

The Office for Budget Responsibility: can we make a difference?

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1. Introduction

It is a great pleasure to be here in York and a great honour to deliver the Ken Dixon lecture. Ken has made an enormous contribution to the university over the years and to the Department of Economics in particular. He is also a former Chair and trustee of the Joseph Rowntree Foundation, which did so much to support our research into income distribution and poverty during my time at the Institute for Fiscal Studies.

I am conscious that I follow today in the footsteps of seven very distinguished previous lecturers. The first Ken Dixon Lecture was delivered in 2004 by Ed Balls, then the Labour government's Chief Economic Adviser and now Shadow Chancellor. In that lecture he highlighted the greater transparency that Labour had brought to UK fiscal policymaking after taking office in 1997. But he also noted that, and I quote:

“Some argue that we would have established greater credibility and legitimacy if we had gone further in institutional reform – by getting independent experts, if not to set the fiscal policy stance, at least to give a public view or to date the economic cycle. I am not sure myself, whether in practice such changes would have made any difference.”¹

Six years later, after an eventful intervening period for the management of the British economy, the current government did ask some independent experts to give a regular public view on fiscal policy and the state of the economy, in the shape of the Office for Budget Responsibility. As its first permanent Chairman, I am delighted that the creation of the OBR has been endorsed across party lines – including by the Labour Party. Without that breadth of support we would not have the legitimacy to fulfil our role as a non-partisan fiscal watchdog and scrutineer of the UK's public finances. But, recognising the doubts that Ed expressed here seven years ago, my task this evening is to ask if such a body can make a difference today.

I shall start out by asking how and why independent fiscal watchdogs have become increasingly numerous around the world in recent years, before moving on to describe the remit that the OBR has been given and how this compares with those of our overseas counterparts. I shall argue that the specifics of our remit make it particularly important for us to demonstrate our independence from government and other political influences, and that, although our formal governance structure will help in this, much depends on the transparency of our analysis and of our relationship with government. We certainly cannot afford to be complacent about our future. Some governments and parliaments have created independent fiscal watchdogs with great fanfare in the last few years, only to squeeze their budgets or as good as abolish them as soon as they began to bark too loudly.

¹ “Stability, growth and UK fiscal policy”, by Ed Balls, Discussion Paper in Economics 2004/03, University of York.

2. Explaining the spread of independent fiscal watchdogs

Independent fiscal watchdogs are not an entirely new idea. Several countries have had them for many years: the Netherlands since 1947, Denmark since 1962, the US since 1975 and Belgium since 1989. The idea gained fresh momentum in academic circles during the mid 1990s, reflecting a desire to replicate in the fiscal sphere the success that independent central banks had had in depoliticising and improving the credibility of monetary policy. The explosion of government deficits and debts in the wake of the recent financial crisis provided further encouragement, partly because it was recognised that in many countries fiscal rules alone had not been sufficient to encourage prudent management of the public finances in the run-up to the crisis, and partly because of the need to bolster the credibility of looming fiscal consolidation programmes. Since 2007, we have seen independent watchdogs created in Sweden, Hungary, Canada, Slovenia and the UK, and they are now planned or being considered in Ireland, Portugal and Slovakia.

The precise remit and operating model differs from country to country, reflecting the perceived policy need at the time each watchdog was created, the system of government in which it operates, and the range of existing institutions with a role in fiscal policy analysis. As a result, independent fiscal watchdogs probably differ rather more from each other in role and structure than, say, independent central banks do. In some cases, it is not even clear-cut whether a particular institution falls into this category. In their excellent recent paper *What should fiscal councils do?*, on which I shall draw heavily throughout this lecture, Lars Calmfors, head of the Swedish Fiscal Policy Council, and Simon Wren Lewis, of Oxford University, identify three criteria:

- first, “a clear fiscal watchdog function” (as distinct from merely a public research and forecasting role);
- second, “macroeconomic competence” (as distinct from merely an auditing role); and
- third, “a high degree of independence from the political system”.²

So why have so many countries chosen to set up independent fiscal watchdogs?

