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Responsibility

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Rt Hon David Cameron MP
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Dear Prime Minister

I note that you said in your speech on the economy yesterday:

> "As the Independent Office for Budget Responsibility has made clear, growth has been depressed by the financial crisis, by the problems in the eurozone and by a 60% rise in oil prices between August 2010 and April 2011. They are absolutely clear, and they are absolutely independent. They are absolutely clear that the deficit reduction plan is not responsible; in fact, quite the opposite."

For the avoidance of doubt, I think it is important to point out that every forecast published by the OBR since the June 2010 Budget has incorporated the widely held assumption that tax increases and spending cuts reduce economic growth in the short term.

To date our forecasts have used 'multipliers' that imply that every £100 of fiscal consolidation measures reduce GDP in that year by around £100 for capital spending cuts, £60 for welfare and public services cuts, £35 for increases in the VAT rate and £30 for income tax and National Insurance increases, with the impact diminishing thereafter. As we discussed in our October 2012 *Forecast Evaluation Report*, applying these multipliers to the consolidation measures put in place by the previous and current governments would have been sufficient to reduce GDP in 2011-12 by around 1.4 per cent.

Needless to say, there is huge uncertainty around multiplier estimates. Over recent months the International Monetary Fund alone has published a variety of estimates for industrial countries, some larger, some smaller and some broadly in line with those we have used to date. We have chosen estimates from within the wide range in the academic literature.

Economic growth has been much weaker since the end of 2010 than we and most other forecasters expected in June 2010 and it is clearly possible that this is in part because the fiscal consolidation measures have had a greater 'multiplier' effect than we anticipated. But, in the *Forecast Evaluation Report,* we concluded from an examination of the subsequent outturn data that the

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impact of external inflation shocks, deteriorating export markets, and financial sector and eurozone difficulties were more likely explanations.

To summarise, we believe that fiscal consolidation measures have reduced economic growth over the past couple of years, but we are not yet persuaded that they have done so by more than the multipliers we use would suggest.

Best regards,

Robert.

Robert Chote
Chairman