

Chair
Treasury Select Committee
House of Commons
London
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Chairman

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Dear Chair

REGIONAL IMBALANCES INQUIRY

Thank you for the invitation to submit evidence to the inquiry.

Geographical differences in economic characteristics and performance are an important issue for public policy and therefore for economic analysis. As we explained to the committee when we gave oral evidence in March, they play a relatively limited role in the work of the OBR because of the particular remit Parliament has given us – to focus on the evolution of the public finances at the UK-wide level, including devolved taxation and spending. Looking beyond the work of the OBR, the committee may wish to explore with other witnesses whether a greater focus on economic data and forecasting at the level of the 12 NUTS1 regions and nations would be the most effective use of resources to improve spatial economic analysis and policy, as in most cases these reflect former administrative boundaries rather than meaningful economic entities.

Sub-UK developments and OBR forecasts

Parliament has tasked the OBR with producing forecasts for the UK public finances, including taxes and spending levied and undertaken by the devolved administrations and local government. Many categories of receipts and spending are affected by developments in the economy, so each public finance forecast is conditioned on a forecast for the economy. This economic forecast is undertaken at the UK level and with a particular focus on those aggregates and variables that drive fiscal outcomes most directly – for example, the various components of UK nominal income and spending.

We do take sub-UK developments into account where this is likely to be material to the behaviour of particular tax or spending streams.

Quantitatively, the most significant example would be the behaviour of London house prices and sales when we are forecasting stamp duty land tax receipts. The London housing market frequently behaves differently from the housing market in the rest of the country, partly reflecting the importance of overseas buyers and sellers, and it accounts for a disproportionate share of total receipts because of the high concentration of high value properties.

When forecasting devolved tax receipts, we draw on administrative tax data at a disaggregated level, beyond which a sub-national economic forecast would be unlikely to add much value. For income tax, we draw on HMRC's 'survey of personal incomes', a sample of around 745,000 individuals across the UK, as the basis for our Scottish and Welsh forecasts. For Scotland, this is supplemented by official outturn estimates. In due course we hope to make greater use of HMRC's real-time information reporting, which covers the entire population of PAYE income taxpayers. These administrative data allow us to estimate the Scottish and Welsh shares of total UK income tax liabilities, which are the building blocks of our devolved income tax forecasts. We need to 'forecast' past years for which neither outturn nor SPI estimates are available. Scottish and Welsh labour market data can be useful in informing these judgements, but we typically place most weight on real-time information from the tax system as it is not subject to sampling biases. Our forecasts also reflect ONS-projected differences in population growth.

Limitations of regional GDP data and forecasts

If regional economic forecasts were thought desirable for other purposes their compilation would also be compromised by the weaknesses and limitations in the regional economic data presently available as discussed in the 2016 *Independent Review of Economic Statistics*.¹ For example:

- Regional GDP estimates are limited in scope and not timely. In particular, there are currently no regional estimates of the expenditure measure of GDP. At present, the earliest ONS estimates of annual regional Gross Value Added (GVA)² only become available a year after the end of the period in question;
- Regional estimates of GVA are currently produced top-down, with regional indicators used to allocate national totals³ – an approach that is unlikely to be reliable for small geographic areas. This also means that there would be little additional value from constructing forecasts at a regional level. Regional estimates of real GVA are also constructed using national price indices rather than region-specific prices;
- Many economic statistics are based on statistical surveys and sample sizes are inevitably much smaller at a regional level, with consequences for quality and reliability. Producing adequate data at NUTS2 and finer degrees of disaggregation would require much greater exploitation of administrative data than is presently possible. Moreover, it is often the case that the source data for businesses operating across multiple regions is not broken down appropriately, so even then there would be gaps.

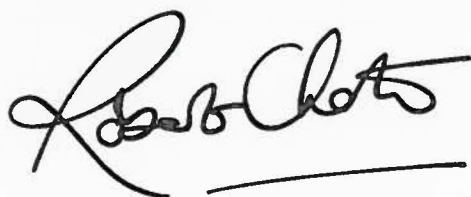
In addition to these practical challenges, there are also more fundamental conceptual questions. The significant interactions between different geographical areas mean that it is often difficult to characterise a well-defined sub-national economy, especially at finer levels of disaggregation.

Current NUTS1 regional boundaries within England reflect the 'government office regions' that were created in 1994 to improve the coordination of government departments' regional activities. They rarely correspond to a neatly defined natural economic unit. For example, there is no clear boundary to the Greater London labour market, with daily commuter transport services running deep into the South-East, South-West and East of England regions.

Even in Wales, a nation in its own right with a devolved administration, the economies of North and South Wales are more closely linked to those of the North-West and South-West England respectively than to each other. Such issues become more important the smaller the geographical unit under consideration. People may not live in the areas where they work and companies may not book output and profits where value is added.

I hope that this will be of some help in your deliberations.

Best regards,

A handwritten signature in black ink, appearing to read 'Robert Chote', with a horizontal line underneath.

Robert Chote
Chairman

¹ Professor Sir Charles Bean, *Independent Review of UK Economic Statistics*, March 2016.

² Office for National Statistics, *Regional economic activity by gross value added (balanced), UK: 1998 to 2017*, December 2018.

³ Office for National Statistics, *Regional accounts methodology guide*, June 2019.