The core analytical argument is that, left to their own devices, democratic governments are prone to ‘deficit bias’ and ‘pro-cyclicality’ in their management of the public finances – on average they borrow more than is optimal, and in particular they spend too much or tax too little during the ‘good times’ when the economy and the public finances both appear to be performing well. The deficit bias literature was stimulated by the trend rise in government debt as a share of GDP that we saw across the OECD between the mid 1970s and mid 1990s. But it is worth noting that even now there seems to be much less agreement about the optimal path of government deficits and debt in the face of shocks than there is around the desirability of central banks trying to keep inflation rates in the low single digits.

² “What should fiscal councils do?”, by Lars Calmfors and Simon Wren-Lewis, <http://www.finanspolitiskaradet.se/download/18.3b8af0c112ec0f3879380005563/whatshouldfiscalcouncilsdo.pdf>

Calmfors and Wren-Lewis identify six potential sources of deficit bias that might recommend the creation of an independent fiscal watchdog:

- First, differential access to information. In their published forecasts, governments may be inclined to over-optimism about the outlook for the public finances, reflecting over-optimism about the economy and/or levels of revenues and spending in any given state of the economy. On occasion this may be a cynical attempt to disguise the need for painful future fiscal action until after an upcoming election. Alternatively, ministers may be seduced by their own rhetoric and mistake a temporary cyclical improvement in the economy and the public finances for the lasting results of their own far-sighted policies. If outside analysts express doubts, the government can always argue with justice that it has access to privileged information on spending and revenues that the outsiders lack, so voters and investors may feel that they have to give it the benefit of the doubt. An independent watchdog has less temptation to be overoptimistic and can be given the same information on spending and revenue that the government enjoys.
- Second, impatience. Governments may be less forward-looking than the voters, because they have elections to win in the short term. Yet the voters may be unable to discipline this short-sighted behaviour effectively because elections are not fought solely over the state of the public finances. A fiscal watchdog can focus discipline in this particular area. It can also help the electorate resist the temptation to back irresponsible tax cuts and spending increases by publicising their likely long-term consequences.
- Third, electoral competition. A government that knows it may be voted out of office at the next election may borrow more than is optimal because it knows there is some probability that the costs of doing so will have to be borne by its opponents. In extremis, a government that actively expects to lose an election may borrow more in order to reduce its opponents' room for manoeuvre when they are in office. A fiscal watchdog can warn against both.
- Fourth, 'common pool' problems. Governments may borrow too much because different groups in society lobby for higher spending and tax cuts without considering the consequences for the public finances as a whole. This is likely to be more of a problem where spending ministers are powerful relative to the finance minister. A fiscal watchdog can strengthen the hand of a virtuous finance minister who is attempting to resist excessive borrowing.
- Fifth, use of fiscal policy for macroeconomic management. If a government uses fiscal policy to help manage the overall amount of spending in the economy, then the same arguments that have been used to justify the use of independent central banks to prevent inflation bias can be applied to the use of fiscal watchdogs to prevent deficit bias. More positively, fiscal watchdogs can also help reassure voters and investors that the use of expansionary fiscal policy for short-term stabilisation needs need not necessarily compromise

the long-term sustainability of the public finances. The Swedish Fiscal Policy Council was actually more enthusiastic about the use of temporary fiscal stimulus measures during the recent crisis than the government was.

- Sixth, exploiting future generations. Today's taxpayers may be tempted to finance their consumption of public services through borrowing rather than taxation, so as to get tomorrow's taxpayers to pick up the bill. A fiscal watchdog sensitive to the verdict of history can act as a representative of future generations (although it is not obvious why a government more concerned about the opinion of the current generation would defer to it).

One question prompted by this list is whether and why we should expect an *official* fiscal watchdog to be more effective in helping to reduce deficit bias than an *unofficial* one, such as the IFS. As Robert Hagemann has argued, smaller countries may not have unofficial bodies of this sort and the creation of an official watchdog may facilitate the pooling of expertise and give access to greater resources.³ In larger countries the argument is less obvious. As I shall discuss in a minute, the OBR's remit obliges us to be an official body as we need access to information, analysis and policy discussions within government in order to fulfil it. But where the role of a fiscal watchdog is to highlight conclusions drawn from publicly available information, official status is not strictly necessary. In that event the main arguments might be that official status gives greater authority in public debate and that the government would find it harder to ignore the findings of a body that it had itself established.

