



Economic Affairs Committee

Uncorrected oral evidence: The UK's fiscal framework

Tuesday 13 January 2025

3 pm

Watch the meeting

Members present: Lord Wood of Anfield (The Chair); Lord Agnew of Oulton; Lord Blackwell; Lord Burns; Lord Davies of Brixton; Lord Lamont of Lerwick; Baroness Liddell of Coatdyke; Lord Liddle; Lord Londesborough; Lord Petitgas; Lord Razzall; Lord Turnbull; Lord Verjee; Baroness Wolf of Dulwich.

Evidence Session No. 7

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Questions 90 - 109

Witness

I: Richard Hughes, former chair, Office for Budget Responsibility.

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Examination of witness

Richard Hughes.

Q90 **The Chair:** Welcome to the Economic Affairs Committee's seventh evidence session for our inquiry into the UK's fiscal framework. Richard Hughes, the former chair of the Office for Budget Responsibility, is our witness today. Richard, we are delighted that you have come along; happy new year to you. This is being broadcast on parliamentlive.tv and, as usual, a full transcript will be taken which we will make available to you shortly after the meeting in case you want to make any corrections. Thank you very much for your time; we are really grateful.

Richard Hughes: Thank you, Chair, and good afternoon, everyone. It is a great pleasure to be before the committee once again. As this is my first parliamentary appearance since I stood down as chair of the OBR, with your permission, I would like to say a few brief words about the circumstances that prompted my resignation last month, before coming on to the topics of this committee around the OBR and the UK's fiscal framework.

I want to start by apologising to Parliament, the Chancellor and the Prime Minister for the inadvertent early release of the OBR's *Economic and Fiscal Outlook* on the morning of Wednesday 26 November. It was a technical but serious error. What happened that morning disrupted the most important event in Parliament's weekly calendar, PMQs, and one of the most important events in Parliament's annual calendar, the Chancellor's Budget Statement. It also had an impact on financial markets.

As soon as it happened, I initiated an investigation, led by the OBR's non-executive directors and with input from the country's foremost cyber security expert, Professor Ciaran Martin. That investigation was completed within a few days. It reported publicly to the Chancellor and the Commons Treasury Committee the following Monday. The report explained what happened and why, and how the OBR can make sure that it never happens again. I took full personal responsibility for all the shortcomings identified in that report and submitted my resignation to the Chancellor and the chair of the TSC that same day.

Let me say something about what that regrettable incident means for the OBR's reputation and future. The OBR is a 15 year-old organisation comprised of 52 staff, with a budget of £6 million. But over those 15 years, and despite the limits of its size and resources, I think the OBR has earned people's trust as the country's independent economic and fiscal forecaster. The OBR has not earned that trust by not making mistakes. It is led by human beings, and human beings make mistakes. People trust the OBR because when we make mistakes, we admit to them, take responsibility for them and learn from them to make our ability to do our jobs even better.

That is true of the mistakes we make in our forecasts. Every year, the OBR devotes an entire 60-page document, the *Forecast Evaluation Report*, to identifying the mistakes made in our previous economic and fiscal forecast and talking about how we will make sure that we fix them and do not make them in the next one. We applied that same OBR ethos to the mistakes we made on Budget Day, which were not in the content of our forecasts but in the process for publishing it.

I hope that this has demonstrated to you and others that, even when it makes mistakes as serious as what happened that day, you can trust the OBR to hold itself to the highest standards of openness, integrity and accountability. I am certain that my former colleagues David and Tom, chief of staff Laura and all the staff at the OBR are already taking all the steps necessary to ensure that such errors do not happen again.

Q91 The Chair: Thank you very much for that statement. I am sure that some of my colleagues will want to pick up some of the things you have mentioned in that opening set of remarks, but I will start with a general question on the contribution of the OBR to fiscal stability in our country. It is a slightly devil's-advocate question. How do we know that the OBR has been a force for good? What are the signs? Given that we all know that debt to GDP has been rising, and your projections are that it will continue to be an issue in the future, what are the metrics by which we evaluate whether the OBR has been a positive force since its inception for the health of UK fiscal policy and of the UK economy?

Richard Hughes: I am conscious that this is an inquiry into the UK's fiscal framework, which comprises the rules that the Government set for themselves, the role of the OBR in forecasting, whether the Government are on track to meeting those rules, and the kind of procedures and processes that the OBR and the Treasury follow in putting together that forecast and making those policy decisions.

To hone in for a moment on the role that the OBR has played in that process, as I said, the organisation has been around for 15 years. Other fiscal councils, such as the CBO in the US and the CPB in the Netherlands, have been around for decades, and much longer than the OBR. But in its short time in existence, I can point to three areas where the OBR has made a positive contribution.

The first thing to say is that the OBR has been a decent forecaster, bearing in mind that, for all of my tenure and much of that of my predecessors, the OBR was forecasting in the midst of four of the biggest shocks the UK has faced in its post-war history. As I said, we do a regular annual review of our forecasting record, but we also produced a much more detailed and comprehensive assessment of our entire forecasting record since the OBR was established back in 2010, and the OBR's forecasting record compares favourably to other UK and official international forecasters. Our forecasts were also more accurate and less biased than those previously done by the Treasury. One of the missions of the OBR is to take the bias out of economic and fiscal forecasting, and it has helped to deliver that.

That applied over the first three years of the forecast in particular. Years four and five have been a challenge for forecasters like the OBR, partly because it has fewer outside forecasters to benchmark itself against. As I think you heard from other experts, the Bank of England stops at three years, and lots of other private sector forecasters also stop at the two or three-year mark, so you have fewer points of reference when looking at the forecast four or five years out.

