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Press Notice

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Chancellor announces policies to enhance fiscal credibility

Independent Office for Budget Responsibility created

Chief Secretary sets out £6 billion reduction in 2010-11 spending

Sir Alan Budd will chair a new Office for Budget Responsibility (OBR), established on an interim basis today, to assess the state of the public finances, the Chancellor has announced.

The Chief Secretary will meet Cabinet colleagues this week to agree £6 billion of cuts in this year's spending. This is to make an immediate start on tackling the UK's unprecedented £163 billion deficit, boosting credibility and helping keep interest rates lower for longer.

This decision follows advice from the Treasury and the Bank of England on the feasibility and advisability of acting quickly.

The Government is also today announcing that it will re-examine all spending approvals made since 1 January, to ensure that they are consistent with the Government's priorities and good value for money.

The fiscal framework since 1997 and its consequences

From 1997, the key decisions on tax and spending were determined by a fiscal framework based on meeting a set of fiscal rules. Whether those decisions were consistent with meeting the rules in the future was measured using forecasts for borrowing made by the Chancellor. While the Treasury produced economic and fiscal analysis and used its macroeconomic and other models to forecast the economy and the public finances, the key judgments used to produce the forecasts under successive governments were the Chancellor's.

The potential incentive to optimistically forecast lower borrowing and higher growth, and so delay necessary measures to strengthen the public finances, led to scepticism over the credibility of the Government's forecasts. Budget forecasts over the last decade consistently underestimated borrowing, compared to both outturn and independent forecasts made at the time.

Confidence and credibility – removing politics from forecasting

The OBR will make an independent assessment of the public finances and the economy for the emergency Budget. For the first time, the forecasts will not be determined by the Chancellor's judgements; the Chancellor will accept the forecasts from the OBR for the Budget and Pre-Budget report. The independence of the OBR's judgements will ensure that policy is made on an unbiased view of future prospects, improving confidence in the fiscal forecasts.

The Chancellor will retain responsibility for fiscal policy and will set the fiscal mandate, his target for fiscal policy. He has instructed the Treasury to provide the OBR with full access to the data and analysis necessary for it to scrutinise the public finances.

In each Budget and Pre-Budget Report the OBR will confirm whether the Government's policy is consistent with a better than 50 per cent chance of achieving the forward looking fiscal target set by the Chancellor. Basing policy decisions on a realistic assessment of the public finances, including of the uncertainty inherent in any forecast, will improve the quality of fiscal policy-making.

International best practice

The OBR will put the UK at the forefront of international best practice, exceeding the IMF's recommendations on fiscal transparency. The UK will be one of the few advanced economies with an independent fiscal agency producing the official fiscal and economic forecasts on which budget decisions are made.

Operation of the interim OBR

The Treasury will set out more detail on the terms of reference for the OBR's independent assessment of the public finances and how it will assess the sustainability of the public sector balance sheet in the coming weeks.

Sir Alan has recommended that the Treasury appoint Geoffrey Dicks and Graham Parker to complete the 3-member Budget Responsibility Committee. They will lead the work of the OBR on an interim basis.

The Queen's Speech will provide for legislation to establish the OBR on a permanent, statutory basis. Sir Alan Budd and the BRC will be advising the Chancellor on the arrangements for the permanent OBR.

The Chancellor said:

> " If we don't get on top of our debt, every family in Britain will be poorer and the dreams of millions of young people will be dashed. Mortgages will be higher, businesses will go bust and debt interest will become one of the largest items of government spending.
>
> We urgently need to restore confidence in our economy. And we need the determination to act quickly in the short-term in order to establish credibility for the longer term.
>
> So, in the space of less than a week this new coalition government has already:
>
> - changed the way that Budgets are made, forever;
> - created a new independent office that will restore confidence in the numbers that underpin the budget;
> - set in train the creation of the first independently audited national balance sheet;
> - confirmed immediate action to identify £6 billion of wasteful spending this year, while protecting the most vulnerable in our society and the quality of front line services on which people depend;
> - and set out the steps towards an emergency Budget that will show that Britain can live within its means and will provide the solid foundation for a private sector recovery.
>
> That is the route to a stable, balanced economy that works for everyone."