The importance of these various sources of deficit bias will vary from country to country and from period to period – and presumably this has helped to shape the remits given to each institution. So let me say a little about the remit given to the OBR and how it compares with those of fiscal watchdogs elsewhere.

3. The remit of the OBR

The OBR was set up in interim form immediately after the May 2010 general election. This reflected the Coalition's desire to have some independent fiscal scrutiny in place before its 'emergency Budget' in June 2010, which increased the size and pace of the consolidation that it had inherited from the outgoing Labour government. A three-person interim 'Budget Responsibility Committee' was set up, chaired by the former Treasury chief economic adviser Sir Alan Budd and aided by a small secretariat of Treasury officials. They produced a forecast for the public finances shortly before the June Budget, followed by a second forecast on Budget day itself that incorporated the impact of the newly announced measures.

Sir Alan and his colleagues then made recommendations to the Chancellor on the remit and structure of the permanent OBR. The Treasury Select Committee also made recommendations. Both informed the legislation introduced to give us formal

³ Hagemann R (2010), Improving fiscal performance through fiscal councils, Economics Department Working Paper 829, OECD.

status, which then made its way through Parliament. The Budget Responsibility and National Audit Act received Royal Assent on the eve of this year's Budget and the OBR became a statutory body on April 4. The Budget Responsibility Committee now consists of me, Steve Nickell, the warden of Nuffield College, Oxford, and Graham Parker, an experienced former Treasury and Inland Revenue forecaster. We have a dedicated staff of 15 and an annual budget of £1.75m – we are at the smaller end of the international spectrum and cheap at twice the price.

The Act defines the duty of the OBR as being, and I quote, “to examine and report on the sustainability of the public finances”. In practice we have four main tasks:

- First, we are now responsible for producing the official five-year forecasts for the economy and the public finances that the Chancellor of the Exchequer was required to produce twice each year by the 1975 Industry Act. One of these forecasts accompanies the Budget Red Book in the spring, while the other prepares the ground for it in the previous autumn. (The current Chancellor says that he does not intend to accompany our autumn forecasts with significant new tax and spending measures, but it remains to be seen if he can resist the temptation – under the previous government, the so-called Pre-Budget Report soon became a second Budget in all but name.) In our latest *Economic and fiscal outlook* in March we forecast a continued but relatively weak economic recovery and a steady fall in government borrowing reflecting both the consolidation and the recovery in economic activity.
- Second, we use these five-year forecasts to assess whether the Government has a better than 50 per cent chance of achieving the fiscal targets that it has set itself on its existing policies. There are currently two such targets:
 - The ‘fiscal mandate’ requires the government to set policy so as to achieve balance or surplus in the structural current budget five years ahead (in other words, to ensure that it will not borrow other than to finance investment, after adjusting for the temporary impact of any spare capacity in the economy on revenues and spending). This is the same principle as the previous government’s ‘golden rule’, but judged over a rolling forward-looking five-year horizon rather than between the estimated start and end points of a particular economic cycle.
 - The ‘supplementary target’ requires the ratio of debt to GDP to be falling in 2015-16. The fact that the current government has chosen to set a target for the direction of travel of the debt ratio, rather than to set a ceiling as the previous government did, presumably reflects the fact that the financial crisis and its economic consequences have pushed us so far from what was previously thought a prudent level.

In March we judged that the Government was more likely than not to meet both targets. We said that the biggest threat to the achievement of the mandate was the possibility that there might be less spare capacity in the

economy than in our central projection, which would mean that there was less scope for economic recovery to reduce the deficit of its own accord.