The other well-understood reasons why our forecasts in years four and five have been more challenging have been around being too optimistic about the outlook for productivity, which was acknowledged by the OBR in its most recent forecast, and the inevitable consequence of shocks. A real challenge for all economic forecasters and policymakers is that we do not assume that there will be a recession when we produce our forecasts, but we know that they are inevitable. That means that the risks and forecasts can be skewed toward the downside—especially recently, when we have seen lots of busts and relatively few booms.

On the fiscal side, one of the reasons why it has been more challenging to deliver good forecasts over years four and five has been that those tend to be the years where Government do not have detailed plans for departmental spending. That has been the single biggest source of a delta in the fiscal forecast—and almost always on the upside. When the Government get beyond the period where they have detailed fiscal plans, they tend to revise. They tend to assume at the outset very slow growth in spending, but when it comes down to dividing that up between health, education, transport and defence, they add £10 billion, £20 billion or £30 billion to the total in order to make those plans deliverable around the Cabinet table and against the Government's policy objectives.

As a forecaster, the OBR has been pretty good. When you compare our track record to others, it compares pretty favourably. Where the OBR has made an undoubted contribution has been in the area of transparency around those forecasts. That is the second area I would underscore in which the OBR has contributed to policy-making. Where outside organisations have come in and benchmarked the UK's fiscal transparency against the outside world, they have concluded that we are among the best, and a lot of that is down to the amount of detail that the OBR provides in its economic and fiscal outlooks. You get more detail about our macroeconomic and fiscal forecasts than you get in almost any other country—detail on what is in the central forecast, on alternative scenarios and on the policies that the Government are costing.

I should also stress that, in addition to what is in all the documentation the OBR produces, the OBR's whole ethos is to be responsive and transparent when asked questions about its forecast. Our principle when I was there, and under my predecessor, was that, if we have the information somewhere in a system in the building and people want to know it, we will disclose it, unless there is some legal reason why we cannot—it discloses confidential taxpayer information or something about policy under development.

Thirdly, and lastly, the OBR has made a contribution to improving analysis of the risks around the OBR central forecasts over the medium term through the use of sensitivity scenarios. During much of my time, because we were forecasting in the midst of either Covid or an energy shock, it was really important to understand what different paths for the virus or different trajectories for energy prices would mean for the economy and public finances. The OBR explores those scenarios in a way which Governments can be reluctant to, because they always want to give a deterministic view of the future, and they struggle to engage with a range of scenarios because they do not always have a plan for every scenario. The OBR underscores the uncertainty around its medium-term forecast and the need to take account of the fact that the world might turn out to be very different from what is in the central forecast.

In our *Fiscal Risks and Sustainability* report, we extend that work all the way to a 50-year horizon and look at the sustainability of the public finances over much longer periods. We not only look at what that means in the aggregate but dig down into some of the key things that might drive down tax revenues or drive up public spending, deficits or debt—be it the ageing population, the trajectory for health-related inactivity or upward pressures on defence spending. By bringing more attention to those issues of risk and sustainability, the OBR has enriched the public debate about the direction of fiscal policy.

Q92 The Chair: Thank you for that. I will follow up with a couple of small things. You rightly mentioned the fiscal risks work you do: the *Fiscal Risks and Sustainability* document. We have heard from various witnesses that they wish that the long-term work you do in that document would get more profile. Obviously, the OBR is always in the spotlight for the annual assessment of the Government's fiscal compliance, but less so when it does the *Fiscal Risks and Sustainability* report. Can you think of any way in which the system of responding to the OBR could help to elevate the issues that you raise in those reports on a regular basis?

Richard Hughes: Part of the answer is just to keep banging on about it, Kevin Costner-style: if you build it, in due course, discussion and policy-making will start to address the issues you highlight.

One thing we did during my tenure at the OBR was try to make the *Fiscal Risks and Sustainability* report not just a scary headline number but something with thematic chapters that dig down much more deeply into a set of sustainability issues, be they around health-related activity, climate change and net zero, different demographic scenarios or geopolitical risks. Those help draw attention to a set of discrete areas where there is potential—and, possibly, a need—to address policy.

By holding regular hearings on the risk and sustainability report, this committee and the Treasury Committee have made a really big contribution to drawing attention to that work. When I started out, we had hearings about the EFOs but no hearings about the FRS. Those have

definitely helped bring attention to these areas and the issues around risk and sustainability.

One thing that could be explored is whether you look just at the level of debt in 2070 and whether the trajectory of the deficit in 2070 provides enough richness on what “unsustainability” means when you look at fiscal policy. You could look at what you would have to do to the basic rate of income tax to bring the deficit towards a more sustainable position if you do not get those spending pressures under control. You could look at what it will mean if you let debt interest rise to 12% of GDP. If you wanted to keep the tax burden unchanged, what would that mean for how much you would have left to spend on education, health and other things? Illustrating the choices and trade-offs that an unsustainable fiscal position might force on the country would be one way of bringing home those messages.

Finally, a real challenge here—you do not have it with the EFO—is that the Government produce a forecast and the policy response is the Budget. With the FRS, the OBR produces the FRS and the Government’s response to it has become increasingly cursory over time. The first time the Treasury produced a response to the first FRS, which was back in 2017, it produced a document of more than 100 pages that talked about how it was going to address the issues raised in the FRS. The most recent Treasury response was 19 pages and came, I think, in a Written Statement to Parliament.

So there is no comprehensive report response from the Government; nor is there a parliamentary debate on the FRS on the Floor of the House in the same way as there is an extensive debate on the Budget. It is great that this committee and the Treasury Committee draw attention to that report but, for the moment, that is the extent of the parliamentary attention that is brought to it.