Sir Alan Budd said:

> "It is quite remarkable that the Chancellor has given us the authority to produce independent forecasts for the Budget and Pre-Budget Report and to provide a public assessment of the action needed to achieve his fiscal mandate, and I consider it the most exciting challenge of my professional life.
>
> We are not claiming that we shall get the fiscal forecasts right; it is easy to demonstrate that that is impossible. Above all, we shall be emphasising the risks and

uncertainties; but every judgement will be ours and we guarantee the independence and integrity of our work. We shall also increase the transparency of the forecasting process. We hope that the result will be greater credibility and an improvement in the quality of the fiscal decisions that will have to be made. "

Starting to act on the deficit now

£6 billion of spending cuts, a down payment towards reducing the deficit, will go ahead as set out in the coalition agreement, the Chancellor and Chief Secretary also announced. Advice from the Treasury and the Bank of England has confirmed the feasibility and advisability of beginning to tackle the deficit this year, and that the economic case for doing so is strong.

Detailed work has already been undertaken on where the cuts will fall and how they will be delivered.

Over the next week the Chief Secretary will meet with Secretaries of State to agree how their department will contribute. These contributions will be set out next Monday.

The Government is satisfied these savings can be taken out of budgets this year without affecting the quality of priority frontline services to the public. There will be savings from cutting back on lower priority programmes, but beyond these, Secretaries of State will guarantee that savings are implemented in a way that does not affect the quality of public services.

As already agreed, the Devolved Administrations will be given the option of deferring their fair contributions to this year's savings until next year, in recognition of the fact that the devolved legislatures have already approved spending plans for the current year. But these savings will still be made.

Given the state of the public finances, the great majority of these savings will be used to reduce the deficit. Some proportion will be used to support jobs in a targeted and effective way, as set out in the coalition agreement.

Re-examining spending decisions made this year

The Chief Secretary has also today written to Secretaries of State asking them to re-examine all spending approvals since 1 January this year and all pilot schemes. Proposals that required Treasury approvals will have to be resubmitted to the Treasury.

Where projects are good value for money and consistent with the Government’s priorities, they will go ahead. Where they are not, it would be irresponsible to waste money on them. There is no point in continuing pilot schemes where they are too costly to implement.

Chief Secretary to the Treasury, David Laws, said:

> “The Chancellor and I are united in our resolve to deal urgently and decisively with the unacceptable state of our public finances. It is both possible and necessary to start taking action this year.
>
> By making an early downpayment we are not only helping to reduce the deficit faster, we’re sending a clear and strong message that we intend to do what's needed to repair our public finances and get our economy moving again.
>
> We can make these cuts while protecting the quality of key frontline services.”

Notes for Editors

The previous fiscal framework

1. A new fiscal framework was introduced in 1997:

   - The framework was specified in the Code for Fiscal Stability.
   - Under the provisions of the Code, the Government set two fiscal rules: the Golden Rule and the Sustainable Investment Rule.
   - The Code for Fiscal Stability stated that, in each Budget Report, the Government must provide "an economic and fiscal projection, an explanation of significant fiscal policy measures introduced in the Budget, and an explanation, where necessary, of how these policy measures restore the path of the public finances to a position consistent with the fiscal policy… rules"
   - In line with this, the assessment of whether or not the Government's tax and spending decisions were sufficient to place it on track to meet its fiscal rules was based on the Budget fiscal projections for borrowing and debt.
   - The Chancellor determined the forecast presented in Budget and Pre-Budget Reports, as required by the Industry Act 1975, taking key judgements on the basis of macroeconomic and fiscal analysis and advice produced by the Treasury.