- Third, we scrutinise the government’s estimates of the fiscal cost or saving resulting from particular tax and spending measures announced in the Budget. It is important to note that while the OBR ‘owns’ the published economic and fiscal forecast, the Treasury ‘owns’ the eventual policy costings that appear in the Red Book. After scrutinising the government’s estimates and suggesting changes where we think appropriate, we have three choices when we are presented with the Treasury’s final costings – to say: “yes, we agree”, “no, we don’t” or “we were not given sufficient time or information to reach a judgement”. In this year’s Budget we were happy with all the costings, bar one which was not only intrinsically very hard to cost (because of a lack of information about the tax base) but which we were also informed about too late to provide adequate scrutiny. We will re-examine that costing and adjust our next forecast accordingly if we end up disagreeing with it.
- Fourth, we analyse the long-term sustainability of the public finances, looking at 40-50 year projections of tax and spending flows, as well as the health of the public sector balance sheet. In our flow analysis we will look, for example, at the potential impact of demographic trends on public spending and of technological progress and natural resource exhaustion on tax revenues. In our balance sheet analysis, we will look at issues such as the scale of public sector pension and PFI liabilities. This analysis will be published annually in our *Fiscal sustainability report*, the first of which will be published on July 13.

To support this activity and our overarching role as set out in the Act, we also publish briefing papers, discussion papers and the like on topics relevant to our remit. We have also begun producing a monthly commentary on the official public finances data published by the Treasury and the Office for National Statistics. We hope that this will help people interpret the data that emerges between our forecasts.

So how does this remit compare with the roles of watchdogs in other countries?

The first point to make is that in common with all other existing independent fiscal watchdogs – and in contrast to independent central banks – we are an advisory body rather than a policymaking body. The government is not compelled to do what we think would be necessary to give itself a better than 50 per cent chance of meeting its targets, and we certainly do not have any tax or spending instruments under our control. The fact that no country has yet created what Xavier Debrun and colleagues⁴ at the International Monetary Fund have dubbed an ‘independent fiscal authority’ is probably explained by the fact that there is much less consensus around the goals of fiscal policy than monetary policy, the conduct of which is seen (by economists at least) primarily as a technical exercise rather than one requiring political choices between competing long-run objectives.

⁴ Debrun S, Hauner D and Kumar M S (2009), “Independent fiscal agencies”, *Journal of Economic Surveys*, 23, 44-81.

Although all existing independent fiscal watchdogs are advisory, the breadth of their remit differs considerably. The UK is in the ‘relatively narrow remit’ camp, focusing on fiscal analysis. The Danish, Dutch, Swedish and German watchdogs all analyse employment, growth and other structural policies too. The US Congressional Budget Office looks at labour markets, employment policy and climate change. Like its Canadian counterpart, the CBO also examines particular spending projects, such as its recent influential work on proposals for healthcare reform. We do undertake macroeconomic forecasting, unlike half our counterparts, but as an input into fiscal analysis rather than to draw wider macroeconomic policy conclusions.

Our mandate is also narrower than that of some of our counterparts in that we confine ourselves to positive analysis rather than making normative policy recommendations. Calmfors and Wren-Lewis argue that the OBR is “the most extreme case of positive analysis”, because Parliament has instructed us not to look at the impact of different policy options (even if we were not to recommend between them). Rather we are to confine ourselves to analysis of the current government’s existing policies. At the other end of the spectrum, the Central Planning Bureau in the Netherlands formally assesses the economic and fiscal consequences of nine political parties’ manifestoes ahead of their general elections.

This aspect of our remit was a subject of lively debate during the design phase of the permanent OBR. Some felt that comparing policy options would enhance the political independence of the institution, while others feared that it would drag it into heavily contested territory where it would inevitably appear to be taking sides.

I told the Treasury Select Committee before my appointment that Parliament needed to give us a clear steer on this – which it has duly done. And its choice certainly makes our life easier than it otherwise would be. But, if the OBR establishes a positive track record under its existing remit, this is a question that Parliament may wish to revisit – perhaps as part of the independent review of the OBR that will take place after five years. Authoritative, independent, positive analysis of different policy strategies and measures can contribute to a better informed public debate and to better policy outcomes. The IFS has attempted to provide such analysis for years in those areas where it has the data and expertise, and this has increased trust in its independence and even-handedness rather than diminishing it. With our ability to draw upon a wider range of official data and expertise, the OBR could do even more, assuming it was given the resources to do so. It is also worth noting the Dutch experience that regular, formal independent analysis of competing policy platforms and measures can be helpful in facilitating post-election coalition formation.

