;

— have responsibility for a sufficiently narrow range of policy, to enable them to get to grips with emerging policy issues and their likely impact on the forecast; and

— be based outside the Treasury.

5. Safe-guarding the forecasting process against both top-down and bottom-up bias will therefore require a significantly better resourced OBR than the current small secretariat. On the other hand, many fewer officials will be required than the hundreds currently involved in the process in some way. Only with this level of resource can the OBR as an institution address the full range of reasons for the failure of the defunct fiscal framework.

INTRODUCTION

6. This submission seeks to address the following two issues for the Office for Budget Responsibility (OBR) in relation to the Committee's terms of reference for this enquiry:

— Appropriate means of ensuring both independence and accountability.

— Appropriate resources for the OBR.

7. This submission draws on original work undertaken by the SMF in our recent publication "Forecasting Independence: Taking the politics out of fiscal projections", which is available to download from the website of the SMF. It also draws on the comments by attendees at a seminar held with Sir Alan Budd at SMF's offices in July 2010.

The Elements of Fiscal Policymaking

8. Arrangements for fiscal policymaking ultimately come down to a set of choices around two dimensions:

— Who should take tax and spending decisions and how?

— Who should carry out the projections of revenue and spending on which those decisions are based?

9. These choices are subject to competing objectives such as the extent to which fiscal policymaking should be political and accountable versus independent and technocratic; and the extent to which decision-makers should be free to act with discretion, or should be constrained by pre-ordained rules or principles.

10. It is widely accepted that decisions over what to tax and how spend are entirely political. Similarly, decisions over when to spend and when to tax are usually deemed to be political. An exception to this is the case of Germany, where, from 2016 a balanced budget rule will operate, forcing the government to balance its books at all points in the economic cycle. However, the international consensus around who should undertake the revenue and spending projections on which policy decisions are made is moving in the direction of independence from government, in the form of an independent fiscal council, of which the OBR is one.

11. Nevertheless, the detailed design of the OBR will be essential to its credibility, longevity, and capacity to provide the best possible fiscal forecasts. In determining the appropriate design, this note argues that a full analysis of the reasons for the failure of the previous fiscal framework is necessary.

The Last Government's Experiment with Institutions

12. The self-imposed fiscal rules of the previous government represented an important experiment in the evolution of fiscal policymaking. The rules sought to articulate formal standards by which fiscal policymaking could be judged thereby increasing political accountability, even if the rules themselves amounted to nothing more than statements of intent.

13. However, the current fiscal outlook, even in the context of the global economic slowdown of 2008–10, must be partly attributed to excessively loose fiscal policy in the years preceding the financial crisis. The reputational costs to the government of infringing their self-imposed rules may have had some constraining effect on policy decisions, but it was clearly inadequate to prevent the Government running a significant structural deficit. As such, the fiscal policymaking framework provided by the previous government's fiscal rules must ultimately be deemed to have failed.

Why Did the Rules Fail?

14. Gordon Brown's fiscal rules failed, not because of over-optimistic GDP growth projections, but because of consistently over-optimistic revenue forecasts. In analysing the reasons for the rules' failure, the charge is that this must be attributable to some form of systemic bias—whether intentional or not—in the production of the forecast.

15. There is widespread belief that ministerial pressure may have been at least partly responsible for the consistent over-estimation of future revenue. This can be called "top-down" bias. But top-down bias is not the only source of the problem—it is only the most visible one.

16. It is all but inevitable that the forecasting process is vulnerable also to pervasive, if unintentional, organisational bias. The forecast is built on myriad finely balanced judgements and assumptions made at all levels of the process—not just on "big ticket" judgements over, say, the size of the output gap. It would be nave to imagine that the judgements exercised by civil servants sitting within an organisation whose role is to serve the chancellor could be immune from bias. Once again, it is important to stress that this "bottom-up" form of bias is most likely to be unconscious on the part of officials.

17. Essential to a full understanding of why the previous fiscal framework failed is, then, an appreciation of two kinds of bias: top-down political bias and bottom-up organisational bias. This understanding has significant implications for the design of the OBR in ensuring its independence, as well as for determining the resources it should command.

Institutions

18. The failure of fiscal projections under the last government has led to a renewed interest in the institutional arrangements that underpin fiscal policymaking. This reflects a wider trend, over the past 13 years, of using careful institutional design to improve public policymaking, particularly by separating different functions according to the need for analytical independence and political accountability. Good examples include the granting of operational independence to the Bank of England, the establishment of an independent UK Statistics Authority and the creation of an independent Low Pay Commission to advise on the level of the minimum wage.

19. Drawing on the success of these examples, as well as studying overseas fiscal councils, the Conservative Party in opposition announced that it would create an independent Office for Budget Responsibility, responsible for providing independent scrutiny of fiscal projections from HM Treasury. Quite rightly, their plans for the OBR aim to ensure the separation of inherently political policymaking from essentially a-political forecasting.

Implications for the Office for Budget Responsibility

20. While the theoretical solution to the independence problem is clear—separating forecasting and policy-making roles—the practical implications are more tricky. The difficulty is driven by interconnectedness of policy and forecasting. For example, to effectively forecast the likely savings from the Government's plans to re-assess the eligibility of Incapacity Benefit claimants, one needs to have a reasonably strong grasp of the policy detail. For this reason the forecasting role of individual HM Treasury or HMRC officials is usually just a part of their mainly policy-focused work.

21. The interconnectedness of policy and forecasting roles, together with the two sources of bias described above, dictate four broad models for the OBR according to the weight one places upon each of the trade-offs:

1. *The independence-light model. An independent but internal OBR, overseeing key discrete choices in the production of the forecast, which remains owned by HMT*

   This "cheap and cheerful" option potentially safe-guards against the problem of top-down bias, although early question marks over the OBR's unemployment judgements means that the external perception of this cannot be assumed. The Treasury Select Committee's active engagement with the appointment of Budget Responsibility Committee (BRC) would also be necessary to ensure the external credibility of appointments, given the perceptions surrounding the Bank's Monetary Policy Committee appointment process.

   Further, this model does nothing to prevent bottom-up organisational bias from creeping into forecasts at a level of detail much below what the BRC would be able to detect. In its favour, this option would be cheap and involve no further institutional upheaval.

2. *The minimalist external model. An external OBR with a small staff, charged with overseeing the forecasting process, which remains owned by HMT*

   An externally housed OBR, with the appropriate appointments process, would immunize the institution from any perception that it was there to disguise, rather than eliminate, top-down bias. However, with just a limited staff, the Office would suffer from huge information asymmetries with the officials who continue to produce the forecast from within HM Treasury. It is therefore unlikely that this model can do anything to resolve the bottom-up bias problem. Indeed, the problem may be exacerbated with the OBR no longer present within the Treasury building.

3. *The seasonal labour model. An external OBR with a small permanent staff, and HMT/HMRC experts seconded into the Office over the Budget and Pre-Budget Report period, while the forecast is done*

   In order to protect against both forms of bias, it has therefore been suggested that policy officials might be temporarily seconded into the OBR, twice a year, to construct an OBR-owned forecast. However, this model entails serious practical problems.

   Those involved in the forecast have both a policymaking role, which must be Treasury based, and a forecasting role, which, on this model, must not be. The fact that those officials responsible for feeding into the forecast are simultaneously needed in HM Treasury for their policy expertise during the budget exercise makes this model problematic. HM Treasury would find it difficult to operate effectively at Budget time.

4. *The full independence model, An external OBR with a more substantial, dedicated staff charged with understanding policy in sufficient detail to develop the forecast from a low level*

   The weaknesses of the above models imply that the OBR must be external, substantial and its workforce cannot be seasonal. The only effective and practical solution to the problems of eliminating bias from the fiscal projections is therefore to ensure that the OBR is sufficiently well resourced for its officials to:

   — take on the forecasting role of officials at an early stage in the process, thus owning the forecast and eliminating the potential for bias;

   — have responsibility for a sufficiently narrow range of policy, to enable them to get to grips with emerging policy issues and their likely impact on the forecast; and

   — be based outside the Treasury.

22. How many staff would be required to operate such a model is for others to determine. Nevertheless, it is clearly significantly more than the current secretariat of eight, while being many fewer than the hundreds of officials currently involved in the process in some way. Only with this level of resource can the OBR as an institution address the full range of reasons for the failure of the defunct fiscal framework.

23. These arrangements proposed by the SMF will not be without cost. However, the annual cost of the OBR must be set against the much longer-term and more substantial cost of poor fiscal policymaking.

Conclusion

24. The SMF argues that a greater level of institutional separation and independence for the OBR will be essential to its success as an independent fiscal council. This means that the OBR must:

- be physically located outside the Treasury walls;
- own the forecast process rather than sign it off;
- have sufficient staff and expertise to be originate the forecast from a low base; and
- have sufficient staff to understand the implications of policy at a detailed level.

About the SMF

25. The Social Market Foundation (SMF) is a leading UK think tank, developing innovative ideas across a broad range of economic and social policy. It champions policy ideas which marry markets with social justice and takes a pro-market rather than free-market approach. Our work is characterised by the belief that governments have an important role to play in correcting market failures and setting the framework within which markets can operate in a way that benefits individuals and society as a whole.

26. The SMF is politically independent, and works with all of the UK's main political parties. Our Board, Policy Advisory Board and staff reflect this. Our research work is undertaken by SMF staff; by our wide network of Associate Fellows and Advisory Board members, and by other experts in their field.

August 2010

Written evidence submitted by the Institute of Chartered Accountants in England and Wales

Introduction

1. The ICAEW welcomes the opportunity to comment on the Treasury Committee's inquiry into the Office for Budget Responsibility (OBR).

