

Robert Chote  
*Chairman*

20 Victoria Street  
London SW1H 0NF

Mr Andrew Tyrie MP  
Chairman  
Treasury Select Committee  
House of Commons  
London  
SW1A 0AA

[budgetresponsibility.independent.gov.uk](http://budgetresponsibility.independent.gov.uk)

6 June 2013

*Dear Andrew*

**Re: Treasury Select Committee report on Budget 2013**

I am writing to respond to some of the recommendations and observations the Committee made in the above report, related to the work of the OBR.

***Forecasting and uncertainty***

You rightly highlight the considerable uncertainty the surrounds all economic and fiscal forecasts. We have always taken care to emphasise this uncertainty in our publications and in our evidence to the committee. For example, in each of our *Economic and Fiscal Outlooks* we point out the confidence that should be placed in our central forecast given the accuracy of past official forecasts, through the use of 'fan charts'. We use sensitivity and scenario analysis to show how the public finances are likely to be affected by alternative economic outcomes. And we also set out a detailed comparison of our central forecast with those of other economic forecasters. You urged us to do more to highlight the role and limitations of forecasting. I addressed this issue as part of my spring lecture to the Institute and Faculty of Actuaries in May and we will have another opportunity to do so when we publish full details of the model that we use to help us in macroeconomic forecasting later in the year.

In thinking about the OBR's forecasting role it is also very important to remember that our primary duty is to assess the outlook for the public finances, where we have access to information and analysis that is not available easily or at all to outsiders. The path of real GDP – which most outside commentators focus on – is much less important in explaining the public finances than other variables: nominal GDP and its components; average earnings; inflation; labour market developments and interest rates. This was illustrated by the fact that in 2010-11 and 2011-12 the budget deficit shrank as a share of GDP much as the OBR had forecast in June 2010, even though real GDP growth was much weaker than expected. This was largely because nominal GDP and the labour market held up more strongly than we might have expected given the weakness of real GDP.

#### ***Fiscal multipliers***

The committee noted that it was sensible to keep estimates of the 'fiscal multipliers' under review. We reviewed the multiplier estimates that were used in the June 2010 forecast in our *Forecast evaluation report* last autumn, looking at the explanations for forecast errors against subsequent outturns. We will examine this issue again in our 2013 *FER* this autumn.

#### ***Contingent liabilities***

The OBR aims to ensure maximum transparency in the reporting of contingent liabilities and other future liabilities, and uses them to assess potential risks to the public finances. In our *Fiscal sustainability reports*, we have provided analysis of the information on contingent liabilities and other future liabilities available from the Whole of Government Accounts (WGA). So far, for the first two years that the WGA accounts have been published, the greatest contingent liability has arisen from successive governments' financial stability interventions. We have reported on the current and future possible fiscal impact of these financial interventions in every EFO. As you noted, there is a significant delay before contingent liabilities are reported in the WGA. However in the FSRs we do try to look ahead to changes in future contingent liabilities reflecting latest policy developments. For instance in our 2012 *FSR*, we reported some limited information that was already available on how



HMRC's contingent liabilities for lost revenue on account of oil decommissioning policies would change in their 2011-12 accounts, following the March 2012 Budget measure that provided greater certainty on reliefs from decommissioning oil field assets.

We also considered the Bank of England's new *Funding for lending* scheme, which was announced in the preceding month, and commented that we thought that this was not likely to give rise to new contingent liabilities in future WGA accounts - because this was expected to involve exchanges of assets between the Bank of England and other banks.

We agree that it would also be useful for us to publish, with each Budget and Autumn Statement, a summary of the available information about the impact on future liabilities of policy measures in that Budget and Autumn Statement. So in future we propose, as a matter of course, to ask the Treasury to identify any changes to future liabilities that it expects from Budget and Autumn Statement measures and we will report them in the relevant EFO. However our *Fiscal sustainability report* is likely to continue to be our best opportunity to consider all future liabilities in detail.

#### ***4G spectrum auction and UK-Swiss tax agreement***

We identified both the 4G spectrum auction and the UK-Swiss tax agreement as particularly uncertain policy costings in the OBR's annex to the Treasury's Autumn Statement *Policy Costings* document.

Our estimate for the proceeds from the 4G spectrum auction was based on two separate published analyses of the likely yield, drawing on the results of comparable spectrum auctions outside the UK. Assessing the economic value placed on the 4G spectrum by auction participants and the level of competition between them is inevitably difficult - if the appropriate price was self-evident then there would be no need for an auction.

The key uncertainties for the UK-Swiss tax agreement are the value of UK financial assets in Switzerland and the behavioural response of those individuals with funds in Switzerland. (Indeed, we made a lower estimate of

the likely yield than that originally made public by ministers and HMRC because we preferred a lower central forecast for the pool of assets.) We will re-assess the yield from the agreement in our Autumn 2013 forecast and will also assess whether this has implications for the expected yield from the more recent tax agreements with Jersey, Guernsey and the Isle of Man.

***Anti-avoidance measures***

We agree that the yield from anti-avoidance measures is generally more uncertain than that from other policy measures and we have highlighted the particular uncertainty of such costings in our policy costings annexes. Key uncertainties include how much avoidance is currently taking place and the extent to which firms or individuals have opportunities for other avoidance routes. Many avoidance costings allow for attrition, in other words an expectation that revenue from the measure will decline over the forecast period as new avoidance routes are discovered. We are working with HMRC to improve the evaluation of anti-avoidance measures. We hope this will help improve future costings, for example the attrition rates adopted.

When we receive costings for anti-avoidance measures, we routinely ask whether there is evidence on the likely yield from similar measures in the past. But unfortunately there is a limit to what can be learned from examining past anti-avoidance measures, as there is always considerable uncertainty regarding what the path of receipts would have been in their absence.

*Best regards,  
Robert*

**Robert Chote**  
Chairman