One of the most distinctive features of the OBR’s remit is the nature of its fiscal monitoring. Unlike many of our counterparts, we do not merely comment on the government’s own assessment of the outlook for the public finances, based on publicly available information. If that was our role, we would not be adding much to what is already being done very well in the UK by the IFS and National Institute of Economic and Social Research. Instead, the government has in effect contracted out

the task of producing the official public finance forecasts to us, giving us access to the information and expertise in HM Revenue & Customs (HMRC), the Department for Work & Pensions (DWP) and other government departments that you need to pull together a disaggregated fiscal forecast in a coherent and comprehensive way.

This makes sense if you believe that the first of Calmfors and Wren-Lewis's six sources of deficit bias – differential access to information – has been important in the UK. After all, there was no shortage of independent bodies warning publicly that the official public finance forecasts published between, say, 2002 and the 2005 election were overoptimistic. The government was able to dismiss those warnings up to and into the election campaign, only to revise up its deficit forecasts and announce spending cuts and tax increases at the first opportunity thereafter. And I am sure you could point to similar episodes under different governments at different times. The creation of the OBR has allowed us to open up the black box of official fiscal forecasting. The government can no longer claim that it has privileged information. This does not mean that our fiscal forecasts will be spot on – they almost certainly won't be, as there is considerable uncertainty around the outlook for most of the components. But people should be able to have confidence that our assessment is both independent and based upon the best available information.

One of the most powerful arguments for having an official independent fiscal forecaster is that it can make full use of data and expertise only available within government. But this argument does not apply as powerfully to macroeconomic forecasting. The OBR does not enjoy any significant informational advantage over the numerous City, academic and international bodies that publish macroeconomic forecasts for the UK on a regular basis. And given the reputation-sapping difficulty of short-term, let alone medium-term, macroeconomic forecasting, you could argue that it would be better for the OBR to take an outside macroeconomic forecast and use that as the basis for its fiscal forecast.

One obvious candidate would be the Bank of England's *Inflation Report* forecasts. But, understandably, the Bank's forecasts are designed for its own needs rather than for ours. It publishes forecasts for only two variables – GDP growth and CPI inflation – and over a time horizon of only three years. We need to publish a much more detailed breakdown of spending, income and prices over a five year horizon in order to explain and justify our forecasts for the numerous revenue streams, spending streams and financial transactions that make up the public finance forecast. Similar gaps would also make it impossible for us to use an average of outside forecasts.

Given the lack of a practical outside alternative, we have no choice but to produce our own macroeconomic forecasts – and we undertake that task with enthusiasm. But bearing in mind that our focus is on the outlook for the public finances and the government's chances of meeting its fiscal objectives, it makes no sense to base our conclusions on the assumption that any particular set of macroeconomic forecasts will be correct. Neither is it particularly helpful simply to quantify the uncertainty that lies around them, although we do do that. Instead we complement our central projections with sensitivity and scenario analysis, so that we can see what impact

changes to some of key parameters and judgements would have on the outlook for the public finances and on the government's chances of meeting its objectives.

So, for example, in our sensitivity analyses we estimate what would happen to our fiscal projections if economic growth was faster or slower than in our central projection, the amount of spare capacity in the economy larger or smaller, and the level of interest rates on government debt higher or lower. Our scenario analyses allow us to test the importance of key judgements in our macroeconomic forecasts, for example our judgement in March that nominal wage increases were unlikely to respond significantly to higher-than-expected inflation. This is clearly a contestable judgement, so we tested the impact on our fiscal projections of greater real wage resistance, implying higher wage growth and a more stubborn increase in inflation.

As an independent advisory body, I suspect that we may find it easier than ministers to publish this sort of sensitivity and scenario analysis – and also to revise our central projections. After all, we are not responsible for determining the overall stance of macroeconomic policy, so we do not face the same pressure to produce forecasts showing that it is a success. We publish a central forecast based on our own best professional judgement, informed but not dictated by the views of the rest of the macroeconomic forecasting community. As the philosopher and Roman Emperor Marcus Aurelius wrote in his *Meditations*: “The object in life is not to be on the side of the majority, but to escape finding oneself in the ranks of the insane”.

