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Dear Andrew

**The costing of pre-election policy proposals**

When we appeared before you on 9 December, I said I would send you a note setting out some of the issues that would arise if Parliament wanted the OBR to cost the tax and spending policies put forward by political parties in the run up to this or a future general election.

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

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

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

As you are aware, the OBR's current remit only allows us to comment on the current policies of the current government – a restriction that had cross-party support when our legislation was passed in 2011. Changing the remit to allow us to look at other policies would require primary legislation. More fundamentally, any significant change in our remit – especially in a highly politically sensitive area such as this – would again require clear cross-party support if it was not to risk calling the legitimacy and independence of the OBR into question.

The reform also implies potentially significant changes for the civil service and civil servants, particularly in relation to contact with opposition parties. The Treasury tells us that requiring civil servants to do work prior to an election being called that could not be shared with the Government of the day would represent a significant constitutional development and that this would be a matter for the Head of the Civil Service and the Permanent Secretary of the Treasury, and ultimately the Prime Minister.

***The current policy costing process***

The proposal to have the OBR cost political parties' policies would build on our existing role in scrutinising the tax and welfare spending policies put forward by the Government in Budgets and Autumn Statements. So it is important to understand how this process works.

Around 6 to 10 weeks prior to a Budget or Autumn Statement, the Treasury shares with the OBR a preliminary 'scorecard' of measures that it is considering announcing. We then discuss the level of scrutiny that each measure would require with the Treasury and the department responsible for its implementation and analysis (most often HM Revenue & Customs or the Department for Work and Pensions, but also the Departments of Communities and Local Government and of Business, Innovation and Skills), based on its complexity and similarity to previously implemented measures.

The department will then send a detailed 'costing note' to the OBR, having previously discussed it with the Treasury. This sets out the details of the policy and explains how the estimates of the amount of money it will raise or cost in each year of the forecast have been produced. (These notes can easily run to 20 pages or more.)

In many cases, the OBR discusses the analysis with the department and the Treasury in a formal 'star chamber' meeting. We look at the key assumptions involved in each costing, suggesting changes and subsequently iterating the analysis until we are happy to endorse the

costing as 'reasonable and central' or until the Treasury and we agree to disagree (which has not happened yet). In the case of tax measures, for example, these discussions focus on identifying the relevant tax base from survey and administrative data and judging the potential behavioural impact of the measure from the experience of similar measures or from relevant estimated elasticities.

As the costing scrutiny process proceeds, the details of the policy in question are often refined, and in some cases significantly amended, partly as a result of issues raised during that process. At the outset, the OBR, the Treasury and the responsible departments agree deadlines by which the details of the policy need to be notified to the OBR for us to be able to guarantee to certify the costing.

This is a time consuming and resource intensive exercise, both for the OBR and for the analysts in the responsible departments. This is partly because a significant number of measures are dropped or postponed before the statement is finalised - in the run-up to any fiscal event, we are sent more costing notes than the number of measures eventually included as policy announcements in the published policy decisions table. In addition to the formal 'star chamber' meeting with the OBR's Budget Responsibility Committee, there will often be additional meetings at staff level as well as considerable interaction by email and phone, for example to ensure that any costing is based on assumptions that are consistent with those underpinning the forecast as a whole.

It is important to note that this process is largely confined to tax and welfare spending measures that have an impact on public sector net borrowing and which appear in the Treasury's published policy decisions table. The OBR does not scrutinise proposals for specific spending activity by individual Whitehall departments on public services and administration – for example, the decision in Autumn Statement 2013 to extend the provision of free school meals.

Our responsibility is to look at the impact that spending decisions have on the public finances, rather than their value for money. So instead we take a judgement on the extent to which departments will in aggregate over- or under-spend the 'Departmental Expenditure Limits' (DELs) for public services, capital spending and administration set for them by the Treasury. For those years of the forecast for which DELs have not yet been set, the Government currently announces a target for overall public spending growth. Combined with the OBR's bottom-up forecasts for welfare, debt interest, locally-financed and other so-

called 'Annually Managed Expenditure', this target yields an implied envelope for DELs in those years beyond the Spending Review.

In the context of the proposal that we should cost the policies of individual parties, the key features of this process are probably:

- the need for the responsible departments – notably HMRC and DWP – to devote significant analytical resources to this work;
- the need for detailed interaction and communication between the OBR and the analysts in the responsible departments;
- the length of time this takes and the need for a clear timetable and deadlines;
- the fact that policy proposals evolve as the scrutiny process unfolds, and that some are dropped altogether; and
- the scope of the process, which does not extend to the scrutiny of the costing of proposals to spend more or less money on particular areas of public services and administration. A significant proportion of manifesto commitments take the form of this type of departmental spending pledge.