Q93 The Chair: That is very interesting; thank you. I have a follow-up question. I want to ask you specifically about the letter you sent at the end of the Budget process, which got a lot of attention. You sent a public letter to the Treasury clarifying the timeline of interaction between the OBR and the Treasury in the run-up to the Budget. Can you set out for the committee why you sent that letter? Presumably, it was in response to some elements of the process either that you found unsatisfactory or that needed clarification for future rounds of OBR-Treasury interaction. Can you explain what unsatisfactory elements you were seeking to draw attention to?

Richard Hughes: Sure. First, the OBR does not discuss the content of its forecasts with the media or anybody else outside the OBR, the Treasury or the departments involved in the preparation of the forecast in the run-up to Budget Day. However, in the run-up to the previous Budget, in the autumn, there had been an unusual volume of speculation. There is always speculation around what the Government are going to do with policy, to some extent, and it is natural for the Government to consult industry, business and other people. So the nature of those discussions

gets out and people understand that there are policies under development.

This was the first time in my 25 years of working in fiscal policy-making, both in the UK and in other places, when the volume of speculation around the content of the OBR's forecast was that great and that persistent. I became concerned that that could create a damaging impression of the OBR's professionalism and integrity in how it conducts the preparation of its forecasts.

Three perceptions in particular seemed to be doing the rounds. One was that the OBR had somehow been fickle and changeable in the judgments it had been making about the economic outlook; and that that was driving volatility in the policy-making process.

My second concern was around a very specific set of stories about how the OBR's forecast had changed at the very last minute after we had closed that pre-measures forecast; and that that had somehow prompted the Government to abandon their plans to raise income tax.

The third perception was that the OBR had somehow colluded with the Treasury around setting the window for the interest rates that we used in our medium-term forecasts; and that we had chosen a window that was particularly fiscally favourable for the Government because there had been a period in which expectations for gilt yields and the bank rate had been falling.

None of those three things was remotely true. We had taken all of the main decisions that we took in that forecast, on both the downgrade in productivity and the offsetting effects of higher rates of inflation and higher real wage growth, at the outset of the forecast. Actually, the variation in the bottom line was remarkably small between the first round and the final round of our fiscal forecast; the variation was a few billion, which was, by the standards of previous forecasts I had worked on, a very small amount in terms of what we were used to.

Also, in the middle of us doing the forecast, Vladimir Putin invaded Ukraine and energy prices quadrupled. Those sorts of things are in the nature of forecasting. We have a very turbulent external environment and a volatile domestic environment. Those kinds of variation must be dealt with but, in this particular exercise, there was none of that. It was not the case that variation in the OBR's judgments was driving policy; in particular, we did not make any changes to our pre-measures forecast after 31 October. Changes made thereafter were not made in the pre-measures forecast and do not explain decisions that were made on policy.

Finally, the decision that we took on the interest rate window that we used for the forecast was taken over the summer. We informed the Treasury of that decision in early September at a time when neither we nor the Treasury could have known whether that window was going to be especially auspicious or inauspicious for the public finances. It is important to clear up any misconception that we somehow did the

Treasury a favour in the last minutes to help alleviate fiscal pressures in that way.

I was conscious that we were going to get all those questions on Budget Day, given the amount of speculation around them and the stories in the media. I informed the Treasury that I planned to write to the chair of the TSC, and I got the Treasury's agreement to publish the letter. I had intended to send it on Budget Day but, given the events that subsequently occurred with the inadvertent release of the EFO, I felt that it was more important to prioritise our communications with the TSC on how we were addressing that much more important problem. Then, when the chair of the TSC asked me for a copy of the letter on 20 November, I sent it on.

Q94 Baroness Wolf of Dulwich: I have a quick follow-up question. You said—this has certainly been our impression, too—that the volume of speculation and discussion in the lead-up to this Budget was out of all proportion in comparison with previous years. Do you have any sense of why that was and whether there were any long-term aspects to it, or was it just a function of the particular state of politics last autumn?

Richard Hughes: I do not know. Part of it may just reflect the fact that people are coming to understand the work of the OBR and its interactions with the Treasury better. In some ways, people have a better sense of what happens at different stages.

The fact is that we published a timetable for the preparation of the forecast, which we started doing after a previous round of speculation around how we had moved the dates of things to make things convenient for the Chancellor. That was one of the reasons why we chose to be more transparent about the timetable. There had been a previous accusation that we had somehow chosen particular dates to be particularly favourable, so we wanted to be clear and say, "Look, we set these dates at the outset. Here they are". A key date is when we close the pre-measures forecast round because then, in effect, we are closing it to new data from the macro economy. So, out of a desire for transparency and accountability, we started publishing the timetable for the forecast.

That has provided a set of hooks for journalists to ask questions. One option is not to answer them and to say, "There's nothing to tell you about the OBR's round 2, round 3 or round 4 forecast". How we have got into a world where those questions are suddenly being answered, or at least speculated about by some people, I do not know.

Q95 Lord Agnew of Oulton: Good afternoon, and welcome back. I have a couple of questions on the bond markets. First, do markets really care about the Government meeting the fiscal rules? It is interesting that, in previous evidence sessions, we have had two almost completely conflicting versions; one referred to France flaunting its rules for nearly eight years without any consequence. I am interested to hear your view.

Richard Hughes: I am not a market participant but I have observed how markets have responded to Governments' fiscal policies, both here and in other countries where I have worked.