Some commentators have argued that our interaction with ministers and Treasury officials in the Budget policy process – and with officials from HMRC, DWP and other departments in the fiscal forecasting process – makes it impossible for us to be truly independent. As I have argued, it is these interactions that allow us to add value to the work already being done by the IFS, the National Institute and others. But the fact that people express this concern underlines the need for us to convince them of our independence year in year out. This should be achieved in part through our governance and accountability arrangements, but the transparency with which we undertake our work is also crucial. So let me say a little about both.

4. Demonstrating independence: governance and accountability

The OBR's formal independence rests upon our rights and responsibilities as set out in the Budget Responsibility and National Audit Act and in the Charter for Budget Responsibility. The latter is a document required by the Act in which the government sets out its approach to fiscal policy. (It is in effect the successor to the previous Labour government's Code for Fiscal Stability). Our rights and responsibilities with respect to our relationships with the Treasury, DWP and HMRC are set out in a Memorandum of Understanding (MOU) agreed between the four of us.

These documents – all available on our website⁵ – set out some things we have to do, some things we cannot do, and an overarching duty that we are free to fulfil as we see fit, subject to these ‘do’s and don’ts’ and to some broad principles of good behaviour.

The Act sets out the overarching duty of the OBR to “examine and report on the sustainability of the public finances”, but also identifies specific duties to:

- Prepare two sets of fiscal and economic forecasts each financial year;
- Assess the extent to which the fiscal mandate is likely to be achieved;
- Assess the accuracy of our previous forecasts; and
- Analyse the sustainability of the public finances.

The Act gives us “complete discretion in the performance of [our] duty”, as long as we perform it “objectively, transparently and impartially” and as long as we take into account current government policies but not alternative policies. (It should be said that defining ‘current government policies’ is not always as straightforward as it sounds, particularly when making projections over five decades rather than five years.) The Act also requires us to operate “efficiently and cost-effectively”.

The Charter says that our independence includes complete discretion to decide:

- The methodology underpinning our forecasts, assessments and analyses;
- The judgments we make in producing these outputs;
- The content of our publications; and
- Our work programme of research and additional analysis.

The Charter sets out some material that we have to include in our forecasts and gives the Chancellor the right to determine the length of the forecast horizon (subject to a minimum of five years). It states that the government remains responsible for policy decisions and costings and says that we “should not provide normative commentary on the particular merits of government policies”.

Importantly, the Act gives the OBR “right of access (at any reasonable time) to all Government information which it may reasonably require for the performance of its duty”. We are “entitled to require from any person holding or accountable for any government information any assistance or explanation which the Office reasonably thinks necessary for that purpose”. Any disputes over access to information or assistance would be discussed and hopefully resolved by the Forecast Liaison Group, which is chaired by the OBR and which comprises representatives of the four MOU signatories. The MOU states that: “Where is not possible to reach agreement, issues may be escalated to the Chair of the OBR and Permanent Secretaries as appropriate”. If we were still being denied information or assistance that I believed we needed to do our job properly then I would simply make those concerns public.

The effectiveness of a fiscal watchdog can be undermined by restricting its budget as well as by restricting the information it has access to. Calmfors and Wren-Lewis

⁵ <http://budgetresponsibility.independent.gov.uk/independence/legislation-and-related-material/>

describe how the Canadian Parliamentary Budget Office (PBO) had its budget reduced in 2009-10 after it released controversial reports on the costs of Canada's engagement in Afghanistan and the economic and fiscal outlook. And after just two years in existence the Hungarian Fiscal Council was stripped of its secretariat and transformed into a more toothless body after criticising the government's budget for overoptimistic assumptions and lack of transparency. The OBR's budget is part of the Treasury's (albeit separately identified within it) and so we could be subjected to a similar squeeze. Our main protection here is transparency – I made it very clear that I wanted the OBR to be given an multi-year budget and for that to be made public, which it has been. So any squeeze would thus be plain for all to see.

The Canadian and Hungarian episodes demonstrate that making a fiscal watchdog formally responsible to parliament rather than to the government does not necessarily protect it from political pressure via its budget – indeed quite the opposite judging from experience to date. Most other fiscal watchdogs (with the notable exception of the CBO in the US) report to governments rather than the parliaments. The OBR is something of a half way house. We are a non-departmental public body under the aegis of the Treasury, but we are accountable to parliament via hearings before the Treasury Select Committee and the TSC also has a veto over appointments to and dismissals from the Budget Responsibility Committee.