Similar issues arise in the work that the Institute for Fiscal Studies has done informally with opposition parties to help them cost their policies ahead of elections, a process that I oversaw there in the run-up to the last two general elections. Like the official process, it is time consuming and necessarily iterative, as the parties modify their policy proposals in light of what you have to say to them about their likely cost and impact. Understandably, the first draft of the policy is often more rough around the edges than in the official process, because opposition parties do not have the same access to data and analytical expertise from the relevant departments as the Government does.

We might hope that the existence of a formal certification process would encourage parties to improve the quality of their initial manifesto policy costings, but there will be some information and analysis that is simply not available publicly. (Indeed, our existing process of certifying official tax policy costings can involve the use of information that is available to HMRC but which is not revealed to the OBR because it is subject to taxpayer confidentiality.)

***General principles***

The experience of the official costing process, and the unofficial process involving the IFS, poses a number of practical questions.

Before addressing some of them, I think it is worth laying out some general principles that should underlie the OBR's involvement in party proposal costing, if Parliament wished us to go down that route:

- **Even-handedness:** As far as possible, we should ensure that parties inside and outside government are on a level playing field. This means that we should apply the same standards to the costing of party proposals that we apply to the costing of Government policies. It also means allowing parties some scope for iteration and policy development in the costing process, as the Government enjoys. This would be resource intensive, but it would be essential to avoid a situation in which the OBR endorsed a 'rough-and-ready' costing for a party proposal ahead of an election, only for the party to enter government and then have us tell it that the costing was materially different when properly scrutinised.
- **Clarity:** We would wish to be as clear as possible ex ante and ex post about the criteria that we adopt for being willing to certify a policy costing, for example regarding the detail of the policy and the time at which it could and would be implemented. We would also wish to be clear ex ante about how we would treat manifesto pledges that did not meet the criteria for certification or which the parties did not submit to us. We could simply point out that a particular policy measure has not been certified by us. Or we could also explain *why* a particular policy had not been certified – for example because particular details were lacking. Our role here could be specified explicitly by Parliament or agreed subsequently between the OBR and the parties involved, but either way it would need to be settled well ahead of time to avoid challenges later in the process. Clarity in this respect would help the parties to frame the policies that they chose to submit to us for scrutiny.
- **Confidentiality:** Parties must feel confident that the OBR and the responsible government departments will respect the confidentiality of our interactions with them, sharing the details of their proposals neither with the public nor with ministers and advisers. This includes confidentiality with respect to proposals that the parties decide to drop.
- **Transparency:** For those proposals which survive, we would wish to be at least as transparent in explaining how we have reached our conclusions as we are currently, through the

Treasury's policy costings documents and our contributions to them. We would wish to reserve the right to comment publicly if we felt that any party was misrepresenting our conclusions, either favourably or unfavourably.

If, purely for the sake of illustration, we were to assume that only the three largest parties in Parliament would be able submit their policies for scrutiny – and that only well-defined policy proposals would be considered – then in the run-up to the last election the OBR would probably have been asked to certify around 30 policies (excluding those confined to DEL spending that would fall outside the existing scrutiny arrangements). These were put forward by the Conservatives and Liberal Democrats; Labour did not announce any significant post-election policy intentions that were not already taken into account in its pre-election Budget forecast. (http://www.ifs.org.uk/bns/bn100.pdf)

Large and/or complex policy measures generally require detailed scrutiny, as they often imply sizeable behavioural effects, whereas simple rate or threshold changes can be relatively straightforward to cost. The majority of the policy proposals put forward by the parties ahead of the last election fell into the former category.

Let me set out a few further questions that the proposal raises:

1. **Which parties should be allowed to participate?** Parliament would have to decide which parties, inside or outside Parliament, would be allowed to submit policy proposals for scrutiny. Needless to say, this would have a significant impact on the resource requirements for the OBR and for the responsible departments. Parliament might also choose to limit the number of policies that each party could submit. Clear rules on how the Coalition parties would engage with us on their separate manifestoes would be necessary to meet the principles of confidentiality and even-handedness.
2. **Which policies should be eligible for scrutiny?** In line with the principle of even-handedness, the OBR could only certify the costing of a policy set out with sufficient detail and certainty for us to be able to quantify its impact on the public finances in each year over an appropriate forecast horizon. We would wish to be as clear as possible in advance about the level of detail required, so as to avoid disagreements about the eligibility of particular measures for scrutiny. It would not be appropriate for us to comment on the possible cost of policy proposals or objectives that did not meet these criteria, even if

parties chose to include them in their manifestoes. But, as discussed above, we could explain publicly the reasons a proposal did not meet the criteria, if that were agreed in advance or required of us by Parliament.