You have heard from market participants when you had them before the committee, such as Rupert and Sanjay, that markets welcome having a clear articulation of the Government's fiscal objectives, and the transparency of the OBR provides whether Governments are on track to meet those fiscal objectives. In a previous life when I was working at the IMF, and we would do these big cross-country empirical studies about the impact of things like fiscal rules and fiscal councils, we tended to find that well-designed fiscal rules and fiscal councils led to both better fiscal outcomes and also lower borrowing costs for the countries concerned.

We had our own natural experiments here in the UK back in the autumn of 2022, when we abandoned both fiscal rules and the fiscal forecasting function that the OBR provides. That led to quite a large and adverse market reaction and contributed to an increase in bond spreads of up to 100 basis points at its peak in the aftermath of the so-called mini-Budget. It was also telling that once those institutions were turned back on and the Government re-established some fiscal rules and brought the OBR back into the process for forecasting it, those spreads against US treasuries and German bonds more or less disappeared, at least for a time.

Therefore, markets value a clear statement of Governments' fiscal objectives and the transparency that the OBR provides about the outlook for the public finances. While it is true that countries like France have lower borrowing costs than ours, they are under a great deal of fiscal stress and their borrowing costs have been rising. It is always tricky to compare the UK with other countries within the eurozone, because to some extent they have a backstop in their bond market provided by the European Central Bank. They also have the disciplining power of being part of the eurozone and the European system where there are other instruments that impose fiscal discipline, whereas when you are outside that system, you have got to create those constraints for yourself. The Government here do not have the kind of backstop that eurozone countries have clearly been demonstrated to have had by recent crises.

Lord Agnew of Oulton: In an earlier session with us, you mentioned that there had been a tremendous number of changes to the fiscal rules over the last 15 years—it may have been as many as 10 changes. Does that not make a slight mockery of the process, and has it changed the way the bond markets view our behaviour fiscally?

Richard Hughes: The UK is very unusual in the number of fiscal rules it has had. We were early pioneers in fiscal rules back in 1997 when we first adopted them, but since then, the average shelf life of a fiscal rule in the UK is 2.8 years—that goes back to 1997. If you take it from 2010, the average fiscal rule is around for about 1.8 years. We should not be terribly surprised that fiscal rules are not binding on fiscal outcomes; they tend to not be around long enough. I am pretty sure it is not since 2005

that any fiscal rule has actually been around long enough for it to be assessed in outturn; it was always being assessed in prospect.

More recently, the fiscal rules we have had are only assessable in prospect, because they are always about what is going on in the forecast rather than what is going on in outturn. The lack of permanence that fiscal rules have had in the UK has meant that we should not be surprised that they are not particularly binding four, five, six, 10 years ahead, because they are very likely to be changed.

The fact that they always have this rolling nature means that even if the objective of the rule is to get the current Budget into balance, you have always got a few years to get there, so those rolling rules always provide a constant excuse for not making progress toward your final destination. For example, at the moment we have got a deficit of around 5% of GDP. The Government's objective is to get it down 2.5%, but that objective is not being met for another four years. That will eventually become three, but even so, the Government can repeatedly show a plan for getting to their objective without ever getting there under the rules that we have got.

Q96 Lord Lamont of Lerwick: I will follow up on some of the questions raised earlier about the pre-Budget situation. On 14 November, the Treasury briefed that it was rowing back on what it had previously briefed on 4 November about proposed possible income tax increases. Professor Miles, when he appeared before the Treasury Select Committee, said, "I think our concern was that there seemed to be a misconception that there had somehow been some good news", because I think the Treasury briefing had referred to better news. Was that a misconception? Perhaps you could comment on that.

Secondly, the Chancellor of the Exchequer repeatedly said before the Budget that the productivity review had downgraded productivity, and this meant lower tax increases. But was the productivity review not meant to be delivered in confidence to the Treasury?

Richard Hughes: On the first question, we made no changes to our pre-measures forecast after 31 October, when we closed our pre-measures forecast. All of the major judgments we had made about the outlook for the macro economy—both on the downgraded productivity but also the offsetting effects we had made to inflation and real wages, which more than offset the downgrade to productivity—had been made in the round 1 forecast. To that extent, there was no good news about the pre-measures forecast after 31 October because that forecast had been closed.

Those main judgments, including the offsetting effects of higher inflation and higher real earnings on things like income tax and VAT, had been made at the start of the process in early September. Those bits of briefing in the media, which I should say were attributed to Treasury sources—one never knows what those sources exactly mean, but they were not words that came out of the Chancellor's mouth—created a misconception that we had reopened our pre-measures forecast after 31

October, and I thought it was very important to correct that misconception.

Lord Lamont of Lerwick: The shadow Chancellor, Mel Stride, is making a speech today about the OBR, in which I understand from what I read in the *Financial Times* that he is saying that the OBR is a very valuable institution which ought to be preserved. But he also poses some questions, of which a couple were quoted in the *FT*. The first is: "Is the economic modelling" used by the OBR "sufficiently flexible to fully capture the dynamic impacts of policy?" That is probably referring to taxation policy in particular. Secondly, he says that the OBR should be prepared to be more open-minded about "innovative approaches", even if "there is little evidence that they have been tried before in the UK and shown to work". Are you open-minded about this, and what do you think about the first question about the dynamic effects?

Richard Hughes: I look forward to catching up with Sir Mel's speech. He is somebody who has made a lot of fiscal policy in his life, and he also chaired the Treasury Committee, so he knows a lot about the work of making fiscal policy, but also the work of the OBR in forecasting it.

The OBR has dynamic models for assessing all of government policy, both on the tax side and on the spending side. As I am sure we will get on to later in the session, over the last three years the OBR has taken a much more transparent approach to trying to assess the so-called supply side effects of policy changes and show it is working in its documentation about how things like reductions in taxes on labour supply can boost the labour supply and people's contributions to the workforce; how reductions in taxes on business can boost business investment; and how changes to the planning rules can boost house construction. We have tried to be more transparent in the way in which we capture those dynamic effects in our forecasts.

