

Chris Philp MP
Member of Parliament for Croydon South
House of Commons
London
SW1A 0AA

Robert Chote
Chairman

102 Petty France
London SW1H 9AJ

budgetresponsibility.org.uk

18 April 2017

Dear Chris

USE OF THE OBR POLICY COSTINGS DATABASE

You asked a number of questions about the figure of £70 billion derived by the Labour Party from the OBR's policy costings database as the cumulative cost of selected tax cuts over the period from 2016-17 to 2021-22, which was explained in its 12 March press release entitled "*The Tories £70bn tax giveaways to the super-rich and big business*".

From the breakdown provided in the press release, the £70 billion figure appears to sum the estimated cost of 11 policy measures over the six years to 2021-22. Seven relate to cutting the main rate of corporation tax, which has been a feature of six Budgets and one Autumn Statement since the June 2010 announcement of staged cuts from 28 to 24 per cent by 2014-15. The remaining four relate to cutting the small profit rate of corporation tax, introducing a nil-rate band for inheritance tax on main residences, cutting capital gains tax rates and the bank levy element of the measure that introduced a corporation tax surcharge on bank profits while cutting the bank levy rate.

There are a number of issues that should be borne in mind when using the costings database, which are set out in notes to the database. Of particular relevance to this figure are that:

- the database contains the **original costings**, which have not been updated for subsequent changes to the information used in the costing process, such as profits growth or the effect of changes in relative tax rates on tax-motivated incorporations; and
- the **costings have been extrapolated beyond the original scorecard period** by growing the final year estimate by nominal GDP (both ONS outturns and our latest forecast). We consider this to be the most neutral assumption to apply across all measures, but it will not necessarily be the most appropriate assumption for each measure in isolation.

To illustrate the uncertainty that this creates around the figures underpinning the £70 billion, the periods over which the 11 policy measures were costed range from up to 2014-15 for those announced in the June 2010 Budget to up to 2020-21 for those announced in the July 2015 Budget and Budget 2016. Around half the £70 billion figure relates to costings that did not cover any

years in the 2016-17 to 2021-22 period, a quarter to those that only included one or two of those six years and a quarter to those that covered five of the six years. There is likely to be greater uncertainty around figures that are extrapolated further beyond the original costing period.

You asked specifically whether the figures in the policy costings database provide the basis for an accurate assessment of the revenue that would be raised by reversing the tax changes that have been summed, and the certainty with which any such assessment could be made, including in relation to wider economic effects of such policy changes.

Taking the second aspect first, we always stress that any forecast or costing is subject to uncertainty. Indeed, since December 2014 we have assigned each certified measure a subjective uncertainty rating. Five of the measures included in the £70 billion figure were certified since December 2014. We assigned the two most recent announcements of cuts in the main rate of corporation tax 'medium-low' uncertainty ratings, but the capital gains tax measure was assigned 'medium-high', the inheritance tax nil-rate band was judged to be 'high' and the bank surcharge/bank levy measure received our highest rating of 'very high' (although that related more to the bank surcharge element than the bank levy rate cuts).

It is therefore almost inevitable that if we were presented with policy costings for the reversal of all these measures, the estimated yield would be different from £70 billion over the six-year period. One reason, of course, is that the period includes 2016-17, which is now in the past. But others include differences in our forecasts for drivers of the tax base (e.g. profits and investment, house prices, equity prices, etc.) and new information and judgements about the behavioural responses of taxpayers to these measures.

Finally, as you rightly note, our forecasts have factored in wider economic effects of cuts to corporation tax, which alter the post-tax rate of return on investment. This is assumed to raise the desired level of the capital stock and therefore increase the flow of new investment until the capital stock has adjusted to that new level. The fiscal effects of such changes are not factored into the direct scorecard costings presented in the costings database. These effects are also subject to significant uncertainty.

Abstracting from the inclusion of 2016-17 in the total, the figure of £70 billion is probably the best estimate that could be derived from publicly available information. It may be very different – higher or lower – from the estimate we would make of the yield from reversing these policies if that was government policy. Such an estimate would itself be highly uncertain.

Best regards,
Robert

Robert Chote
Chairman