This 'dual lock' is seen as an important foundation of our independence in the UK and it has set a challenging precedent for other public appointments. Interestingly, it does not seem to impress most of the overseas visitors who come to talk to us about our role and structure. They point out that the Chair and the majority of TSC members are from the governing parties and wonder why anyone would expect them to take our side against ministers when the going gets tough. Most people who have seen select committees in action in the UK would have rather more faith, but it is important that none of us are complacent and assume that everyone is reassured.

This concern certainly underlines the fact that while we need to be accountable and responsive to the Chancellor and to the TSC, we must remain independent of both. Our ultimate responsibility is to the general public and we owe them our best judgement, whether the politicians like what we say or not. As regards the specific issue of appointments, it is certainly very valuable for members of the Budget Responsibility Committee to have gone through a confirmation hearing with the TSC and to have received its endorsement. But I was conscious that if my appointment had been approved by a bare majority of the committee, voting on party lines, and had been opposed by the Opposition front bench, my position would have been untenable. The OBR's legitimacy requires broad support across the party spectrum.

Getting the balance right between accountability and independence will not always be easy. Our non-executive directors (the first cohort of whom will be appointed shortly) can play a valuable role here. Their task is to help ensure that we fulfil our duty in line with the principles of good behaviour set out in the Act – and they will report on our success or failure in doing so in our annual reports. They can offer a

useful second opinion and channel of communication if we in the OBR are concerned about the behaviour of the politicians or if the politicians are concerned about ours.

Direct comparisons are hard to make, but I suspect that our formal governance and accountability arrangements offer a pretty strong underpinning for our independence when judged by international standards. Calmfors and Wren-Lewis argue that formal arrangements to guarantee independence are rare for most other fiscal watchdogs, noting for example that watchdog members generally have shorter terms of office than monetary policy committee members (the opposite being true in the UK). Calmfors and Wren-Lewis argue that: “The lack of formal safeguards for the independence of fiscal councils means that they – much more than central banks – have to rely on the informal independence they can acquire through building a reputation for impartial and well underpinned analysis”. However strong our formal arrangements may be, the same surely applies to us.

5. Demonstrating independence: transparency

If we are to build a reputation for impartial and well underpinned analysis, transparency will be crucial – transparency regarding our interactions with government and transparency regarding the conclusions that we reach.

Let me say a bit about each.

As I have already mentioned, the Chancellor’s decision to outsource the official public finance forecasts to the OBR requires us to have frequent and detailed interactions with those government departments that have expertise in particular revenue and spending streams and those that are involved in the design of specific tax and spending measures. We also have contacts with the Chancellor himself, notably to provide him with draft forecasts that indicate whether we think action is necessary for him to remain on course to achieve his fiscal targets. He can then decide whether to adjust policy accordingly, before we finalise our forecasts.

We endeavour to be as transparent as we can about these interactions. All substantive meetings with the Chancellor, his special advisers and his private office are logged and published on our website. Our *Economic and fiscal outlook* documents set out the dates on which we submit draft forecasts to the Chancellor and when he and his officials receive the final publication so that they can prepare his statement to Parliament. We publish the deadlines by which we have to be informed of policy measures, in order to guarantee that we can incorporate them in our economic forecasts or ratify their costings. And we list any measures that were revealed to us after these deadlines and say how we have dealt with them. We have also published a detailed briefing note setting out which departments we deal with to forecast each tax and spending stream and the key judgements that are involved.

The fact that we have relationships with multiple departments is sometimes underappreciated by outside observers, who imagine a simple and intrinsically

hostile relationship between us on one side of the table and “the government” or “the Treasury” on the other. The reality is more complex than that. We deal with Treasury ministers, officials from different parts of the Treasury and officials from other departments – and their incentives and instincts are not necessarily uniform. In the numerous trilateral challenge and scrutiny meetings at which we discuss particular policy measures or parts of the fiscal forecast, the Treasury and HMRC or DWP do not arrive with a “line to take” to defend against us. There is a genuine desire by everyone to probe what the data and analysis has to tell us.

