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Sir Dave Ramsden
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Dear Dave

Incorporating the Government's medium term public spending assumption in the OBR's March 2015 economic and fiscal forecasts

At the Forecast Liaison Group meeting on 26 January, we agreed that it would be useful to exchange letters regarding the process for incorporating the Government's preferred assumption for public spending for the years beyond 2015-16 in the forecasts that we shall be publishing in our March 2015 *Economic and fiscal outlook*.

As you know, Parliament requires the OBR to produce forecasts over a five year horizon consistent with current Government policy. To that end we produce bottom-up forecasts for tax receipts and welfare spending, based on our best judgements regarding the likely evolution of the economy and on the Government's stated plans for tax rates and thresholds and benefit levels and entitlement rules. We also produce bottom-up forecasts for other receipts and other annually managed spending.

In addition, we also need to incorporate forecasts of future discretionary spending on public services, grants and administration, and on capital investment. Through to 2015-16, these are based on the detailed resource and capital departmental expenditure limits (RDELs and CDELs respectively) set out by the Treasury, most recently in 2014, adjusted for our estimates of likely over- or under-spending.

For the years beyond 2015-16, for which no detailed plans have yet been set out, we require the Government to tell us how much it assumes it will wish to spend within RDEL and CDEL. We can then incorporate these figures in our forecasts, reserving the right to adjust them for expected over- or under-spending. In our forecasts to date, the Government has chosen to provide these assumptions by setting out a path for total resource and capital spending ('total managed expenditure' or TME), which, together with an assumption on the growth of public sector gross investment, then implies envelopes for RDEL and CDEL given our forecasts for other spending. Since Autumn Statement 2012, the Government has described this as a "*fiscal assumption*" and has noted that "*It would, of course, be possible to do more of this further consolidation through tax instead.*"

The Coalition parties agreed a fiscal assumption that generated a path for TME beyond 2015-16 at the Autumn Statement, although each stated that it would make different choices regarding the level and composition of receipts and spending if governing alone.

Given the recent desire of the Coalition parties to make their individual positions clearer – combined with our legal duty to produce a single forecast based on a single Government policy – I felt that it was important to take legal advice on the options and constraints we face. The advice I have received was clear that the OBR's duty to produce forecasts based on government policy means we must produce only one forecast and that it must be based on the agreed policy of the Coalition Government. Where no policy has been agreed, the Charter allows us to make an assumption, but the Act is clear that we must not consider "alternative policies".

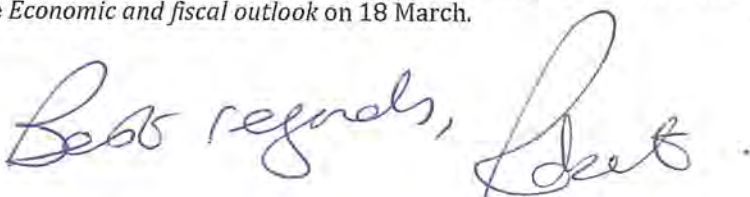
Our officials have proposed a timetable that involves three steps, with two deadlines for decisions on the Government TME assumption:

- For the **first and second rounds of the forecast**, we will base our forecasts on the TME assumption as worded in December. (This is likely to generate different cash forecasts for implied DEL spending due to changes in forecast outturn data on spending, ONS revisions to the GDP deflator, and our forecasts for annually managed spending and the GDP deflator in 2015-16.)
- On 25 February, we will provide the Chancellor with the Round 2 fiscal forecast. On **26 February, by 2pm**, you will provide us with the preliminary TME assumption for the March forecast. The implications for the economic forecast will be fed into our Round 3 economy forecast, thereby producing a Round 3 fiscal forecast that is fully consistent with any changes to the TME assumption. (If no agreed assumption was to be provided, we would continue to base the forecast on the assumption as worded in December.)
- On 6 March, we will provide the Chancellor with the Round 3 fiscal forecast – the final pre-measures forecast. On **10 March, by noon**, you will provide us with the final TME assumption for the March forecast. This is the same deadline by which we must be notified of any policy measures that are expected to affect the economy forecast. The implications of any changes between the preliminary and final TME assumption will be fed through to our Round 4 economy forecast and our final post-measures fiscal forecast. (Again, if no agreed assumption was provided, we would base the forecast on the assumption as worded in December.)

To ensure clarity in the transmission of the preliminary and final TME assumption from the Treasury to the OBR, I would be grateful if the Deputy Director for General Expenditure Policy could inform my Head of Staff in writing – copied to our head of public expenditure forecasting – of the assumption and its status as Coalition government policy for the purpose of this forecast. As ever, my staff will confirm with you that we have interpreted the assumption as Ministers intended.

I would be grateful for your confirmation that we are agreed to follow this process for setting the TME assumption in this forecast.

The timely exchange of information and policy assumptions has been one of the strengths of the forecasting process over the Parliament to date and I hope that this exchange of letters will ensure that this remains the case in the somewhat unusual circumstances of the final fiscal event before the election. We intend to publish this exchange of letters alongside the *Economic and fiscal outlook* on 18 March.

Best regards,


Robert Chote
Chairman