Previously, they had always been implicit in our economic and fiscal forecasts, but—both for the sake of transparency and accountability for the judgments we were making, and also for the sake of providing more predictability to policymakers about what kind of dynamic effects we might assume—we felt that it was only fair to provide more detail about how we make those judgments. I should say that we are always open-minded and keen for people to provide us with input, evidence and analysis that can help inform those judgments.

Be it the effect of tax changes on people's employment choices or the effect of planning reforms on house building, we always drew on the best empirical studies out there in the literature on which to base any judgments. If they existed in the UK, that was great, because they would take account of all the peculiarities of the United Kingdom. If they existed for other countries, we would do our best to transpose them on to UK experience and context. We always try to draw on the best empirical literature we would find. We thought it was important to have some empirical grounding to those judgments, and we are blessed in having

lots of really good macro and micro economists in this country who do lots of work on these kinds of areas.

One thing which I think the OBR and the Government could do more on is, where there are areas where they know they have an advanced and future policy agenda, to get some good pieces of analysis to say, "Look, you want to make this change to labour taxation or to business taxation. What would a good panel regression show you about the impact of that on people's decisions to work or remain at home, or businesses' decisions to invest or not invest?", so that when those policies are mature and announced to Parliament, the OBR is in a position to take full account of their impact.

Lord Lamont of Lerwick: Lastly, and very briefly, does the UK have the right fiscal rules given the current economic fiscal circumstances? Was policy tightening at the start of this Parliament appropriate given the background situation? In other words, is the fiscal framework too procyclical?

Richard Hughes: Fiscal policy was actually loosened at the start of this Parliament. The fiscal rules that we now have in place are among the loosest that the UK has had in its history, in that balancing the current Budget means that the Government can borrow, based on their current investment plans, up to around 2.5% to 3% of GDP every year. As I said, because it is a rolling target, it needs to get there only in three years' time rather than be there at any point in time. So at the moment it is allowing us to run a deficit of just under 5% of GDP, and most of that is structural. The economy looks reasonably close to trend, given where inflation and unemployment are. Much of the borrowing that the Government are doing right now is structural borrowing. Therefore I do not see much element of the Government being constrained in their ability to support the economy at the moment. If anything, the rules that we have at the moment are providing the Government with the capacity to run quite a significant structural deficit.

The Chair: I have just a quick follow-up to that. One of the things this Chancellor has done is to change the measurement of debt from targeting net debt to net financial liabilities. Has that changed the way the Government approach borrowing? Do you think they are taking advantage of that? Has behaviour switched as a result of the change in the way we measure debt?

Richard Hughes: It is a significant change to the fiscal rules the UK has traditionally had. As you said, they have usually just focused on net debt, which means that, on the basis of that measure, the Government could offset the borrowing that they did essentially against only holdings of cash or other countries' debt. What moving to net financial liabilities allows the Government to do is to borrow so long as they are investing in a financial asset—in some kind of financial instrument—so that means either the issuing of a loan or the purchasing of equity. It still does not allow the Government to borrow to invest in fixed assets, such as

schools, hospitals, railways and military equipment, but it gives them that additional flexibility to borrow to invest in financial assets.

Based on what we have seen so far, I would say that the Government have made relatively limited use of that additional flexibility. Back in the spending review they announced over the summer, looking out over the next three or four years, the Government increased the amount of what are called financial transactions—so loans and equity investments—by around £2 billion per year, which is not a very significant increase in that kind of investment given how much they are doing elsewhere.

On why that has happened, I think it is partly because the Treasury has had a very sensible idea, which is to corral the investment decisions in a handful of expert institutions: the National Wealth Fund, something called the National Housing Bank, and a few others, where you have expertise in project assessment, making this kind of portfolio management and these kind of investment decisions. Some of these institutions are very new, and I think it is just taking a bit of time for them to get going. But another reality is that, in practice, the Government are still quite constrained on just the gross financing side. The Government still have a relatively high gross financing requirement and gross debt issuance of around 8.5% of GDP, and they still have a net cash requirement of over £100 billion most years. That just means that, even if the Government might want to invest in lots of loans and equity investments, they still feel constrained and conscious that there is a limited appetite for going out there and borrowing lots of money on financial markets.

Q97 Lord Razzall: We have had a lot of evidence that the current rules incentivise Governments to operate without a significant fiscal buffer. Indeed, some of us, and certainly I, suspect—not from our evidence—that the Chancellor this time had to rather mask what she was doing to increase the headroom in all the run-up discussions in order to avoid pressure from the Tory party to reduce taxes and from her party to increase expenditure. Do you want to comment on certainly the first and possibly the second of my questions?

Richard Hughes: I will comment on the first. As I said at the outset, the current rules that the UK has are relatively loose by historical standards and by the standards of fiscal rules that other countries in Europe impose on themselves. They do very little to rebuild fiscal resilience at a time when we are now getting on for three or four years since the last major shock that hit the UK, and we are still running a deficit of just under 5% of GDP. So we are at a significant fiscal disequilibrium despite the fact that we have moved on quite a bit in terms of the shocks that we have faced. The rules that we have at the moment do not require you, as you leave shocks behind, to significantly rebuild resilience. We are running a significant structural deficit and are still piling up debt several years on from a shock. We aim to get borrowing down to around 2% to 2.5% of GDP by the end of the decade. That is a level that the average advanced economy already reached two years ago. Other countries have been much faster, either because they wanted to be or because their fiscal rules require them to have been much faster at rebuilding fiscal resilience

in the wake of a common set of shocks that all of us have faced in Europe: Covid and then the energy crisis.