Needless to say, government departments have much more resources than we do and some observers wonder whether we can avoid having the wool pulled over our eyes as a result. I don’t think that this is too much of a risk if we have the right mix of skills, a combination of inside experience and outside perspective. This is one reason why having some staff and BRC members from the ranks of former Treasury, HMRC and DWP officials is a strength rather than a weakness. They are well equipped to challenge their former departments and often relish the opportunity too.

These engagements with the Treasury and other departments necessarily involve additional formality, time and effort, compared to the days when it was only a table for two. We have to set out and keep to a timetable for the exchange of information, to ensure that the process can be concluded in time for us to prepare our publications, the Chancellor his statement, and the Treasury their publications and briefing. Together with the need for consultation between the coalition parties, this creates an incentive to avoid last minute policy decisions so that everyone can be satisfied that they have received adequate scrutiny. Late political decisions have long been one of the weaknesses of British Budgets and the incentive to avoid them whenever possible is a very welcome consequence of the new framework.

To demonstrate the quality and impartiality of our work, we also need to be as transparent as possible in the analysis we produce. The more we “show our working”, the more people can see why we have reached the conclusions that we have and reassure themselves that they are based on sound professional judgement (even if they disagree with our conclusions). To that end we have significantly increased the amount of analytical detail in our *Economic and fiscal outlook* publications. For example, we now publish detailed diagnostics tables explaining why our forecasts for particular revenue and spending streams have changed from one publication to the next. We have revamped the presentation of public spending forecasts, pruning away billions in obscure ‘accounting adjustments’. We are publishing more of the variables and assumptions that underlie the forecasts. And we release additional material underpinning the forecasts if people request it after publication. We have also enhanced transparency by publishing more detail of the forecasting process and more information on our methodology – for example the techniques we use to estimate the amount of spare capacity in the economy.

The Treasury has also made an important contribution to the transparency of the Budget process with the publication of its new policy costings documents. These set out the analytical and empirical basis for the costing of each tax and spending

measure, including a description of the tax base and an assessment of any assumptions about behavioural effects. These documents reflect the conclusions of the challenge and scrutiny process that we engage in and they include an annex by the OBR in which we highlight particular uncertainties and risks to the estimates.

We have been very pleased by the reaction to all these innovations in transparency, but they remain work in progress and comments from users are very welcome.

5. Conclusion

By describing the remit that we have been given, and the way in which we intend to pursue it, I hope that I have done something this evening to persuade you that the OBR can make a difference for the better to the management of the public finances and to informing the public debate about the policy choices that this involves.

All economic and fiscal projections – medium or long term – need to be treated with caution, given the enormous uncertainty that surrounds them. But contracting official projections out to an independent body – with no political axe to grind and with access to all the information that ministers have access to – should allow us to increase public trust in the evidence base on which policy is built. People may disagree with our assumptions or conclusions, but I hope that they will come to recognise that what we say is informed by the best available data and reflects our best professional judgement rather than politically motivated wishful thinking.

Needless to say, while economic and fiscal forecasting are difficult tasks at the best of times, these are not the best of times. The budget deficit has barely fallen from its post war high, the economy is still struggling for momentum, there is significant uncertainty about our medium-term growth prospects, and there is considerable disagreement about the appropriate path of fiscal policy. But it is not for us to complain. We must simply set out our judgements as clearly and convincingly as we can, while being honest about the scale of the uncertainties that surround them.

Our credibility will depend not just on our forecasts, but on what else we do to inform public debate about the fiscal challenges that we (and many other countries) face. That is why next month's long run *Fiscal sustainability report* is such a challenge and such an opportunity for us. There are many dimensions to long-term sustainability and to the health of the public sector balance sheet, certainly too many to do full justice to in a single report. So this will be a first step. We will need to set out a framework for the analysis and then build up the analytical and evidence base year by year. And we will be very keen to hear your reactions to our efforts in this, and in all our work, to help shape the work programme that lies ahead.

With that request, let me conclude by thanking the University for its invitation to speak here today and you for your attention.