Forecast performance

2. The Government's forecasts since 2000 have, on average, underestimated borrowing when compared with outturn figures.

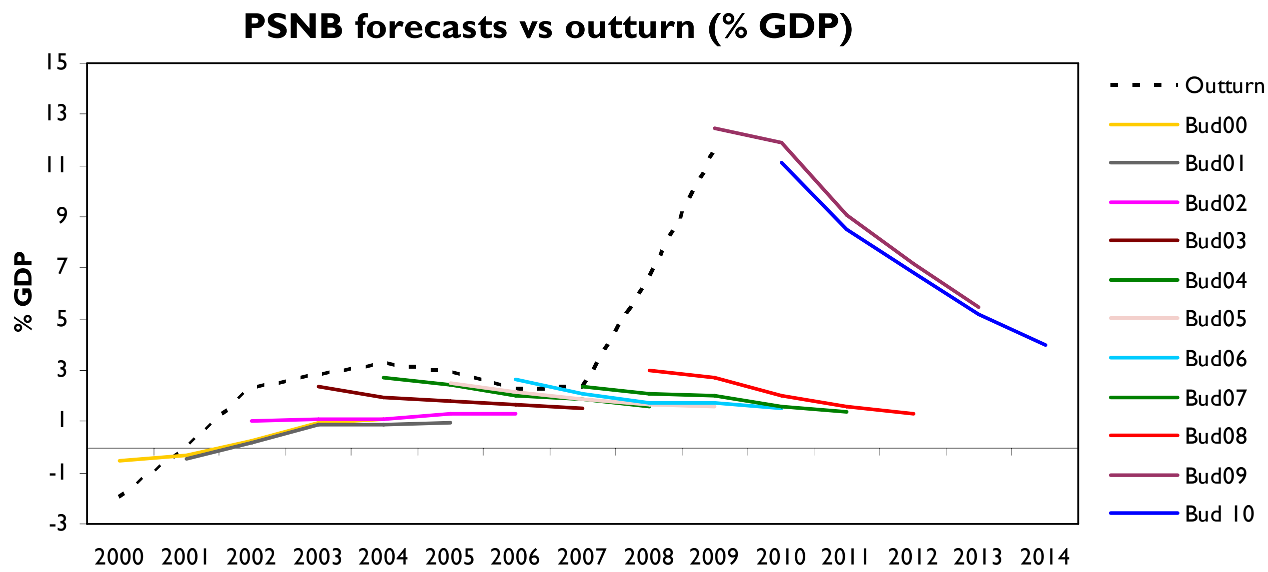
3. All forecasts for borrowing for more than one year ahead since Budget 2000 have underestimated borrowing. The average one year ahead forecast was 0.4% of GDP lower than outturn between Budget 2000 and Budget 2009, with average 5 year ahead forecasts 3.5% of GDP lower than outturn, equal to £52bn in today's prices.

	1 year ahead	2 year ahead	3 years ahead	4 years ahead	5 years ahead
Average Forecast error	-0.4	-2.2	-2.8	-3.1	-3.5

