Office for
Budget Responsibility

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House of Commons
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Dear Nicky,

RE: The EU exit agreement and OBR forecasts

Thank you very much for your letter of 16 April regarding the incorporation of the Government's prospective exit agreement with the EU in our forecasts.

Once a firm and substantive exit agreement is in the public domain it would constitute a meaningful and deliverable statement of government policy and we would wish to incorporate it in our subsequent *Economic and fiscal outlook* forecast, updating as necessary the broad-brush assumptions we have made to date regarding the potential implementation and impact of Brexit.

The Committee has expressed its desire for Parliament to see such a forecast before voting on the agreement. We are happy to do what we can to make that possible, but whether this timetable can be delivered will depend in large part on several factors that do not lie in our hands. Namely:

- when the agreement is reached and published;
- whether it is firm and precise enough to justify moving beyond some or all of our current broad-brush assumptions;
- how complex and time-consuming the detail is to incorporate;
- Parliament's timetable for considering the agreement; and
- the Government's timetable for the Autumn Budget and Spring Statement and the forecasts that will accompany them.

Production of the *EFO* forecast is time-consuming and resource-intensive, not just for the OBR but also the dozens of officials in government departments and agencies whose time and expertise we rely on when putting it together. For this reason, our Memorandum of Understanding with the Treasury and other departments states that when, as required by the *Charter for Budget Responsibility*, the Chancellor sets the date for a fiscal statement and accompanying forecast, we will normally be given at least 10 weeks' notice.

Chancellors have typically held the autumn fiscal event on a Wednesday in late November or the first week of December, having announced the date when Parliament is sitting in mid-September (which gives us the necessary 10 weeks' notice). The date chosen balances many considerations: from when the Office for National Statistics issues its first estimate of nominal GDP to the Chancellor's and Prime Minister's international commitments and, of course,

Office for
Budget
Responsibility

the Parliamentary timetable. Over the past two decades, the autumn event has only once taken place later than the first week of December.

Let us assume for illustration that a firm and substantive exit agreement is published at the conclusion of the European Council meeting on 18-19 October. We do not know what the content of the agreement would be or how much (if any) advance notice we would have of that, but it should nonetheless be possible to incorporate an assessment of the impact in an *EFO* forecast published alongside a Budget in the first week of December. As you will appreciate, the agreement would have to be incorporated into the pre-measures forecast on which the Chancellor bases his final Budget policy decisions. This pre-measures forecast is completed around two weeks before the date of the Budget itself, to give the Chancellor a stable base for his final decisions and for us to assess their impact on the published forecast.

One consequence of incorporating the exit agreement on this timetable would be that some of the key judgements that shape the medium-term outlook for the public finances and the need for policy action to adhere to the fiscal targets – notably our assumptions about the future path of potential GDP – would likely be finalised much later in the forecast process than usual.

It is important to emphasise that the exit agreement would not be the only policy development that we would need to incorporate in the autumn forecast. Following last month's scorecard-free Spring Statement, this could well be a measures-heavy Budget. A large number of consultations are currently underway that could generate measures and the Chancellor said that "*at this year's Budget I will set an overall path for public spending for 2020 and beyond*", with the detailed Spending Review to follow next year.

So it is far from clear that the exit agreement would be the largest moving part in the forecast. And neither we nor the Committee should allow crystal-ball gazing around the potential impact of Brexit to crowd out proper scrutiny of the concrete policy decisions in the Budget. Whatever the exit agreement is able to set out in detail, it will not address potentially important post-Brexit issues around trade deals with other countries or the extent of regulatory divergence – 'non-tariff barriers' – that will emerge once we have left the EU.

Looking beyond the autumn, the next formal opportunity to incorporate the agreement would be the Spring Statement. Chancellors have typically held the spring fiscal event in mid-March, but it could presumably be brought forward a little. Given the nature of the forecast process, it would certainly not be practical to produce a full additional *EFO* forecast between the Autumn Budget and Spring Statement, given the likely availability of the specialists across government that we would need to draw upon over that period.