2. The ICAEW advocated the creation of an independent fiscal authority in our manifesto for the UK 2010 General Election manifesto, and convened high-level policy discussion on how such a body could work at the "Securing the Future of UK Public Finances" Policy Summit, held in March 2010. On Thursday 17 June, the ICAEW hosted the interim Office for Budget Responsibility consultation seminar, which brought together stakeholders to discuss the development of the interim OBR into a permanent fiscal institution.

Who We Are

3. We draw on our technical expertise and the experiences of our members, Chartered Accountants, to assist policymakers. ICAEW operates under a Royal Charter, working in the public interest with governments, regulators and industry to maintain the highest standards. We represent and support over 134,000 members in more than 160 countries, across every sector in business, practice and in the public sector.

Executive Summary

4. The OBR's role in assessing the UK's fiscal sustainability is crucial, and of equal importance to its role as an independent forecaster.

5. It is currently nearly impossible to make a comprehensive assessment of liabilities in the public finances, though stakeholders including the Office of National Statistics (ONS) and ICAEW have made attempts. This is a major obstacle to achieving sustainable public finances. The OBR can play a critically important role in addressing this problem.

6. The OBR should take an active role in public debate on fiscal sustainability issues, commenting and making recommendations on initiatives and policies intended to improve the transparency of public finances.

7. That role should extend to the international stage, working with international finance bodies to improve the quality of public financial information worldwide, and taking a leading role in the G20's efforts to establish an early warning systems for financial risk issues related to national debt.

8. The OBR should employ a dedicated full-time staff, independent of the Treasury, to support its forecasting and fiscal sustainability work.

9. The OBR should co-ordinate a "fiscal sustainability research committee" of interested UK authorities, from the public and private sectors, to advise its work.

10. To avoid "group think", the Budget Responsibility Committee should include at least one non-economist; an individual with expertise in public finance, accountancy and fiscal sustainability issues.

Responses to Specific Questions/Points

Remit of the permanent OBR

11. The ICAEW is a strong supporter of a permanent Office of Budget Responsibility. We believe that the OBR has a great opportunity to improve the quality and transparency of public financial information in the UK. At a basic level, ministers, public sector managers, parliamentarians and the public currently do not know enough about what our national liabilities are.

12. The permanent OBR will have an important role in producing independent forecasts for both growth and borrowing, and there are a number of complex resource, accountability and independence issues to resolve around the OBR's forecasting role. However, in this submission, the ICAEW is focusing on the role that the OBR can play in the broader effort to increase the transparency of public finances and improve fiscal sustainability.

13. The interim OBR began "an independent assessment of the public sector balance sheet and fiscal sustainability, including assessing the impact of ageing, public service pensions and PFI/PPP contracts". The ICAEW believes that the OBR's fiscal sustainability research role is of critical importance and should be considered on a par with its economic forecasting role in terms of the value that the organisation can bring to public and political decision making.

14. UK public sector net debt (excluding financial sector intervention) for 2010–11 stands at £932 billion.[6] Beyond the official public sector net debt figure, research conducted by ICAEW and the Centre for Economics and Business Research (CEBR) indicates that the government is exposed to an additional £1.13 trillion of liabilities.[7] The majority of the additional liability derives from public sector and local government pension liabilities, PFI/PPP obligations and contingent liabilities (those arising through implicit or political guarantees rather than contractual obligations, like specific financial sector interventions). Our research aimed to quantify public sector "off balance sheet" liabilities and improve awareness about why there are different approaches and standards for assessing public debt.

15. While our research and a recent study by the ONS attempted to quantify an overall figure for UK public liabilities, the overriding issue for policy makers is the uncertainty around the number. Investors, taxpayers, ratepayers, public officials, the media and politicians require more complete information about the broader liabilities facing the UK than is offered by the official Public Sector Net Debt figure. Such information can only be pieced together, incompletely, from component official sources and economic estimates. As a result, policy makers and the public are not able to make a comprehensive assessment about the public liabilities, which frustrates both the incentive and the capacity to achieve sustainable public finances in the long-term and, at a more basic level, fairness from one generation to another.

16. We fully support the interim OBR's recommendation for the permanent OBR to publish an annual long-term sustainability report alongside its major Budget forecast report.[8] The permanent OBR should build on the OBR's work on fiscal sustainability in its report published prior to the 2010 emergency Budget, the ICAEW's own research and recent ONS research on "Generational Accounts" to examine the impact of future fiscal pressures on public sector liabilities. Contingent liabilities in particular are are a hugely complex topic. Much more research and public debate is required to better understand and quantify the extent of UK exposure to these contingent liabilities.

17. The ICAEW believes that the OBR's fiscal sustainability role should include actively informing public and media debate on fiscal sustainability issues; making policy recommendations on initiatives that could improve the transparency of public finances; and taking a leading role in international efforts to improve the comparability of national fiscal performance and establish an early warning systems for systemic financial risk issues.

18. First, the OBR should advise and inform public, media and parliamentary debate around fiscal sustainability issues. Against the context of the Government's ambition to be more transparent about the way in which public money is spent, including the publication of the COINS database and expenditure more broadly, the OBR will need to take an active role in responding to media coverage that uses public financial information "out of context". The independence and credibility of the OBR's commentary will be critical in order to achieve a sophisticated public debate around financial information released to the public, strengthening the political viability of transparency agenda over the long-term.

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6 Office of National Statistics "*Public Sector Finances*" Report (June 2010).
7 ICAEW/CEBR "*Improving Transparency*" study paper into public liabilities (July 2010).
8 Interim Office of Budget Responsibility letter to the Chancellor "Establishing the Office for Budget Responsibility", para 27 (12 July 2010).

19. Secondly, the OBR should advise the public and parliament of the value of technical initiatives that have the potential to improve the transparency of public finances. This should include evaluating the development of the Treasury's "Clear Line of Sight" and 'Whole of Government Accounts' projects, which are likely to bring pensions and PFI/PPP liabilities "on-balance sheet" and consolidate statutory accounts across the public sector in one place for the first time on an auditable basis. The OBR should also offer opinions on the likely value of other initiatives designed to improve the transparency of public finances, such as publishing all new items of central government spending over £25,000 online.

20. While the ICAEW agrees that the OBR should not make recommendations on tax policy to the Chancellor, the OBR's fiscal sustainability remit should include the power to make recommendations on the technical projects and tools that could enable greater transparency and better financial management in the public sector. This will require an active and constructive dialogue with the Treasury's Financial Reporting and Management Directorate.

21. Thirdly, the OBR should have an international remit. On the fiscal sustainability agenda, the OBR should work with authorities such as the International Federation of Accountants (IFAC), the International Public Sector Accounting Standards Board (IPSASB), and the International Monetary Fund (IMF) to improve the quality and comparability of public financial information worldwide. The OBR's international work should also include working with the IMF, the European Union and a global network of information sharing bodies to fulfil the G20 ambition of establishing an international early warning system for instability resulting from government debt and liabilities.

22. A strong and broad remit on fiscal sustainability is likely to yield substantial benefits. These include increasing the OBR's credibility by placing it at the centre of a public debate about public finances and fairness from one generation to another; and strengthening the OBR's forecasting methodologies through insights gained as a result of original fiscal sustainability research.

Appropriate means of ensuring both independence and accountability for the OBR

23. The ICAEW agrees with many of the interim OBR's recommendations on the independence and accountability of the permanent OBR. The OBR and its remit should have a legislative basis, and the Treasury Committee should scrutinise its appointments and work. The OBR should be located outside the Treasury building, and the OBR should have far-reaching rights to access public data.

24. However, once operational independence and an accountability regime has been established, the ICAEW would support the need for OBR to have a close working relationship with the relevant public and private sector authorities in connection with its fiscal sustainability research. The ICAEW believes that the OBR should actively seek to coordinate the research effort of those organisations, and we recommend that the OBR convenes a "fiscal sustainability" research committee of interested UK authorities, potentially to include the Government Actuary's Department, the Office of National Statistics, the Bank of England, the National Audit Office, the National Institute of Economic and Social Research, the Debt Management Office and relevant private sector authorities. Secondment arrangements between the relevant institutions and the potential for outsourcing and partnerships should be encouraged.

25. While there are important considerations for the Treasury Committee to analyse about the possible duplication of forecasting staff between HM Treasury and the OBR—taking into consideration the peak-flow nature of the work, confidentiality, and independence issues—similar concerns do not exist for fiscal sustainability or public sector accountancy research. On the fiscal sustainability agenda, we recommend that the OBR employs dedicated full-time staff and also commissions academic or consultancy work as required. The OBR's fiscal sustainability work will require a close working relationship with the Financial Reporting and Management Directorate in HM Treasury and will continue to rely on existing research produced by the government and elsewhere. We agree that the relationship between the Treasury and the OBR should be formalised in a Memorandum of Understanding.

Appropriate resources for the permanent OBR

26. The ICAEW believes that the OBR should have the necessary resources to carry out the ambitious fiscal sustainability research role outlined in this submission, including staff and travel budget for international engagement and budget for promotional and advisory activities, as well as the budget and staff required in order to produce independent economic and fiscal forecasting.

27. However, the ICAEW believes that the OBR will be in a position to exercise a "power to convene" model. The OBR will be in a position to coordinate and lead the fiscal sustainability research agenda across relevant authorities in the UK. While the OBR will need credible in-house resource, it should look to use the resources and expertise available in other public bodies or public interest professional bodies, such as the ICAEW, through a "fiscal sustainability" research committee.

28. A strong and robust governance and consultation regime will help ensure the long-term viability of the OBR. When public or political pressure is put on the OBR, it will be important that it can point to consultation and dialogue with relevant authorities.

29. To avoid group-think, the ICAEW recommends that the OBR leadership—the Budget Responsibility Committee—includes at least one individual who is not an economist, but has expertise in public finances, accountancy and fiscal sustainability issues.