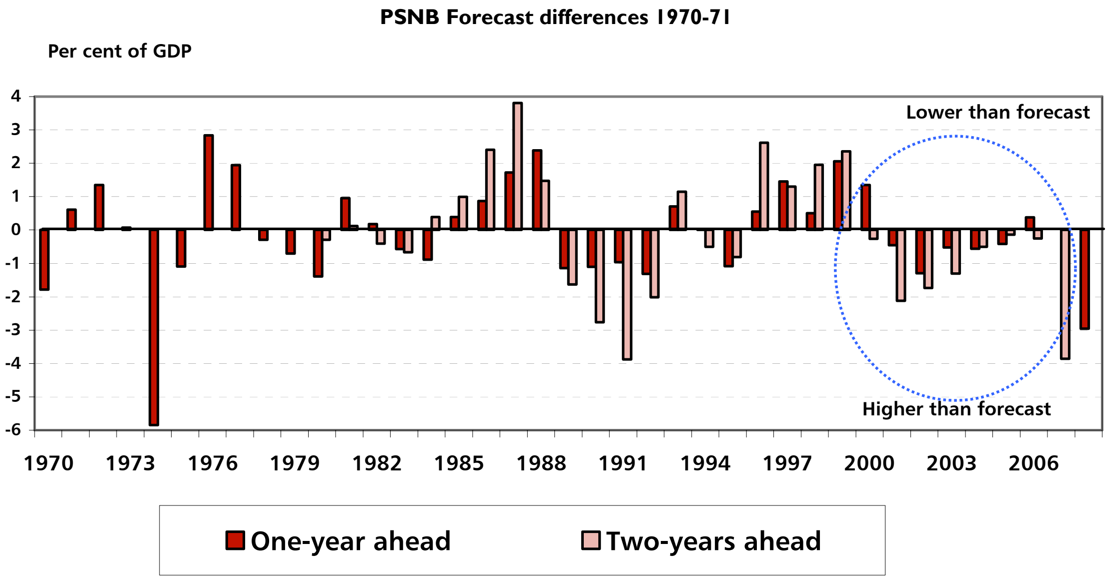
	Forecast Error (£bn)	
	One year ahead	Two year ahead
Budget 2000	13.3	-2.8
Budget 2001	-4.8	-23.1
Budget 2002	-14.1	-20.1
Budget 2003	-6.1	-15.8
Budget 2004	-6.8	-6.4
Budget 2005	-5.4	-1.9
Budget 2006	5.1	-3.5
Budget 2007	0.2	-66.6
Budget 2008	-53.6	-125.1
Budget 2009	11.9	
Average	-6.0	-29.5

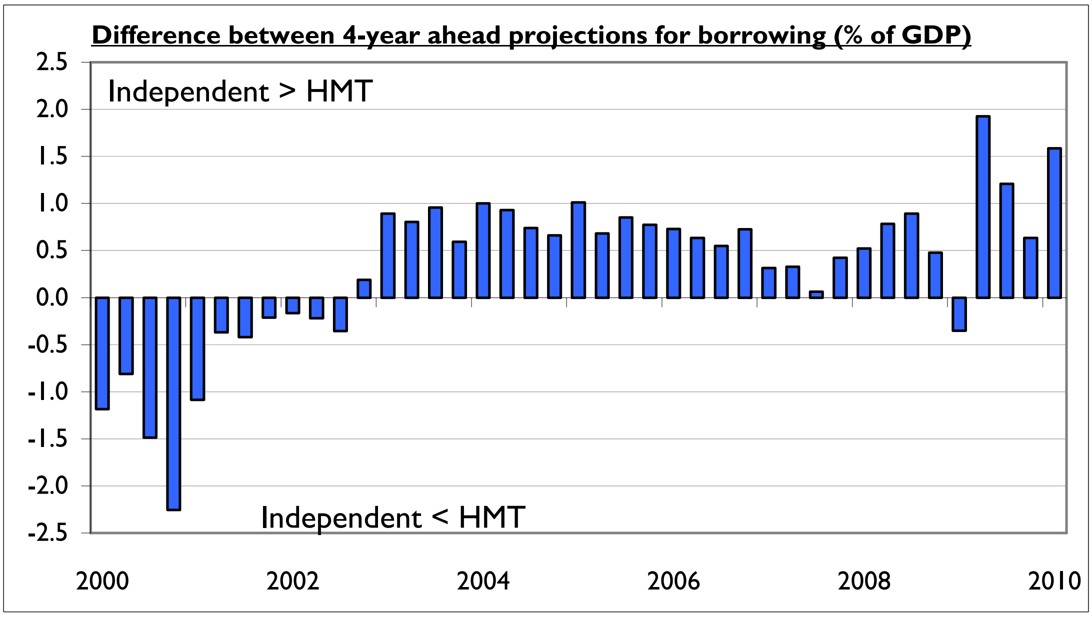
	Forecast Error (% GDP)	
	One year ahead	Two year ahead
Budget 2000	1.4	-0.3
Budget 2001	-0.5	-2.1
Budget 2002	-1.3	-1.7
Budget 2003	-0.5	-1.3
Budget 2004	-0.6	-0.5
Budget 2005	-0.4	-0.1
Budget 2006	0.4	-0.2
Budget 2007	0.0	-4.6
Budget 2008	-3.7	-8.9
Budget 2009	0.8	
Average	-0.4	-2.2