The rules that we have at the moment, partly because they have been loosened over time and partly because of their role in nature, just mean that righting the fiscal ship after a shock happens much more slowly at the moment in the UK compared to what other rules might have required had they remained in place, or compared to what other countries are getting on with doing in other jurisdictions.

On top of that, you have the issue that Governments have recently set themselves very little headroom against even those relatively loose rules. It got as low as £6 billion, then in the first Budget of this Government it was £9.9 billion, and it has now gone up to just above £20 billion. That is still a fraction of the average forecast error against the OBR's forecast, which is around £54 billion, and, to be honest, against any macroeconomic forecast that is a very small amount of headroom.

It was interesting when you had Simon French in front of you that he said that the average contingency margin for a UK plc would be around 5% of turnover. The OBR's forecast error is about 3% of turnover, if you consider that to be £1.5 trillion-worth of revenue. Even if you had enough headroom to basically provide you with enough insurance against the OBR's average forecast error, that would be less than a typical corporate would be setting aside against its own margin for risk. A combination of having relatively loose rules and then also setting aside relatively small amounts of headroom, given the risks of the outlook, has been one of the reasons why fiscal outcomes have drifted away from what you have seen in other countries and what previous Governments might have targeted.

Lord Razzall: But would you accept that the way the politics works, irrespective of who the Government are, is that the economic press forecasts before a Budget or a significant fiscal event that there is going to be headroom of X, and that immediately puts pressure on the Chancellor to fill that gap, either if you are a Tory by cutting taxes or if you are Labour by increasing expenditure? Is that not pressure that comes from the fiscal rules?

Richard Hughes: I think so, but it is sort of the nature of having rules that you want them to do that, in that they are the objectives that you have set for themselves, you want to meet them, and Chancellors typically do. So I would describe that as a system that is working rather than not working.

Q98 **Lord Blackwell:** The OBR's role is scoring and evaluating government policies once they are in office. But the reality is that a lot of decisions about future fiscal policies, and indeed the rules, are made in the run-up to an election, in manifestos and in election promises, and the pressures of the election are such that parties are inclined to be less honest than they might be about the difficulties they are facing and paint a more optimistic picture of what they can do. Do you have any thoughts about how in the UK we could encourage more responsible policy-making in the

run-up to the election, and would the OBR have any role in that?

Richard Hughes: Three things happen in the run-up to general elections which have contributed to the fiscal situation that we find ourselves in.

First, as you approach elections, the incumbent party's fiscal plans become increasingly heroic and implausible, particularly for the post-election period. We saw that with the previous Conservative Government's plans for departmental spending, which froze real per capita spending in cash terms for five years as a way of delivering their stated fiscal objectives going into the next Parliament. However, they explained how they were going to deliver those spending plans for only one of those five years, which was the year ahead. As it turned out, when we reopened those spending plans and looked again, based on more comprehensive disclosure from the Treasury, there were a number of undisclosed risks in there. As you approach general elections, there is extraordinary pressure on the Government to say increasingly implausible things about the future as a way of trying to show that they can square the circle between their fiscal objectives and what they are promising the electorate.

The second challenge is an issue with all parties—those in government and those in opposition, which are looking to get into government. When we looked at the last general election, I do not think that any political party presented a comprehensive and costed financial plan for government. They tended to be very explicit and very specific about what they were not going to do or were not going to touch, but they avoided being specific about what they were going to do when they were in government.

Look back at Labour's manifesto: the costed part of its manifesto had it raising, then spending, around £8 billion or £9 billion in the final year of this Parliament. Now look at Labour's first Budget: it raised £40 billion in tax and spent £70 billion. Its fiscal plan was nothing like how things actually turned out in government. Compared to what you see in other countries, party manifestos in the UK are much less comprehensive and less well-costed plans for government, and they tend to be very different from what Governments end up doing in practice.

A third issue that we have in the UK is that, when Governments get elected and codify their fiscal objectives in legislation—in the Charter for Budget Responsibility—there is remarkably little discussion either in public or in Parliament. There is no parliamentary debate. Very little analysis goes into assessing, evaluating and demonstrating the features, risks and benefits of that set of fiscal rules. As a result, fiscal rules tend to be tied to the person of the Chancellor but seem to have much less buy-in from the governing party and the rest of Parliament. In other countries, fiscal rules last longer because there is much more buy-in: people think, "These are the right rules for the country, and they should guide fiscal policy-making until the objectives are met".

Post election, it is remarkable how quickly fiscal rules can just be adopted and put into statute. People then start to criticise them in retrospect and say, "I wouldn't have gone for those ones had we known this or that". Most of those features were well understood at the time; those rules were presented to Parliament for discussion.

Other countries have found ways of addressing these various problems, sometimes by using their fiscal councils but sometimes by using interesting institutional and procedural innovations. The Australians produce something called a PEFO, which is a pre-election economic and fiscal outlook. It is not produced by a fiscal council—it is produced by the Australian Treasury—but it is put together by the Treasury in concert with the central bank and the Parliamentary Budget Office. It is signed off by the Permanent Secretary to the Treasury—that person offers his or her best view of where the economy and public finances are going to go—and is produced after a general election is called. It is a kind of discipline for the outgoing governing party: it would not want the Permanent Secretary to the Treasury and this group of people to produce a forecast that looked different to what the Government's plans looked like, because it would be ruled that those were not built on credible bases.