August 2010

Written evidence submitted by the Directorate General for Economic and Financial Affairs (DG ECFIN) of the European Commission

INTRODUCTION

1. DG ECFIN welcomes the opportunity to contribute to this inquiry. In the context of its surveillance work, DG ECFIN has undertaken substantial analysis of the effectiveness of different fiscal institutions across the EU.[9] This work shows that independent fiscal forecasting bodies can play a positive role in fostering fiscal discipline and contributing to macroeconomic stability by removing from governments the temptation to assume growth will by itself do the job of providing fiscal resources adequate to meet public spending needs by being over optimistic about potential growth or by overestimating the yields from revenue-raising measures. Over the long run, credible independent checks and balances have the potential to reduce borrowing costs by increasing market confidence in the capacity of the government to plan and deliver prudent fiscal policies.

2. In a number of EU countries, the government has entrusted an independent institution with the provision of macroeconomic forecasts against which the official projections can be assessed, with a view to reducing the potential bias of governments in setting overoptimistic economic and budgetary assumptions. Although, in most cases, fiscal authorities are free to base budgetary plans on their own forecasts and do not provide any justification in case both sets of projections diverge, in Belgium, Austria, the Netherlands and Slovenia the budget law is prepared relying on the macroeconomic forecasts provided by independent bodies.[10] These can be considered a successful policy experience, helping to avoid the emergence of an optimistic bias in the budget process. Based on the work accomplished by the interim OBR, we believe that the OBR has the potential to make a positive contribution to the quality of UK fiscal policymaking.

REMIT OF THE PERMANENT OBR

3. Experience across EU Member States suggests that a clear and unambiguous mandate for an independent fiscal institution specifying the tasks assigned to it and the scope of its activities, backed by strong legal provisions, is of central importance. In the OBR case, this mandate should ensure that the OBR's tasks are carried out on a regular basis and not only occasionally. To ensure a high performance, forecasts, monitoring tasks and assessments should be comprehensive and not limited to partial aspects of fiscal policy. For example, some less successful independent forecasting bodies entrusted with the provision of budgetary forecasts (eg revenue and budget balance projections) have been required to rely on macro forecasts and external assumptions generated by central government. This hampers the quality of the budgetary forecasts as optimistic bias in the macro projections is likely to lead to similar bias in revenue projections and deficit figures. Overall, this experience suggests support for a mandate providing full control of all discretionary forecast inputs, including macro parameters and final judgements on the yields or costs of particular measures.

4. A further important factor is adequate data access. An independent institution can be more effective where its mandate provides access by default to any government information it deems necessary to fulfil its duties, with any exceptions minimal and tightly defined. For the OBR, this would imply full access to all Treasury and HMRC forecasting and revenue estimating models and all relevant data inputs. This data access could be provided for in the OBR mandate. Public access to the Treasury's forecasting model (or any different model the OBR adopts) could also be maintained to maximise external understanding of the OBR's forecasting process.

5. The involvement of the institution in the budget process emerges as the most crucial element determining its influence on the conduct of fiscal policy. Delegation of macro forecasts for the budget preparation is a particular and successful case of involvement in the budget process. The National Account Institute in Belgium and the Central Planning Bureau in the Netherlands are telling examples of this kind of involvement in the domestic budget process.

6. To maximise its positive influence and help it in establishing a strong reputation, the OBR should have a significant remit beyond pure forecasting. It could play in a role in monitoring spending. While the UK's highly centralised fiscal structure has helped it to deliver relatively good performance in terms of meeting

[9] See for example chapter 3 of the Public Finance Report 2010, available at http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ee-2010-4_en.pdf. Further material is available on request.

[10] These are the National Account Institute in Belgium, the WIFO in Austria, the Central Planning Bureau in the Netherlands and the Institute of Macroeconomic Analyses and Development in Slovenia.

spending targets, this cannot be taken for granted, especially in the face of unprecedented spending cuts. The OBR could therefore aim to satisfy itself that departmental spending is in line with spending review limits and report any concerns to Parliament.

7. The OBR could also develop the role given to it in the interim terms of reference to assess fiscal sustainability, including an assessment of the impact of ageing on public finances and more generally of off-balance sheet liabilities. It should aim to develop a strong public voice on this issue to ensure that sustainability issues receive the necessary attention in political debate and that any temptation for the government to hide liabilities is minimised.

8. Finally, the OBR could assess the robustness of the tax base to cyclical and asset price developments and monitor the cyclical position of the economy to provide a strong basis for estimates of the structural balance. The underestimation of the exposure of UK public finances to asset (financial and housing) market cycles was a key contributor to the present fiscal situation.

9. This year-round role would imply a need for the OBR to maintain a permanent full-time staff, complemented, as necessary and appropriate, by part-time collaboration. This would further strengthen its independence in comparison to relying on Treasury secondees over the long term.

Ensuring Independence and Accountability

10. The issue of ensuring independence and accountability cannot be divorced from that of setting the remit, and much of the analysis in the first section is therefore relevant here. In particular, experience suggests that the mandate should ensure a high degree of autonomy and functional independence vis-à-vis the fiscal authorities—neither the fiscal authorities nor any other entity should ever be in a position to "lean on" the independent authority. It should therefore receive an independent legal status together with an appropriate and pre-agreed public financing, set down in law. Its appointments procedure and the conditions of tenure of its senior appointees should be designed to ensure its functional independence, for example through independently approved and/or non-renewable appointments.

11. As discussed below, resources are also important. The OBR should have and be seen to have adequate resources to exercise independent judgement on all the main variables in its forecast. It needs to be able to estimate the key variables itself—eg growth, inflation, external factors, tax elasticities. Calculating the spending or revenue impact of specific budget measures could still remain to some extent a joint exercise with the Treasury and Her Majesty's Revenue and Customs (HMRC) but the OBR should retain the ability to perform these calculations itself in case it disagrees with the Treasury.

12. In terms of accountability, while forecasting error is inevitable and not on its own evidence of poor quality forecasting, forecasters are inevitably judged and scrutinised on their past performance. To make it as easy as possible for Parliament and the public to scrutinise the OBR, it could publish assessments of its forecasting record including:

- average deviation and average absolute deviation from the outturn over different time periods to help in identifying long-term bias and non-correlated variance;
- a comparison with the performance of the consensus, with the top performing external forecasters and with simple moving average models; and
- external assumptions and macro-econometric models used for the forecasting exercise.

13. Such information on forecast accuracy would be valuable not only through its contribution to an overall assessment of OBR performance but also in providing the Government and Parliament with a means to assess the extent to which they can rely on the forecasts and the size of deviations which they should plan to be able to deal with, notably by devising contingency plans.

14. The OBR should also work to facilitate a continuous dialogue with the professional and academic economist community, both on forecasting and other issues. Engaging openly and comprehensively with external experts will help in establishing the OBR's credibility and in enriching inputs into its forecasting and other judgements.

15. A final question on accountability is the OBR's relationship to the National Audit Office (NAO). The NAO could scrutinise the OBR both in the typical value-for-money sense or in auditing external assumptions as it did for Treasury forecasts. The former certainly seems likely to be worthwhile. Given that the OBR will itself be independent of central government however, it does not seem necessary to subject its forecast assumptions to external audit. It could eventually be useful for the NAO and the OBR to establish a memorandum of understanding to delineate their respective roles in areas in which they may overlap.

Appropriate Resources for the OBR

16. The key test of the adequacy of OBR resources will be to ensure that it permits the OBR to exercise informed and independent judgement on all of the key forecast variables without having to rely unduly on central Government or other external sources. This implies a need for a substantial core of professional economists with relevant experience. Whilst there is a clear trade-off between value-for-money and size of the executive staff, excessive parsimony in this particular area would risk being a false economy. Given that

there is important and substantive work to be done outside the forecasting cycle, the OBR remit seems likely to be sufficiently broad to justify a substantial executive staff, complemented by collaborations with external experts.

August 2010

Written evidence submitted by Robert Barrie, Head of European Economics, Credit Suisse

1. As we understand it, the permanent OBR is intended to have two main functions—the provision of short-term economic and public finance forecasts and the longer-term analysis of fiscal sustainability. These activities are related in that both should contribute to better policy outcomes, but in a number of practical respects they are quite different, which may have implications for organisational size and structure. In this submission, we focus on forecasting. On one level, the role of the forecast is straightforward. It allows us to see whether a particular policy objective—in this case, the fiscal mandate—is likely to be met if policy settings remain unchanged. The forecast might suggest that it is likely or it might suggest that policy needs to change to make it more likely. It might also have something to say about the timing of any such change, in the light of the more general economic context.

2. That approach is probably a necessary, but not a sufficient, condition for better policy outcomes, in our view. One of the lessons of the past two to three years is that there are times when the forecast isn't right. The policy process needs to be robust to forecast errors. It's possible that policy needs to overachieve, in some sense, when things are going right in order that it can underachieve when they are not. The budget said the following: "once the exceptional rise in debt has been addressed, a new target for debt as a percentage of GDP will be set, taking account of the OBR's assessment of long-term sustainability." We see this as an important area of work and one where, for now, there is relatively little consensus as to what an appropriate debt ratio might be and whether the target should be static or more dynamic. A thoughtful and independent contribution from the OBR on this subject would be very useful.

3. The other thing that the policy process needs, in our view, is a timely way of identifying when the forecast isn't right. Another lesson of the last two to three years is that when things go wrong they can do so very quickly. More frequent forecasts might allow decisions to leave policy unchanged, or to make changes and start planning for their reversal, to be more timely and potentially more effective. A single annual forecast is, on average, six months out of date. If we make two forecasts per year they are, on average, three months out of date. We would favour a higher frequency than that, with two very limited interim forecasts between two more substantial forecasting events per year. The interim forecasts would typically say that very little had changed since the last more substantial forecast—but just occasionally they might say that a lot had changed and that policy needed to take that into account.