3. **Would costings be limited to the direct effects of the policy measure?** At present, certified policy costings that appear in the Treasury's 'scorecard' take into account the direct effects of the policy measure, which include micro-level behavioural effects, but not macro-level second round effects on the economy and public finances. These second round effects are incorporated through the economy forecast. In most cases, we consider the second-round effects of a Budget or Autumn Statement policy package as a whole, with few individual measures (or their behavioural implications) being large enough to warrant changing the economy forecast in isolation – Corporation Tax cuts have been an exception here. Needless to say, for most policies there is considerable uncertainty around both the first and second round effects on the public finances. The costings would also depend on the baseline forecast for the economy and public finances that underpins it. All costings would need to be based on a common baseline.

4. **When would we need to be notified of the policies?** In order to carry out the necessary iterative process that would allow certified policy costings to be included in party manifestoes, it would be necessary for parties to notify us of their policy proposals well in advance and to an agreed timetable. As with our current practice, we would need to police deadlines strictly to ensure a level playing field for all involved. This would represent a significant departure from the existing flexibility that parties enjoy in the production of their manifestoes if they chose to participate. Achieving cross-party agreement on such a timetable could be a challenge. Resource constraints in the OBR and responsible departments would argue for a longer process than that undertaken ahead of Budgets and Autumn Statements, so proposals might be required two or three months ahead of manifesto publication. However, it is important to recognise that a May election date with April manifesto publications would imply that the work of certifying manifesto costings would need to be undertaken alongside the Budget and preceding Autumn Statement, when the OBR and responsible departments are at or near their peak workloads.

5. **What involvement should the parties have in discussions between the OBR and the responsible departments?** Given the iterative nature of the scrutiny and certification process, with evidence brought to light often informing further policy development, parties are likely to benefit from involvement in the scrutiny discussions. But this could raise difficult issues for OBR staff and officials in responsible departments, where the information they bring to bear in the scrutiny process is not always publicly available and where contact with opposition parties in normal times is restricted by legislation and the Civil Service Code. Again, assuming such issues could be addressed, it would be important for all parties to agree in advance on a process that delivered even-handedness for all.

6. **Doesn't the civil service cost opposition policies already?** It does cost some proposals – for example, departments prepare briefing packs for incoming Ministers that are informed by their manifestoes and other information. But this analysis is not in general undertaken with anything like the rigour that is applied to the Budget and Autumn Statement costings process. And the existing approach is also unlikely to meet, or to be seen to meet, the general principles set out above.

7. **What resources might this involve?** There are many ways in which the proposal could be implemented, with varying resource requirements. An approach that broadly matched the certification process that we currently perform at Budgets and Autumn Statements would have significant resource implications for the OBR and for the departments that we work with. Given the likely timing of the work, the OBR would need additional staff dedicated to the process and perhaps a temporary additional member of the Budget Responsibility Committee; we certainly do not believe the work could be carried out within our existing resources. (It is important to bear in mind that the skills and expertise necessary to scrutinise policy costings are less widely available than those for macroeconomic analysis.) For the forecasting and policy teams in HMRC and DWP, the additional demands on their time are likely to be greater still, since it is they that would undertake the analytical work for the initial costing and that the flows from the iterative scrutiny process. In the current framework, access to analytical resources in HMRC, DWP and Treasury is assured via a Memorandum of Understanding

between us and the three departments. An extension to the MoU would certainly be necessary for the process to be carried out credibly. It might also be helpful for all parties participating in the process to sign up to an MoU.

8. **Might the process be exploited?** Whatever rules were put in place, there would be incentives for the parties to game the system to achieve the most favourable results. This has been a feature of the Dutch fiscal watchdog's experience with manifesto costings over successive elections. It has prompted significant expansions to the process there to fill gaps that were being exploited or where the existing evaluation was considered insufficient. If the same happened in the UK, there would be further resource implications over time.

These issues are certainly not insuperable, but they underline the importance of careful planning and adequate resourcing, not just for the OBR but also for the civil service and for the parties.

By way of conclusion, it is worth noting that the approach of an election poses potential challenges to the OBR's policy costing process even under the current arrangements. In particular, a Chancellor would in principle be in a position to submit policy proposals to the OBR in the Autumn Statement or Budget costings process, even though he or she might privately have no intention of announcing them in these statements. He might ask us to certify the costing of a measure that he intended to include in his party's manifesto, so as to say that it had been endorsed by the OBR. Or he might ask us to certify a measure put forward by an opposition party, so as to say that the costing endorsed by the OBR was different from that put forward by the party in question. We would regard either tactic as an abuse of the current arrangements and would make our concerns public.


**Robert Chote**

Chairman