Other countries, including the Dutch and the Australians, rely on their fiscal councils to cost manifestos. This is not a tradition that we have in the UK; it is not in the legal framework. I am not necessarily saying that it is something the OBR should do because we have institutions, such as the Institute for Fiscal Studies and other bodies, that cost manifestos quite well.

The main problem is that there tends to be not enough specifics in the manifestos themselves to do the costing, but I do think that somebody could provide guidance on good practice and writing party manifestos so that people can understand the financial implications, understand what the Government are committed to and do the costing. Perhaps the IFS could do that, or perhaps the Treasury Committee could promulgate it, but making sure that the electorate have a better understanding of what they are actually voting for through party manifestos would be good.

On the fiscal rules side, there should be more public debate and parliamentary discussion on fiscal rules before they get adopted. Better analysis of their features—as well as better assessment of how they are consistent both with being resilient against the known risks around the forecast and with medium-term fiscal sustainability—will lead to a better and more collective decision by Parliament and the nation, where they can commit themselves to these rules before they are implemented.

Lord Blackwell: May I crystallise a couple of possible recommendations? The Australian example is interesting. Clearly, we would want to avoid either the Treasury or the OBR becoming party political, in terms of costing manifestos and being accused of being on one side or another, but can you see a case for the OBR, say, producing a pre-election view of the fiscal challenges—not costing what any party was going to do, but simply setting out a view on what the economy faces over the coming

years? Parties could then be challenged against that and asked to address how they would deal with the challenges.

Richard Hughes: It is a role played by the Australian Treasury in Australia. In the Netherlands, the role is played by something called the Study Group on the Budget Margin; I suspect that that is an odd translation into English from the Dutch but, basically, a report is produced by a consortium made up of the head of the Dutch version of the OBR, the Treasury, the central bank and others. They report on the risks and challenges that are going to face the Government in the next parliamentary period, and they provide explicit advice on how much headroom the Government should have against their fiscal rules in the light of those risks. It is a way of trying to build some contingency into fiscal plans and to take account of those risks.

Other countries have managed to find institutional solutions both to informing the election debate and to bringing greater realism into fiscal plans. Once Governments are formed, rules are set and decisions are made. They have managed to do this without any particular politicising of any of the organisations involved. I do not think that anyone would accuse the Dutch version of the OBR of being a political institution. The Australian PBO works similarly, in terms of costing policies without being seen to be drawn into party politics.

As I said, I am not saying that the OBR needs to do the costing of manifestos, but we need better guidelines from somewhere on how to make sure that a manifesto is actually informative from the point of view of economic and fiscal policy-making.

Lord Blackwell: Secondly, on your point about debate around fiscal rules, at the moment, the Chancellor simply announces them and they keep changing, as you have commented. Can you imagine a situation where the Bank of England—it ought to be part of this—the OBR and the Treasury set out some possibilities and there is a period of discussion before they are adopted?

Richard Hughes: The most important thing is that, when rules are adopted, there is an exploration of, an understanding of and a discussion about how they are consistent with restoring fiscal sustainability, which is what most Governments want to achieve.

Also, either in the design of the rules themselves or in the amount of margin set aside against them, that margin must be consistent with other known risks around the forecast. Those include the inherent risks in any forecasting process—as I said, for the OBR, on average, four years out is over £50 billion—as well as the known risks and pressures that everyone knows are unfunded at the moment, be they things that come from the geopolitical sphere, the volatility of interest rates and market conditions, or the ordinary economic cycle. Stress-testing rules before everybody commits to them, as well as demonstrating their features and risks, is something where we could do a better job before we snap and say,

"Right, these are now our permanent fiscal rules, and we are going to stick with them for a Parliament".

Q99 Lord Burns: You mentioned that the OBR does the long-term exercise, and we agree that it has been a very welcome innovation; it has provided some very valuable analysis. But could more be done to encourage Governments to actively manage fiscal risks and safeguard fiscal resilience over a longer period? You say that there could be a better response from the Government to your reports, but is there anything in the present architecture that means that these long-term pressures receive so little attention?

To say that some of the numbers that you have produced for the longer term are scary is to minimise them. There is a general view that this cannot happen; something else will have to intervene. Could any changes to the way in which this is all conducted mean more discussion about the longer-term public expenditure issues and tax reform? I am staggered by the extent to which the work that you do in this area receives such little attention. It is not just that it does not receive press attention; it does not seem to inform debate within government.

Richard Hughes: One of the main reasons is that there is no expectation that the Government produce a comprehensive response to the OBR's *Fiscal Risks and Sustainability* report. As I mentioned, it has gone from being 136 pages to 19. If you want to know what the Government's response is, there has to be an expectation on the Government to produce a response that is more comprehensive in explaining how their overall fiscal strategy is consistent with meeting their fiscal rules over the medium term, given the risks that the OBR has identified, and then maintaining fiscal sustainability in the long term, given what we know are the pressures on the public finances.

The Government also need to engage more in the specific risks that the OBR identifies in its reports. Obviously, there are lots of them. In addition to the report, which highlights a handful, the OBR produces a kind of encyclopaedia of other fiscal risks, be they risks to the expenditure side or the tax side, which add up to 50-odd. You would not expect the Government to have a detailed response to every single one of those, but they could say more about what are seen to be the most material risks to the current outlook.

As I said, it is good that the report gets the attention of this committee and the Commons Treasury Committee, but it is notable that there is no parliamentary debate about the FRS and no expectation on any Minister, other than to present a Written Ministerial Statement, which lately just gets published alongside the EFO and everything else. There is no focus on the Floor of the House or in other places on these issues.

Lord Burns: Putting yourself in the position of the Chancellor, could you reflect on why there might be frustrations with the existing dialogue that takes place? We keep hearing suggestions from various quarters about this. Would any changes to the rules and the way in which these

exercises are conducted make the Chancellor's job easier and make the Government feel more in touch with the analysis of what is going on?