4. A final point to make is that, as a practical matter, much of what we call forecasting is really monitoring and extrapolation. Forecasts are to a large extent judgements about whether current trends will continue or not. On that basis, forecast errors can come from new shocks and from making the wrong call about current trends. Both can be identified earlier if adequate resources are employed in monitoring current trends. There may be sophisticated models that forecast the budget deficit would reach unprecedented levels as a result of the crisis, but there were also a number of sophisticated models that didn't forecast the crisis in the first place. On the other hand, its impact could clearly and quickly be seen in the public finance outturns. A concern we have about the division of function between the Treasury and the OBR is where it leaves the main responsibility for this sort of monitoring. It could be done by either, perhaps, but the important point is that it needs adequate resourcing and, in our view, a reasonably direct line into the forecast and the policy decision.

August 2010

Written evidence submitted by George Kopits, Chairman, Fiscal Council, Republic of Hungary

Introduction and Summary

1. In response to a request from the Treasury Committee, herein are my views on the creation of a permanent Office for Budget Responsibility (OBR) in the United Kingdom. The views seek to draw on good practices developed by independent fiscal institutions (IFIs) in general—discussed at a conference held recently in Budapest (http://www.mkkt.hu/conference-on-independent-fiscal-institutions)—and on the experience of Hungary's Fiscal Council (FC) in particular.

2. These remarks focus mainly on the three areas listed in the Committee's request: the remit of the OBR; means of ensuring independence and accountability; and appropriate resources for the OBR. The interim Budget Responsibility Committee (BRC) must be commended for an excellent start over an extremely short period of time. There is, however, scope for improvement in several areas, to be carried out by the future permanent OBR. First, the OBR will have to raise the transparency of its macro-fiscal forecasts by revealing more detail about the underlying methodology and calculations, and by exercising full control over the

forecasts and policy costing, instead of relying on the Treasury and other government agencies for these tasks. Second, from the outset, it is indispensable for the OBR to assert fully its independence from the government in a number of ways, outlined below. And third, the OBR must be endowed with an adequate size staff to carry out its responsibilities, again, without having to rely on other government agencies.

Remit

3. The remit of the OBR has been formulated against the backdrop of recent trends of public finances in the UK, characterised by a marked widening in the public sector deficit and the concomitant rise in public indebtedness. This deterioration was underpinned by the failure of the previous government of adhering to its own fiscal policy rules, and of the National Audit Office to monitoring the transparency of government forecasts and the compliance with the rules. These developments led to significant erosion in the credibility of fiscal policymaking.

4. Therefore, the OBR is correctly envisaged to restore fiscal responsibility. To this end, its core remit consists of preparing unbiased macro-fiscal forecasts, assessing the realism of official fiscal targets, and analysing long-term debt sustainability. The interim OBR has actually fulfilled the first phase of this remit (leaving a full-fledged debt sustainability analysis for the permanent OBR) by issuing, at impressive speed, pre-budget forecasts and budget forecasts over a four-year horizon anchored onto the June 2010 budget bill.

5. Apart from their high quality, forecasts should be as transparent as possible as regards the underlying data, methodology and key assumptions, and should be reported in clear non-technical language. In addition, to enhance the credibility of the exercise, the IFI should have control over the calculations in all stages. Interestingly, since the OBR's forecasting process and output resembles very closely those applied by Hungary's FC, the latter may be regarded as a useful comparator for the OBR. A cursory comparison suggests that the OBR reports provide an excellent, concise and reader-friendly set of forecasts, which can be viewed as laying the foundations of a set of good practices for the future.

6. However, there are two shortcomings (as compared to the FC forecasts) that will need to be dealt with by the permanent OBR, so as to strengthen transparency and independence—see the discussion of independence below. First, the OBR reports do not seem to provide sufficient detail (in supplementary appendices, etc) on forecasting methodology (eg, underlying macro-fiscal model specification, calibration to initial conditions, etc) and on revenue estimates and expenditure costing. Overall, more information would be desirable on the present and future estimates of major categories of PSCR and of AME spending, which together comprise the nondiscretionary budget. Second, the OBR does not seem to have control over the calculations; all too often reference is made to outside sources (mainly Treasury, Revenue and Customs). These shortcomings are particularly sensitive in view of the very favorable OBR assessment of the official medium-target, whereby a cyclically-adjusted current budget in balance or surplus is likely to be reached by 2014–15.

7. In line with the remit to assess the risk around forecasts, so as to gauge the realism of official targets, the OBR has presented a fan chart illustrating the probability of deviations from forecast. Well-known problems with the fan chart include: (a) past distribution of underlying macro forecast errors is highly aggregative and possibly non-recurrent, and (b) the chart glosses over a host of technical and policy risks that would need to be incorporated explicitly in the calculations. The permanent OBR would be well-advised in exploring alternative approaches to assessing fiscal risk in a more explicit manner (eg, G Kopits, "How to Help Europe Cope with Fiscal Risk", *Financial Times*, 12 November 2004). In any event, besides a selected statistical approach, it would be very informative to identify (and quantify if possible) specific areas, measures or future events that may result in substantial expenditure overshoot or revenue shortfall—as done, for instance, by Hungary's FC.

8. In the future, the OBR is expected to make assessments of long-run public debt sustainability. This is an important task that will need considerable preparatory work that could not be undertaken by the interim OBR, given its very limited time span. Since long-term debt sustainability is dependent not on the annual budget bill, but on substantive laws determining tax rules and mandatory expenditures (eg, public pensions), the OBR will need to assess the budgetary effects of any proposed amendment to such laws. More generally, the interim BRC is correct in recommending an annual updates of the debt sustainability analysis. Both the US Congressional Budget Office (CBO) and the Netherlands' Central Planning Bureau (CPB) have considerable experience in this area that is well worth reviewing.

9. As most other IFIs, in general, the OBR should abstain from making normative judgments or formulating policy recommendations, as this may be seen as a departure from nonpartisanship. Budgetary and macroeconomic forecasts tend to reveal anyway possible allocative distortions of a budgetary or tax measure.

Independence and Accountability

10. Independence and impartiality are fundamental attributes of all IFIs. They are critical ingredients for establishing the institution's reputation and thus for cementing its effectiveness in anchoring market expectations. In turn, a favorable budgetary assessment by a credible IFI, such as the CBO or the CPB, built on a lengthy track record, can bestow credibility on the government's fiscal policy. By the same token, a negative assessment by such an institution can undermine the government's credibility.

11. The new UK government has wisely decided to create the OBR with the overarching goal of restoring responsibility in the conduct of fiscal policy, but more immediately, presumably with the (political) purpose of enhancing its own credibility. But to achieve this goal in the near future, it is essential that the OBR be endowed with a maximum degree of independence particularly from the government that created it. Indeed, 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 the 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.

12. There are several aspects where an IFI exhibits independence and impartiality:

(a) contacts with government;

(b) composition of staff;

(c) modus operandi; and

(d) physical location.

These should be adopted as well for the OBR.

(a) Contacts between the BRC Chairman and the Chancellor or the rest of government should be strictly limited to informing the other party about its position, forecasts or statements—but only a few days in advance of the release of a critical document—to avoid unnecessary surprises or embarrassment for the government. This does not preclude possible contacts on technical issues, albeit at arm's-length, between the staffs of the OBR and the Treasury.

(b) No member of the BRC or the OBR staff should have any links (including through secondment) to the Treasury or to another government agency.

(c) Forecasts or costing should be prepared in-house by the OBR staff, with temporary support, if necessary, from paid consultants unrelated to the government.

(d) OBR headquarters should be physically separate from the Treasury and should not be located in any existing government premises.

13. An IFI should be accountable especially by maintaining an open-door policy toward the legislature and the public at large, ready to respond at any time to queries addressed to the institution. Accountability of the OBR can be primarily sustained if (as in the Hungary) the BRC Chairman is regularly invited to appear at public hearings of relevant parliamentary committees. But above all, the OBR must be accessible to the media that for the most part represent the most critical and eloquent audience. Despite the possible nuisance and effort involved, the institution should welcome (rather than ignore or reject) any entreaties from the press, since the press is the main vehicle for influencing public opinion and policymaking.

Resources

14. Administrative, professional, technical and human resources at the disposal of the IFI should be sufficient (in both quantitative and qualitative terms) to deliver the highest caliber output, in timely fashion, to the legislative body so that MPs have access to budget assessments and forecasts, that is, in time that they can serve as input for the legislative debate and prior to votes are cast in committee or on the floor of the legislature. Needless to say, the IFI should have adequate funding and full access to relevant government data, to fulfill its responsibilities.

15. The OBR should avail itself with such resources, possibly from the start of operations and continuously. Any concerns about ups and downs dictated by the legislative agenda or the budget cycle, and about seasonal or peak-flow periods, or occasional idle capacity—expressed by the interim BRC—seem unwarranted. Given the nature of the work, off-peak periods can be useful to recharge batteries and conduct research on complex and recurrent methodological issues. Examples of staff size are: US CBO with about 250, Netherlands' CPB 170 (though mostly involved in non-fiscal issues), Hungary's FC some 45 employees—comprised of economists, budget specialists, lawyers, IT specialists, administrative personnel.

16. Concerns about the quality of the staff are equally unwarranted. For example, 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 work. (See http://www.mkkt.hu.) The high motivation of the staff can be explained by the scope for professional work, unconstrained by political pressures often associated with government service. There is every reason to believe that it should be far easier to recruit a comparable staff in Britain, given the ample supply of self-respecting professionals attracted by the OBR's independence and well-focused remit.