It is not clear that under any of these scenarios the challenges we face would be eased significantly by requesting more resources for the OBR, tempting though that is. To produce a robust and transparent forecast we need to draw upon the established expertise of the existing staff at the OBR and other departments. The constraint is a lack of weeks in the year, not of bums on seats. And whether any of these scenarios is consistent with the forecast being published before Parliament has to vote on the exit agreement is something that you will have a much better sense of than I do.

I am glad that the Committee feels that Parliament would benefit from the incorporation of the exit agreement in an OBR forecast. But I think it is important to be realistic about the scope and robustness of the additional analysis that we would be able to provide, in the context of the momentous decision that Parliament will have to take. In that regard:

- The exit agreement may be neither firm nor detailed enough about the UK's post-Brexit policy settings to justify moving away from our current broad-brush assumptions (bar incorporating the agreed 21-month transition period, which would have relatively little impact on the forecast). Specifically, will the agreement (and any accompanying Government policy statement) be clear about our end-state trading relationship with the EU, the future migration regime or future contributions to the EU budget and other spending consequences?

- Even if the exit agreement is firm and comprehensive, some policy consequences are almost certain to remain unclear for some time. For example, what use will this or future Governments make of the regulatory room for manoeuvre created by Brexit and will that be growth enhancing or growth reducing? And what future trade arrangements will the UK agree with non-EU countries? Our remit does not permit us to consider the implications of possible future policy settings, so any such gaps could not be incorporated in an OBR forecast until firm policies had been set.

- The scope and time horizon of the OBR's forecast outputs are very different to those of the provisional cross-Whitehall study that has been made available to Parliament. Under the legislative requirements placed upon us, we forecast the public finances over a five-year horizon, based on a macroeconomic forecast constructed for that purpose. Many potential implications of Brexit would only affect the economy and the public finances gradually and with their full impact not being felt until many years beyond our forecast horizon (especially with an initial transition phase during the early years of the forecast). We would need to make some assumptions about the steady-state impact of Brexit – and the path towards it – to generate our medium-term forecasts (as we did in November 2016), but we do not produce detailed forecasts over 15 or 20 years.

- Parliament will presumably be interested in the regional and sectoral implications of Brexit (as discussed in the cross-Whitehall study) and in its potential distributional consequences. These lie beyond our remit. In principle, the Government could provide such analysis based on our macroeconomic judgements. But we would not of course be responsible for the judgements they reach.

- Some of the specific fiscal modelling challenges created by Brexit mean that any initial methodological approaches would necessarily

Office for Budget Responsibility

be provisional. An obvious example is the need to develop a robust methodology for assessing the effect on customs duty revenue of any changes to the customs regime. This is likely to remain work-in-progress for some time as we learn about how the UK's cross-border trade responds to any policy changes.

- The OBR is required by legislation to produce its forecasts based on current Government policy, and not to look at alternative policy scenarios. (This is a legacy of the debate over whether we should assess the impact of Opposition policies. Parliament decided not and primary legislation would now be required for us to do so.) In practice this means that we could include the potential impact of the exit agreement in our central forecast (even before it is legislated for) and we would be as transparent as possible in explaining the impact of any changes to our provisional broad-brush assumptions. But we would not be able to compare the outlook under the exit agreement with the outlook if we remain in the EU or if we leave without agreement, whichever is the relevant counterfactual. And, even if we could, it is not clear how well specified that counterfactual would be, as I presume the Government is unlikely to set out in advance its putative policy response to being defeated in the meaningful vote.

- Finally, it is of course important to emphasise that any assessment of the potential economic and fiscal consequences of a particular Brexit outcome will be clouded by uncertainty given the nature of many of the judgements that have to be made – measuring and assessing the impact of changes to non-tariff barriers with the EU, to give just one obvious example. And this comes on top of considerable uncertainty around the economy's underlying long-term growth and revenue generation prospects, thanks to the productivity puzzle. So it will be very hard to estimate the impact of Brexit even after the event.

Parliament will face a very important decision when it considers the exit agreement. It is entirely understandable that it should seek as much information as possible before doing so – and we are keen to help where we can, consistent with the remit that Parliament has assigned to us. But it is important to recognise the limitations of any economic and fiscal assessment of Brexit and to accept that when Parliament makes its decision the consequences will in part be unknowable.

I hope this is helpful for your hearing with the Chancellor and I am copying this letter to him.

Robert Chote

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Chairman