Note: In the tables above, a negative number shows that forecast was lower than outturn.



4. Since 2000, The Government's forecasts continued to display the serial correlation of forecast errors that has been characteristic of them over the longer term. A series of overestimates of borrowing over a period of years were followed by a series of underestimates.





5. The Government's forecasts for borrowing in the medium term have consistently been below those of independent external forecasters. Over the last decade, the Government's forecasts for borrowing 4 years ahead have on average been 0.3% of GDP below the independent average, or around £5bn.

6. The Budget 2010 forecast for growth is above the average of independent forecasts. The forecast for borrowing is below the independent average.

GDP Growth

	2009	2010	2011	2012	2013	2014
Budget 2010 (March)	-5	1 - 1½	3 - 3½	3¼ - 3¾	3¼ - 3¾	3¼ - 3¾
Independent Consensus[1]	-4.9	1.3	2.1	2.4	2.7	2.5

[1]Forecasts for 2010 & 11 based on April Consensus, forecasts for 2012-14 based on February.

Public Sector Net Borrowing

	2010-11	2011-12	2012-13	2013-14
Budget 2010 PSNB Forecast (March)	163	131	110	89
Independent consensus[1]	168.8	146.9	126.1	116.3

[1] Forecast for 2010-11 and 2011-12 based on April consensus and 2012-13 and 2013-14 based on February

Role of the OBR

7. The OBR will make independent assessments of the public finances and the economy. It will have direct control over the forecast and make all the key judgments that drive the official projections. It will have full access to the necessary data and analysis produced by the Treasury.

8. In addition, the OBR will present a range of outcomes around its forecasts to demonstrate the degree of uncertainty. Based on these range of outcomes, in each Budget and Pre-Budget Report the OBR will confirm whether the Government's policy is consistent with a better than 50 per cent chance of achieving the forward looking fiscal mandate set by the Chancellor.

9. The OBR will also have a role in making an independent assessment of the public sector balance sheet, including analysing the costs of ageing, public service pensions and Private Finance Initiative contracts.

International fiscal institutions

10. The OBR will be at the forefront of international best practice in terms of the role that independent fiscal institutions play in the budget process. The IMF's Code of Good Practices on Fiscal Transparency states, "Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions." The OBR goes one step further, in that it will make the official forecasts and not simply scrutinise the Government's. The IMF has also said that "strong fiscal institutions can enhance the credibility of consolidation plans, which could mitigate any adverse short-term impact of fiscal withdrawal on activity."

11. The roles and responsibilities of the OBR will go beyond many existing independent fiscal institutions in other countries, such as:

   - the Congressional Budget Office in the United States, which produces regular projections for public finances and scores the borrowing implications of all legislative proposals for Congress but not for the Administration, and does not make recommendations on the scale of fiscal adjustment;

- the Fiscal System Council in Japan, which provides advice on budgetary issues, but does not produce forecasts; and
- the Parliamentary Budget Office in Canada. This produces reports on economic and fiscal analysis as a service to Parliament, but these are not adopted as the official forecasts.

12. The UK will be one of the few advanced economies with an independent fiscal agency producing the official fiscal and economic forecasts on which budget decisions are made.