17. At the top of the structure, it makes good sense to preserve the three-person BRC on a permanent basis. Presumably selected or nominated at the highest level of government, candidates should be subject to confirmation by Parliament, with the majority of each party voting in favor of the candidate—possibly allowing opposition MPs to veto the candidate. To ensure nonpartisanship, BRC Chairman and members should be elected for a lengthy (spanning beyond an electoral cycle) and nonrenewable term. The Chairman

should have a distinguished civil service experience, with proven grasp of macroeconomic and fiscal policy analysis, and a nonpartisan background. Membership may include academic economists as well. Hungary has been served well with a similar structure consisting of the three-person FC, supported by an excellent technical staff.

18. In addition, in the UK legislative context, the period following submission of the budget bill might be too short for the OBR to conduct a thorough analysis of the impact of new fiscal measures, in time for legislative consideration before the final vote in Parliament. Hence, some allowance should be made to extend the time allotted between submission and action on the budget bill; or alternative options, such as providing advance information to the OBR on key parts of the budget bill might be considered to relax the tight time resource constraint.

August 2010

Written evidence submitted by Economic Perspectives Ltd

1. The Remit of the OBR

1.1 *Independent assessments of public finances and the economy*

There are essentially two approaches to macroeconomic forecasting: one which insists upon a coherent framework of economic analysis as the basis for forecasting and the other whose objective is to make the best possible forecasts for each of a range of variables, irrespective of the apparent conflicts between them. The advantage of the former approach is that it presents the forecast as a credible whole. Its weakness is that, when the forecast is seriously inaccurate, all aspects of the forecast share this malaise. My recommendation to the OBR is that it adopts an eclectic approach in making its assessments that does not derive from a single analytical framework (such as the Dynamic Stochastic General Equilibrium model). Rather, that it constructs individual multivariate models of the key forecast variables and examines the robustness of these models using out-of-sample testing.

1.2 *Uncertainty analysis*

The appropriate bands of uncertainty to set around the central forecasts should reflect not only the standard errors of the individual forecasting models, but also their out-of-sample errors. To the extent that a conventional macro-model framework is used to make forecasts, the uncertainty analysis should explore a variety of scenarios rather than merely the confidence intervals around each forecast variable in the central forecast.

1.3 *Public sector balance sheet analysis*

An audit of the evolution of the complete public sector balance sheet extending back 20 years should be carried out and published as a separate report, to enable the contributions of ageing, public sector pensions and asset price movements to be clearly identified. This would then provide the appropriate context to consider projections of the balance sheet for the next 20 years based on a variety of assumptions and policy changes (eg state retirement ages).

2. Appropriate Means of Ensuring both Independence and Accountability

2.1 *Independence*

While the OBR will necessarily remain dependent on the Treasury and other government departments for technical advice and detailed models of taxation and other public finance variables, it is important that the OBR establish a separate identity in a separate building. Preferably, the OBR will make a clean break with the forecasting process used by the Treasury and published in the Budget Report and pre-Budget Report for the past several years. These have become stale and lifeless documents, divorced from the realities of a complex, credit-driven and interconnected global economy.

2.2 *Accountability*

The permanent officials of the OBR should be subject to a similar process of regular (possibly twice-yearly) examination and questioning as the members of the Bank of England's Monetary Policy Committee.

3. Appropriate Resources for the OBR

3.1 *Staffing*

Based on its remit and the resources available to other comparable bodies in other developed countries, I would suggest a total headcount of around 40 people would be sufficient to carry out the task.

3.2 *Other resources*

The OBR should live in a modest and functional building within a mile of HM Treasury. It should pay salaries comparable to those of HM Treasury, rather than those of the Bank of England or the Financial Services Authority. It should have a budget to allow for specialist external work to be commissioned and may find it helpful to establish a Panel of External Advisors. The OBR should have rights of access to unpublished data sets of the Office for National Statistics and have the right to insist that the ONS remedy any data gaps or discontinuities that hinder its analysis.

August 2010

Written evidence submitted by staff of the International Monetary Fund

Please note that the views expressed in these comments are those of the IMF's staff, and not necessarily of its management or Executive Board.

EXECUTIVE SUMMARY

IMF staff appreciate the Treasury Committee's invitation to submit views on the OBR's future structure and remit. We broadly agree with the Interim OBR's advice on this issue. The comments below, prepared by the staff of the European Department and the Fiscal Affairs Department, focus on ways to further clarify the OBR's mandate and strengthen its independence and resources. These comments are organized around five "best practices" for fiscal councils (FC), based on IMF staff analysis of international experience with FCs.[11] Where applicable, we indicate in brackets examples of countries in which FCs employ a certain practice.

1. *Objectives and activities*

FCs are typically intended to reduce deficit bias, enhance policy credibility, and improve fiscal outcomes while leaving full discretion for policymaking to the government. They can best do so by providing three types of output: (1) nonpartisan analysis of fiscal developments and long-term sustainability issues; (2) independent projections and forecasts for both budget and relevant macroeconomic variables; and (3) analysis of the implications of a particular fiscal stance, including the consequences for needed future adjustment to meet specified fiscal goals.

— **Recommendations:** The OBR's proposed focus on fiscal forecasts, economic analysis, and assessments of fiscal sustainability is consistent with the above objectives. However, it would be worthwhile to spell out more explicitly what this might entail. In this regard, the OBR's "judgment of the sustainability of the public finances" (paragraph 20) should include not only a discussion of the debt path that arises from announced fiscal policies, but also a discussion of the sustainability of policy measures and assumptions that underpin the debt path [Belgium, Hungary, Netherlands, Sweden, USA]. This could include discussing any key risks to the trajectory of policies assumed in the official forecasts and by producing alternative scenarios that show the projected path of fiscal variables under alternative assumptions regarding the path of future policies. Such scenarios and commentary by the OBR may reduce the incentive for governments to resort to questionable devices (such as assuming that an implausibly large fiscal adjustment will occur suddenly at some point in the distant future) to achieve balanced fiscal paths or to meet fiscal mandates only on paper. It would also be useful to clarify that the OBR would take a lead role in assessing compliance with any future fiscal rule that may be adopted to succeed the current fiscal mandate.

2. *Role of forecasts and policy assessments*

An FC should prepare forecasts on a regular basis throughout the year. The FC's forecasts should be used in the budget preparation process, and the FC's analysis should be channeled into policymaking through explicit mechanisms.

— **Recommendations:** We see merit in having both pre-budget and budget forecasts, as this would help clarify the effects of the new budget. These forecasts should be detailed and include, among other items, the scoring of key policy measures [Chile, Belgium, Netherlands], information on the main assumptions underpinning the forecasts, and information on how projections for key variables compare with outside (eg, consensus) forecasts. We also strongly support the proposed annual report on fiscal sustainability (paragraph 35). In addition to projecting the fiscal path under baseline policies, the annual sustainability report could also further public debate by scoring the fiscal savings from possible reform measures (eg, accelerating increases in the retirement age), based on proposals submitted by the government, opposition members, academia, and think tanks. To preserve its reputation as a nonpartisan agency without a political agenda, the OBR should refrain from explicitly advocating any specific tax or spending measure, but it could usefully discuss the likely effects of such measures on fiscal sustainability from a technical perspective. To

[11] See Debrun, Hauner, and Kumar (2009), "Independent Fiscal Agencies", *Journal of Economic Surveys*, 23: 44–81.

provide the OBR with sufficient instruments of influence, it should also be empowered to issue other public reports and statements aimed at informing the public debate on fiscal policy [Sweden] and be provided with regular hearings in Parliament [Hungary].

3. *Independence*

It is essential for an FC to operate in a manner free from political influence, requiring formal guarantees on funding and independence in decision-making.

— **Recommendations:** It is essential that the OBR be fully independent from Treasury. Measures that would help guarantee de facto and de jure independence include (i) providing multi-year budget appropriations for OBR to reduce the government's ability to coerce the OBR through reduced appropriations; (ii) establishing the OBR as its own entity that is not an office or agency of the Treasury (paragraph 61), with a separate physical location; (iii) establishing sufficiently long fixed terms for members of the Budget Responsibility Committee, making removal of a member before expiration of his or her term difficult or impossible; (iv) adopting restrictive qualification requirements for members (eg, members could be required to have an advanced degree in economics or public policy and be chosen from a list proposed by the Treasury Select Committee, with current or former elected representatives excluded from consideration); and (v) framing the needed collaboration with Treasury in a way that is clear and transparent [Netherlands] and ensures that the OBR has unfettered access to Treasury fiscal data; a well-designed Memorandum of Understanding with Treasury (paragraph 56) will be critical in this regard.

4. *Staffing*

Well-trained and adequate numbers of staff are key to the FC discharging its mandate and retaining credibility.

— **Recommendations:** The OBR should be provided with sufficient staff resources to fully perform its duties. This will likely require a significant expansion over its current staff size, though this could be developed over time. To attract competent staff, the salary scale should be competitive [Hungary, Netherlands, USA]. To facilitate independence, staff should report solely to the OBR and not be seconded from Treasury. The OBR should also be tasked with maintaining a working culture that is supportive of providing nonpartisan technical advice devoid of any specific political agenda.

5. *Accountability*

Formal mechanisms should ensure that the FC is accountable to the relevant Parliamentary Committees.

— **Recommendations:** The OBR should ideally be accountable only to Parliament [Hungary, USA].

August 2010

Written evidence submitted by Professor Matthew Flinders, Professor of Parliamentary Government & Governance, University of Sheffield

1. The challenges in terms of the foundation, governance and independence of the Office for Budget Responsibility (OBR) stem from its potentially conflicting roles (ie as a form of external watchdog and internal critical friend in terms of forecasting). This is the "ambiguity" that Sir Alan Budd referred to when giving evidence to the committee on the 20 July 2010. The former role necessitates a high degree of organisational independence and a more direct relationship with Parliament and the public. The latter, by contrast, suggests a more internalised and quasi-autonomous role that would account to the public and Parliament through ministers.

2. The role of this memorandum of evidence is to highlight three inter-related issues:

(i) the currently confused and opaque system of public administration beyond ministerial departments;

(ii) ic options for establishing the OBR and how they relate to the central aims and ambitions of the organisation; and

(iii) issue of patronage and politicisation.

Issue 1: Delegated Governance: Walking Without Order

3. The creation of the OBR raises a number of questions about the structure and efficiency of British government and governance. The central objective of the OBR is to remove any possibility of political influence from official financial forecasts. It therefore forms part of a wider process in which the capacity of politicians to interfere in certain policy areas has been increasingly restricted.

4. As my book *Delegated Governance and the British State: Walking Without Order* (Oxford University Press, 2009) and the more recent report from the Institute for Government *Read Before Burning: Arm's-Length Government for a New Administration* (July 2010) emphasised, the structure of the state beyond the core (ie ministerial departments) is in dire need of fundamental review and reform. It is nearly three decades since the last comprehensive review of arm's-length bodies (see Cm 7797, 1980) and most ministers have little knowledge of the raft of public bodies that they are constitutionally responsible or what those organisations actually do.

5. If the government is serious about building a more efficient, simple and streamlined state—a "smarter state"—then the Treasury Select Committee's inquiry into the future status of the OBR could play an important role in underlining the importance and potential benefits of rationalising the labyrinthine bureaucratic architecture that currently exists. This would dovetail with the Government's plans to bring forward a Public Bodies (Reform) Bill.

ISSUE 2: OPTIONS FOR REFORM—A GOVERNMENTAL OR PARLIAMENTARY BODY?

6. The OBR's report to the Chancellor of the Exchequer (dated 12 July 2010) resonates with this memorandum's concern about the lack of any clear governing framework for (semi-) independent public bodies. The document suggests (at para 61) that there are broadly three main options in terms of organisational status for a statutory OBR—an Office/Agency of the Treasury, an executive Non-Departmental Public Body (NDPB), or a Non-Ministerial Department NMD). There is a fourth option—an Independent Parliamentary Body (possibly modelled on the Electoral Commission or Independent Parliamentary Standards Authority).

7. If a final decision is taken that the primary role of the OBR is fiscal forecasting/internalised "critical friend" then legislation to establish it as a NMD would be appropriate. However, if the Government and Parliament decided that the OBR's most important task was to operate as a form of fiscal watchdog then foundation as a statutory parliamentary body should be considered. The relative advantages and disadvantages of each organisational form are set out in Table 1.

Table 1

COMPARING AND CONTRASTING ORGANISATIONAL OPTIONS

	Non-Ministerial Department	*Parliamentary Body*
Staffing	Easy to arrange temporary staff transfer and secondments from other departments.	Arguably greater flexibility (organisationally and culturally). The notion of a Treasury "mindset" is, however, fallacious.
Accountability	Indirect: Through the Chancellor of the Exchequer to Parliament.	Direct: The Chair of the OBR would enjoy a direct relationship with Parliament.
Independence	Potentially restricted due to ministerial sponsorship. (The *perception* of ministerial control may be greater than the actual reality.)	Constitutionally greater and arguably more legitimate in the eyes of the public. The greater distance, however, may create an unhelpful "them and us" relationship.
Conflict	Ministers would have more internal control mechanisms but at a price of impairing the independence and credibility of the OBR. The convention of ministerial responsibility would be maintained (but arguably in an eviscerated form).	Political tensions are bound to arise between the Government and OBR at some point. A greater degree of constitutional independence may encourage ministers to respect the views of the OBR, while also allowing the OBR to "speak truth unto power".
Appointment	By the Chancellor with the approval of the Treasury Committee.	By Parliament (with cross-party approval).
LOGIC	Suited more towards semi-independent forecasting.	Suited more towards a rigorous public-interest regulatory role.

8. The central question in terms of organisational status (see Table 1 above) revolves around the presumption in the OBR's own evidence that it should account to Parliament *through* ministers. This standpoint may well be based upon sound professional judgments concerning expertise, confidentiality and the transfer of documents and information. The OBR's evidence, however, also emphasises the need to guard against not just political interference but also the perception of political interference and therefore a significant and constitutionally protected zone of separation might be viewed as appropriate.

9. An interesting parallel is provided by the Statistics Commission. This was established in June 2000 to "help ensure that official statistics are trustworthy and responsive to public needs", to "give independent, reliable and relevant advice" and by so doing to "provide an additional safeguard on the quality and

integrity" of official statistics. However due to concerns about political interference and manipulation the Statistics Commission was reclassified as a public body *responsible to Parliament and not to ministers* from the 1 April 2008 (renamed the UK Statistics Authority).

10. When considering the future status of the OBR it is therefore worth asking—would the Electoral Commission, Commission for Public Appointments, Statistics Authority or the National Audit Office really be generally seen as "independent" if they were funded by and accountable to ministers? Establishing the OBR as a parliamentary body would reinforce the position and capacity of the organisation to "own" the forecasts it produces and to be able to account for them in public. It would in no way preclude the temporary secondment of officials from mainstream departments—or external secondments—to the OBR. This would allow high-flying officials to develop their professional and personal skills in a new and dynamic context.

11. Whichever organisational form is selected the future OBR should adopt a *board model*. The board should consist of no more than nine people including three non-executive directors, the three members of the Budget Responsibility Committee (BRC), the Chief Executive, Director of Finance and the Director of External Relations. The non-executive directors would act as critical friends within the organisation while also acting as external ambassadors for the OBR. The board model would in many ways provide a valuable buffer between the day-to-day work of the OBR and any potential political influence. The recruitment of three non-execs would also allow extra skills and professional competencies to be drawn-into the OBR. It may also be of great value to ensure that at least one member of the board is recruited from beyond the United Kingdom, or has extensive experience of fiscal forecasting in an international context.

12. The line of accountability will depend on the organisational form selected but should flow logically from the founding legislation. This may involve the traditional convention of ministerial accountability or could potentially involve the Electoral Commission model whereby a member of the Speaker's Committee accounts to the House of Commons instead of a minister.

13. Once established, the OBR should draw-up a Memorandum of Understanding with the Treasury and other cognate departments. This would be a flexible statement outlining the intended working relationship and how this was designed to underpin the statutory roles and responsibilities of the OBR. The basis of the Memorandum would be the "no surprises rule" in which all parties agreed to liaise regularly on a formal and informal basis to ensure the generation and maintenance of high-trust low-cost relationships. In order to create this relationship the memorandum should draw-upon best practice and stipulate a series of quarterly meetings between officials in order to ensure there is sufficient dialogue across institutions and (through this) a co-operative relationship.

Issue 3: Appointments

14. Members of the OBR should be appointed for a term of five years and no individual should be able to serve more than two successive terms. (Initial appointments should be made with a view to staggering turnover.) This process for making appointments should ensure a balance between institutional stability and fresh thinking.

15. The Chancellor has announced his intention to empower the Treasury Committee with a statutory veto. This is a major constitutional innovation with potentially profound consequences.

16. The role of select committees vis-à-vis ministerial appointments to public bodies has increased rapidly since 2000 (see Table 2).

Table 2

THE LADDER OF LEGISLATIVE CONTROL OVER EXECUTIVE PATRONAGE

Standard of Control	*Standard of Control*	*Procedure*	*Examples*
Step 5	Very High	Dual-Lock. Statutory power of veto over minister's candidate.	None. Proposed for the OBR.
Step 4	High	Formalised Pre-Appointment Hearings AND Affirmative Legislative Vote	Chairs of Electoral Commission, Statistics Board, IPSA, Comptroller and Auditor General.
Step 3	Medium/High	Formalised Pre-Appointment Hearings	Chairs of Natural England, Office of Rail Regulation, Food Standards Agency, Care Quality Commission.
Step 2	Medium/Low	Formalised Post-Appointment Hearings	Members of the Monetary Policy Committee, Chair of the Financial Services Authority, proposed for members of the OBR.

Standard of Control	*Standard of Control*	*Procedure*	*Examples*
Step 1	Low	Non-Statutory Confirmation Hearings	Treasury Committee scrutiny of the Monetary Policy Committee, 1998–2007. All ministerial appointments not selected for the formal legislative review process.

17. The introduction of a statutory power of veto over a ministerial appointment, as suggested in the Chancellor's evidence, would therefore shift the balance of power between the executive and Parliament significantly (ie Step 5, Table 2). The previous government's position on the issue of select committee scrutiny of ministerial appointments to public bodies was "more voice, not choice". But the current Government is clearly moving towards a system (known as "dual-locking") in relation to the OBR. This raises at least five major issues.

18. First, if the dual-locking procedure is combined with a Non-Ministerial Department then the potential for friction and confusion is increased due to the manner in which a Chancellor of the Exchequer may, at some point in the future, be held responsible for the behavior or actions of a Chair of the OBR that was actually their second, third or even fourth choice for the position.

19. Although (secondly) this inquiry is focused on the OBR the Treasury Committee should be aware that the Chancellor's decision to give the committee a statutory veto over the appointment of Chair is very likely to stimulate demands for the same measure to be extended to other appointments. Why would the logic that has been applied by the Government in this case not be equally relevant in relation to a number of other politically salient pubic bodies?

20. Thirdly, creating the OBR is designed to *depoliticise* fiscal forecasting by removing the opportunities for political influence in the creation and dissemination of those forecasts. Making the appointment of the Chair of the OBR subject to the formal approval of the Treasury Committee does, however, risk *politicising* fiscal forecasting from a different direction. It would be imperative that the Treasury Committee wielded its new powers in a sensible and proportionate manner and did not drag candidates into party-political turf-wars. The recent experience with the Secretary of State for Education's appointment of a new Children's Commissioner underlines the manner in which appointment hearings may unwittingly lead to the politicisation of both candidates and appointments.