Membership of the OBR

13. The interim Office for Budget Responsibility will be located in the Treasury building, to reduce costs and to ensure access to data and analysis.

14. The 3-member Budget Responsibility Committee will be supported by a small secretariat of economists and public finance experts redeployed from within the Treasury. The interim OBR will draw on experts from within the Treasury.

15. Sir Alan Budd will chair the OBR on an interim basis. He held various academic roles before he became a senior economic adviser in HM Treasury between 1970 and 1974. During the 1980s he was professor of economics and director of the Centre for Economic Forecasting at the London Business School. Between 1991 and 1997, he was Chief Economic Adviser to the Treasury, and headed the Government Economic Service. He served as a founding member of the Monetary Policy Committee of the Bank of England between 1997 and May 1999. He then served as Provost of Queen's College, Oxford. Among his activities as an economist, he is a governor of the National Institute for Economic and Social Research; a founder member of the UK-Japan 21st Century Group; an executive editor of World Economics; a member of the editorial advisory board of the Oxford Review of Economic Policy; and an adviser to the Observatory Group. He is also a senior adviser to Credit Suisse and Brevan Howard Asset Management. Ongoing appointments have been suspended for the duration of his chairmanship of the OBR.

16. Geoffrey Dicks will be a member of the Budget Responsibility Committee. He has held various roles in the public and private sectors, working as an economist in the Department of Employment, (1970-72), teaching at University College School 1973-75) and in various roles as a researcher and associate professor at the Centre for Economic Forecasting at London Business School (1976-1993). From 1993 to 2009, he was Chief UK Economist for NatWest Market/RBS Global Banking and Markets. Since then, he has been Chief Economist at Novus Capital. He has appeared before parliamentary select committees to provide expert evidence

on the economy and written widely in the media on economics. He is on sabbatical from Novus Capital for the duration of his membership of the OBR.

17. Graham Parker will be a member of the Budget Responsibility Committee. Graham worked in a variety of civil service roles from 1972, including 7 years working on manpower planning, 5 years advising on economic statistics, 13 years providing analysis, forecasts and policy costings for the Inland Revenue and 9 years as head of the Public Sector Finances team in the Treasury, forecasting the whole of public sector expenditure, receipts and advising on the fiscal position. He was awarded a CBE in 2008 for his service to the Treasury and his work on the public finances. Following his retirement in January 2009, Graham was appointed to the IMF Fiscal Affairs Division's panel of technical experts in July 2009.

Spending reductions in 2010-11

18. The Government has committed to setting out detailed spending plans for the rest of the Parliament at the spending review in the autumn. But it also agreed that there was a case for starting to reduce the deficit before then – with cuts of £6 billion to back office and low priority programmes.

19. The Treasury has undertaken work on how these cuts should best be implemented. It expects savings to be made:

    - in discretionary areas like consultancy and travel costs;
    - through doubling the current delivery plans for savings in IT spending;
    - from immediate negotiations to achieve cost reductions from the 70 major suppliers to government;
    - from reductions in property costs;
    - from restraining recruitment;
    - by cancelling wasteful projects like ID cards; and
    - from cutting other lower value spending.

20. The Treasury has assessed the potential economic impact of these plans, and has concluded that the economic case for an immediate spending reduction of £6 billion is strong. Any direct impacts of such a reduction that might arise should be modest and there are a number of offsetting positive indirect effects, including the reduction of downside risks from adverse market conditions. The overall impact is likely to be positive due to the commitment to a credible fiscal consolidation plan and a potential reduction in long-term interest rates.

21. To undertake due diligence on the inheritance of the Government, all spending approvals since 1 January and all pilot schemes are being reviewed. Where Treasury approval is required, proposals are being resubmitted. Where there are potential implications for projects already underway, decisions will be fast-tracked.

Non-media enquiries should be addressed to the Treasury Correspondence and Enquiry Unit on 020 7270 4558 or by e-mail to public.enquiries@hmtreasury.gsi.gov.uk

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