21. The role of the House of Commons (fourthly) in relation to appointments to the OBR should be limited to the position of Chair. Not only would this provide a very clear and focused link between the OBR and Parliament but it would also ensure that the two other members of the Committee were to some degree protected from being politicised before they were even appointed. Although it may be appropriate for the Chair to act as the political lightning-rod it may be prudent to, as it were, 'earth' the other two members of the main OBR Committee from direct legislative contact. This is particularly true in relation to the appointment process because the two other appointments are highly likely to be appointed on the basis of esoteric skills that may not be easily assessed within the parameters of a select committee hearing. In light of this the *potential* risk of deterring strong candidates from applying due to the possibility of them having to endure a select committee appearance may not be worth taking. Put slightly differently, those individuals with the capacity and skills to put on a good performance in front of a select committee may be quite different to those required to successfully navigate the professional demands of the OBR.

22. Finally, although the global financial crisis has placed great pressure on public sector spending and public sector salaries the OBR must have the resources to recruit world-class staff. The overall staffing levels and expenditure of the OBR are unlikely to be significant when set against the importance of its role. The roles and responsibilities that have so far been identified suggest that a staff of between thirty and forty people (full-time equivalents) and an annual budget of around one to one-and-a-half million pounds would be appropriate.

Final Thoughts

23. The OBR was established in a matter of weeks and in a politically intense atmosphere but still managed to produce reports of an incredible quality. The formative moments of any institution are frequently its most traumatic and Sir Alan Budd, Geoffrey Dicks and Graham Parker deserve great credit for what they have achieved.

24. What level of independence from the executive does the OBR require to function credibly? This is the primary question that the Treasury Select Committee must grapple with during this inquiry. When in opposition the current Government promised that the OBR would "hold the Government to account for the promises it makes to the British people" and for exactly this reason this memorandum has challenged the OBR's own view that it should be a *governmental* organisation (albeit with a high level of day-to-day independence). An arguably more ambitious, appropriate and rational blueprint for the future of the OBR would be to instill a far higher degree of independence, and therefore public credibility, by constituting it as a *parliamentary* body.

25. However, the Treasury Committee's inquiry into the creation of the OBR must not be undertaken in isolation. On the 28 July the Minister for the Cabinet Office agreed (in principle) to give the Public Administration Select Committee a role in approving the creation of new arm's-length public bodies. It may therefore be necessary for the Treasury Committee to liaise with its colleagues on other committees before presenting the Government with a final set of recommendations.

August 2010

Written evidence submitted by Simon Hayes, Chief UK Economist, Barclays Capital

SUMMARY OF VIEWS

1. The OBR's core duties should be to provide an independent view of whether the government's public finance forecasts are "reasonable", and to provide an assessment of whether the prevailing fiscal stance is consistent with medium-term sustainability. If resources allow, the remit could be augmented with a requirement to promote best practice in fiscal policy.

2. The OBR must "own" the macroeconomic forecasts, and must develop and maintain its own macroeconometric model. It is not necessary, however, for the OBR to replicate fully the Treasury's forecasting effort, although the OBR must have the expertise and access to information to scrutinise Treasury forecasts of tax and revenue streams.

3. The OBR should not be involved in the specification of the government's fiscal mandate.

4. The OBR should have its own budget, and staff should report to, and be remunerated by, the OBR executive.

5. The co-existence of two "official" forecasts—the MPC's Inflation Report projections and the OBR's budget forecasts—seems likely to hinder the clarity with which macroeconomic policy is communicated to the public.

THE OBR'S REMIT

6. The OBR is potentially an extremely powerful innovation. Recently, an overseas client asked me whether the Budget forecast for the revenue gain from switching the indexation of some government expenditures to CPI from RPI was credible, or whether it might have been exaggerated. The answer was straightforward: the decision to make the switch was the government's, but the forecast for the gain was made by the OBR. The OBR's independence nipped any hint of impropriety in the bud.

7. I believe the OBR should have two core duties:

— To provide an independent view of whether the government's fiscal forecasts are "reasonable".

— To provide an independent view of whether the prevailing fiscal stance is consistent with medium-term sustainability.

8. The purpose of these duties is to keep the government "honest" and "informed" and thereby to enhance public confidence in the management of the public finances.

9. Having the OBR produce the budget forecasts is an effective way of hard-wiring the first of these into the system, but it is not the only way. Fundamentally it is the OBR's sign-off, and the perceived independence of the sign-off, that are crucial, rather than the source of the forecasts. From this perspective I do not think it necessary for the OBR to replicate fully the forecasting effort of the Treasury. It makes sense for the OBR to "own" the macroeconomic forecast, but the detailed tax and revenue forecasts could be provided by the Treasury and other relevant government departments. The OBR must, however, have the ability (the expertise and the access to information) to scrutinise these forecasts.

10. There has been some debate about whether the OBR should comment on the fiscal "mandate"—which I take to mean the government's stated goals for the public finance dynamics. I see no reason why the OBR should be involved in the specification of the mandate. In fact, I think there may be a danger in the OBR becoming associated with any particular mandate: there should be no suggestion that the OBR has an incentive to produce forecasts that show that the mandate is likely to be supportive of growth, for example. Of course, the OBR will be commenting implicitly on the mandate through its growth forecasts and its sustainability assessment: this is, after all, its fundamental raison d'être.

11. The remit could be extended to give the OBR a more substantive role in framing the debate about the appropriate configuration of fiscal policy. For example, the OBR could be asked to assess the likelihood of meeting the mandate, or to produce analysis of fiscal "good practice" and fiscal "bad practice" against which existing or prospective government policies could be compared. The benefit of broadening the OBR's remit along these lines would be to help raise the quality of debate about the appropriate setting of fiscal policy. However, I would see this as a "nice-to-have" rather than a "must-have" feature of the set-up. So, for example, although the government of the day may wish for the OBR to provide an assessment of the likelihood of its mandate being met, as the current government did in June, I do not see this as a necessary OBR function and I would see no need to specify it as a core duty.

12. If the resources were available for "nice-to-haves" I would suggest giving the OBR an additional duty of promoting best practice in fiscal policy. The idea would be to improve the understanding, primarily among political leaders, of the economic efficiency arguments for and against certain tax and spending policies. The government, and opposition parties, might be encouraged to ask the OBR for independent assessments of prospective policies.

Means of Assuring Independence and Accountability

13. I have nothing to add to existing suggestions for the Budget Responsibility Committee (BRC): I think three people is the right size, that appointments should be made in a similar way to those of external MPC members and that the Treasury Select Committee should scrutinise the appointments.

14. The OBR must have its own budget, preferably set in advance for a fixed period out of synch with the electoral cycle (eg a five-year budget set three years into each parliamentary term) or according to a pre-specified formula.

15. I think it is important that OBR staff report to, and are remunerated by, the BRC. Given the limited supply of relevant expertise it makes sense to allow staff to move between the OBR and the Treasury. This raises the concern that OBR staff might have an incentive to produce assessments that are viewed favourably by the Treasury in order to keep their career options open. I think this is a legitimate concern, but short of barring staff from crossing over I see no obvious solution. (A similar tension is likely to exist at the Bank of England, between the "internal" Monetary Analysis area and the MPC Unit, which services the external MPC members. It may be worth consulting with the Bank of England to gauge whether it is viewed as a material problem and whether there are measures that can be taken to minimise it.)

Appropriate Resources

16. Although it is difficult to take a strong view of the appropriate level of resourcing at this early stage, as a ball-park figure I would envisage the OBR as having a permanent staff of around eight analysts to cover the two core duties set out above. This is a little larger than the Bank of England's core forecast team, I believe, and certainly larger than the UK economics teams in the City, which typically comprise two to three analysts. The need for a larger forecast team at the OBR stems from the greater complexity needed to produce/scrutinise tax and revenue streams at a detailed level.

17. If the OBR is to own the macroeconomic forecasts it needs to develop and maintain its own macroeconometric model. 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. In any case, I would imagine that the OBR's forecasts are unlikely to stray far from the consensus view: to a large extent it has been HM Treasury's propensity to publish macroeconomic forecasts that were some way different from the consensus that gave rise to concerns about the plausibility of budget projections in the first place. Indeed, I would think the OBR should maintain a constant (two-way) dialogue with other forecasters to gauge how its views are evolving relative to the consensus. It may also be beneficial in the medium term to encourage movement between the forecast teams at the OBR and the BoE.

18. I think that the OBR should be strongly encouraged to draw on outside academic expertise, engaging in joint research projects on *ad hoc* issues relating to macroeconomic forecasting and sustainability analysis.

A Single "Official" Macroeconomic Forecast?

19. One broader concern I have is with the communication of macroeconomic policy when there are two "official" economic forecasts—the MPC's Inflation Report projections, which form the basis of monetary policy, and the OBR's budget forecasts, which underpin fiscal policy. 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.

20. It is easy to see circumstances in which the MPC and the OBR might produce materially different forecasts of the economy. For example, assessments of the level of the output gap, and the economy's "trend" rate of growth, are key inputs into both monetary policy and fiscal projections and yet there is no consensus in the economics profession about how to measure either. The OBR is currently assuming that trend growth is around 2–2.25% per annum: although the MPC tends to be reluctant to disclose its trend growth assumption, the indications are that its baseline assumption is that trend growth is faster than this—around 2.5%. If the MPC is right, the OBR is too pessimistic about the medium-term public finance outlook. If the OBR is right, the MPC is too optimistic about the inflation consequences of its growth projections. This is not a wholly satisfactory state of affairs.

21. Some would argue that this was not an issue in previous decades when policy was set with reference to different forecasts in different parts of government. However, forecasts have taken a much more central role in policymakers' communication efforts in recent years—in no small part because of the MPC's use of the Inflation Report projections as a communication device.

22. Note also that this is primarily a point about communication rather than about policy itself. Even within the MPC, members will have different views about the plausibility of the central Inflation Report projections and their policy votes will reflect their personal assessment of the outlook. This freedom lies at the heart of the principle that nine independent experts should, on average, make better judgments than a consensus view. However, the Inflation Report projections are used as way of communicating the MPC's "best collective judgment" to the public at large, and so it is perfectly reasonable for the public to ask how the MPC's assessment squares with that of the OBR and what the implications are of the forecasts being different.

23. At best, this introduces noise into the policy debate: at worst, differences in the assumptions underlying the forecasts make any claims of consistency or co-ordination implausible, and this could be harmful to the credibility of the overall framework. I think this concern argues for the OBR co-ordinating closely with the Bank of England to ensure a high degree of congruence between the forecasts—but it also raises the broader question of whether a single "official" projection is desirable for the purposes of communicating macroeconomic policy.

About the Contributor

24. Simon Hayes is the Chief UK Economist at Barclays Capital, the investment banking arm of Barclays Bank. He is responsible for formulating the company's view on the outlook for the UK economy, including monetary and fiscal policy. Simon joined Barclays Capital in 2005 after eight years working at the Bank of England. Simon has a BA in Economics and a PhD from Newcastle University, and an MSc in Economics from Warwick University.

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Written evidence submitted by Dr Frank Eich, Senior Economist, Pension Corporation

You have asked me whether I would like to submit written evidence on the future structure and remit of the Office for Budget Responsibility (OBR). I would like to take up this invitation.

Before doing so, I have to disclose that I am on secondment from HM Treasury to Pension Corporation and that this secondment will, as it stands, come to an end in mid-October. I also led the Treasury's Long Term Unit in the past, which was in charge of producing long-term public finance projections etc. As such I might even have a professional interest in the OBR.

Executive Summary

Taking a cue from its title, the OBR should help this and future Governments produce "responsible budgets", which take into account known future trends and uncertainties, to the benefit of today's and future generations. To achieve this, the OBR should not only produce independent high quality economic forecasts and long-term structural analysis but should also contribute to a public debate on these issues by publishing understandable documents and by engaging pro-actively with the public, whether it is Parliament or the media. Given the importance of the issues and to gain traction within Parliament going beyond this legislative period, the OBR should report to Parliament directly. It should be able to comment on fiscal policy within a longer-term context. The OBR should have its own offices but should work closely and congenially with Treasury and other government departments. Having a senior civil servant run the OBR's secretariat, who will probably be line managed by a more senior Treasury official, could create conflicts of interest. The OBR also needs a success measure. The precision of its forecasts should not be such a measure as forecasting is not an exact science and depends on luck as well as good judgement. Making clear what assumptions have been used and helping others understand them and the uncertainties around forecasting would be a success measure. Raising the quality of debate on these issues would be a very good success over the medium to long term. Ultimately all of this would help to hold politicians to account.

Introduction

What should be the role and structure of a permanent OBR? The OBR's name suggests that its remit should go beyond just producing independent forecasts and that the OBR should help this and future Governments set "responsible" budgets. "Responsible" in this context should mean that this and future Governments are looking after the well-being of the British people, whether they are part of today's or future generations, and that their actions take account of known or likely future developments such as population ageing while acknowledging uncertainties—just like a "responsible person" would drive within his abilities, slow down ahead of corners and adjust the speed to circumstances like bad visibility. It is a desirable character trait, which instils trust.

More Detailed Discussion

Measuring success

The OBR needs a success measure. The precision of its forecast should not be considered a success measure as it is not an exact science. Getting the forecast "right" has as much to do with luck as with understanding the issues. A more appropriate success measure would be an increase in the transparency in the underlying assumptions used to generate the forecasts, and to help others understand these assumptions and the uncertainties around the forecasts better. The OBR could be judged to be extremely successful if the quality of public debate—in the media or Parliament—improved over the coming years as a result of its work. Ultimately, all of this would help to hold politicians to account. For example, the UK might not have entered the recession with such high structural deficit had there been more independent analysis and scrutiny.

On the OBR's remit

1. Given the importance of the work, the OBR should submit its forecasts and analysis to Parliament. This would encourage all MPs from across the parties to engage in these important issues and would give the OBR much needed traction going beyond this Parliament. It would also signal that the issues are not only of a technical nature of interest to HM Treasury but potentially affect every part of society.

2. There was a consensus at the seminar that the OBR should not only focus on short- to medium-term forecasting but should also conduct substantial and original work into longer-term structural issues, including an assessment of the long-term sustainability of the public finances. I agree with this view, not least because there is no other institution in the UK doing this. The IFS, for example, focuses more on short- to medium-term aspects of the economy and Government policy. The importance of such a role should be reflected in the number and seniority of staff asked to work on these areas.

3. Related, and based on my previous experience, I see a clear role for the OBR to help raise the quality of the public debate on longer-term economic and public finance issues relevant to everybody. In my view the quality is disappointingly low currently. The OBR should conduct high-quality independent work in these areas but should equally invest time and effort translating its findings into something the interested general public can understand. It could be a genuine value added and could over time help raise the quality of policy making through the democratic process. This could be achieved by:

- publishing discussion papers, which showcase on-going research and explain in understandable terms what it means. These could be published outside the fiscal events such as the Budget; and
- organising workshops with journalists, MPs and the Treasury Select Committee to explain the technical work and the issues under consideration. Many of the issues are not well understood outside expert circles and the mere presentation of facts, figures and conceptual issues could genuinely help to raise understanding. Not everything needs to be discussed in a confrontational setting.

Such efforts might help to give the public a better sense, for example, how "responsible" policies could look like, which took account of the interests of future generations.

4. There is in my view limited value in producing ever more sophisticated analysis, which might please a number of academics, when that fails to make any impact on the public debate and policy making process. In my view the long-term analysis published by the previous government was state of the art, a view shared back then by external commentators such as the OECD, European Commission or the IMF. Many longer-term issues have by now been well analysed and are reasonably well understood. However, its impact was only modest.

5. The original remit states that the OBR should take account of government off-balance sheet items when assessing the long-term sustainability of the public finances. I agree with that. However, I would go further and would like the OBR to consider the interactions between the public and private sectors too. To give an example: even post reforms, UK state pension spending, as a share of GDP, is projected to remain low over the coming decades relatively to that in other developed countries. The underlying assumption is that future pensioners will derive large parts of their retirement income from other sources, including occupational pensions. This contrasts with the underlying assumptions used in many other countries, where it is assumed that the government will remain the main source of income in retirement. Given the decline of defined-benefit pension schemes in the private sector in the UK and the failure of defined-contribution schemes to take off (unlike in Australia for example, where the switch from DB was into mandatory DC schemes), how realistic is the current assumption and how much trust should we put into the current long-term projections and as such any assessment of long-term sustainability? Pensions are not the only policy area. Government and household debt would be another example.

6. One point discussed at the seminar was whether the OBR should be able to comment on the Government's fiscal target(s). Some argued that this was fundamental to an independent OBR; others thought that there were advantages from staying out of this process (as the Bank of England does with the inflation target). In my view the OBR should be in the position to comment on the Government's target(s) in the context of longer-term trends such as the mounting spending pressures arising from an ageing population. For example, would the Government still be able to achieve its targets with a 50 per cent or higher probability in, say, 2020 or 2030? Or what type of fiscal adjustment (if any) would have to be made

in the future to achieve longer-term fiscal sustainability given the current target(s) or what the current target(s) imply with respect to inter-generational fairness. This would be one way for the OBR to help this and future Governments produce "responsible" budgets. A question, which has not been answered successfully anywhere yet, is how to translate our understanding of longer-term fiscal developments into medium-term fiscal policy settings. The OBR could contribute to this important debate though it would obviously be for Government to set its objectives.

On the OBR's structure

7. With respect to the general functioning of the OBR, I think it is important that the OBR will have its own office but equally that OBR staff will continue to work closely and congenially with HMT and other Whitehall colleagues, ONS etc. There is no need to be confrontational to establish credibility and independence. In any case, the OBR will rely heavily on others for data and also ideas. While the OBR might be given a strong enough remit putting it in the position to demand inputs from others, it would be much better if good interpersonal relations would facilitate such process.

8. The OBR ought to have a research budget, which it can use as it pleases. HM Treasury's own macroeconomic research budget might provide a good blueprint for this.

9. One way to strengthen its independence and to ensure that the OBR benefits from the latest thinking would be to have external experts such as City economists on one to two-year secondments into the office.

10. In my view it is important to think about the appropriate line management structure within the OBR. It is my understanding that the OBR' day-to-day affairs will be managed by a secretary who is a Senior Civil Servant. Will OBR staff report to him/her who will then report to a more senior manager within HM Treasury? Does that mean that OBR staff would be appraised on the HM Treasury's appraisal system? Such an arrangement could lead to potential conflicts of interest and might also make it more difficult to recruit experts from outside the civil service who do not wish to be drawn into civil service procedures and structures. For example, more senior experts who could make a very substantial positive contribution to the technical and other output of the OBR might find it inappropriate to report to a team leader-equivalent civil servant running the secretariat.

11. Related, I believe that the OBR's credibility will depend on the expertise of its staff generally and not only on the reputation of its chair and two main colleagues. Using again the IFS as an example, its reputation is based on the excellence and credibility of its staff generally and not only of its senior management. This should be reflected upon in the general recruitment process.

I leave it to others to comment on the structure and remit relevant to the short- to medium-term forecasting process. The only comment I would like to make here is that I see little value in entering a race with commercial forecasters to provide an ever higher frequency of "forecast updates".

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