Richard Hughes: Do you mean about our forecasts or FRSs, or other things?

Lord Burns: I am thinking of the whole Budget process, where I sense some frustration that it is a bit like playing postal chess: there is a long delay between what you say and the government response, and some of that could possibly be leading to some frustration. I am just wondering what, in the architecture that we are looking at, would make the Chancellor's job easier.

Richard Hughes: During my time, partly because I was forecasting in the midst of a pandemic and then an energy crisis, I was oftentimes the bearer of bad news to Chancellors and the Treasury. To some extent, it is understandable that they are not thrilled to hear about the latest shock to the economy and the public finances, its consequences and the difficult set of decisions it requires. Oftentimes, these things disrupt what are ultimately their policy plans, for which they feel they got elected and they want to implement. Suddenly they are told a bit of bad news, which will make that more difficult.

To some extent, the Treasury did not always look forward to meetings with the OBR for those reasons, but we meet regularly the current Chancellor, and did her predecessors, to talk through our forecasts. Those discussions were always respectful and professional. They became increasingly focused on substance over time, which was a good thing—talking about changes to our forecast and how we were going to treat measures. On the OBR side, we endeavoured always to try to be predictable in the judgments that we made. When making big judgments, such as the change we made to productivity in the most recent forecast, we try to make them as early as we can, so that we can signal to policymakers that they may well require an adjustment to policy and some thought about the consequences of the changes.

We try to operate a no-surprises policy in the way that we arrive at our own judgments, but the reality is that the world offers plenty of surprises these days anyway, including policies being made in other jurisdictions, which you just have to reflect on and plug into the forecasts. From the OBR side, it is about trying to be as predictable as possible in the judgments that it makes, which means being as transparent as it can about how it put forecasts together. On the Treasury side, it means accepting that there is a lot of volatility out there in the world, which gets reflected in a volatile forecast, and basically trying to give yourselves enough headroom to absorb that kind of volatility. It also means being nimble enough in policy-making that if it turns out that the shock, such as that we saw in the most recent forecast, exceeds that headroom, you are able to make policy changes to keep you on track to meet your fiscal targets.

Q100 **Lord Londesborough:** Many commentators describe the OBR as policing

government policy rather than simply being a forecaster and assessor of fiscal policies. I will give you a couple of examples, with which I am sure you are familiar. This month the economist Julian Jessop described the OBR as being “the economic equivalent of football’s VAR—overly fussy and constantly second-guessing” government decisions. Andy Haldane described the OBR as “an inhibitor, not enabler, of growth”, and Daniel Susskind, in a similar vein, described the OBE as the “ultimate arbiter” on the Government’s plan to achieve economic growth—in other words, judge and jury. What do you make of these assessments?

Richard Hughes: I do not agree with them. The only powers the OBR has are those given to it by Act of Parliament. These powers, delegated by a vote of people in this House, are to produce a forecast and analyse the risks around it, to assess whether the Government are on track to meet their fiscal rules and to cost government policies. The OBR has done those three things throughout my tenure and that of my predecessors. Unlike the majority of the 50-odd fiscal councils out there in the world, we are explicitly prohibited from giving the Government policy advice or feeding our ideas into the policy-making machine, either publicly or privately. Something we have consistently done, including in our private interactions with the Chancellor and the Treasury, is to always stop ourselves advising on policy, because that is not our role; it is for the Treasury and policymakers to do that.

When it comes down to whether, none the less, we are somehow having an influence on the policy-making process, Chancellors set their own fiscal rules. If they want to break or change them, they can do so. As we have discussed, they frequently do—once every 1.8 years since 2010. Chancellors constrain themselves to their own rules, but often change rules. Governments often change rules when they do not suit them. As I think you have discussed in this committee, in principle, Chancellors are not obliged to use our forecasts if they do not want to. They can disagree with aspects of them, but none has opted to do without an OBR forecast, with one exception, which had the consequences that it did.

More fundamentally, in a given Budget, we are costing a few tens of billions of pounds-worth of policy measures one way or the other. At any point in time, every Chancellor is in charge of £1.5 trillion of revenue and £1.5 trillion of spending. That gives them £3 trillion-worth of choices in which to make those decisions. What creates the impression that the OBR’s forecasts are somehow driving policy has been the fact that Chancellors have left themselves very tiny amounts of headroom against fiscal rules to which they are very personally committed.

The net result is that the normal amount of volatility in any macroeconomy over any six-month period gets translated into a normal amount of volatility in terms of changes to the forecast, which cannot be absorbed by the tiny buffers Chancellors have left themselves in recent years. That results in significant volatility in policy-making.

What is driving that relationship between the forecast and policy-making is the very small amount of headroom that Chancellors have left

themselves. There was not this relationship back when George Osborne had £80 billion-worth of headroom against his fiscal rules, or Philip Hammond had £40 billion. You did not see that kind of one-to-one relationship between changes in forecasts and changes in policy. It really is an artefact of leaving very small margins against rules to which Chancellors feel very personally committed to meeting, and them operating in an inherently volatile environment.

Lord Londesborough: This issue of very narrow headroom and a very tight fiscal tightrope certainly raises the profile and the influence of the OBR, because of the sensitivity, does it not? As you say, if it was an £80 billion buffer, there would be far less media and political interest in the assessments and forecasts of the OBR. Has the OBR not found itself in this corner partly because the margin for error is so tight that the organisation is a bit of a convenient punchbag?

Richard Hughes: I think so. It is a bit like blaming the Met Office for changes in national fashion trends. If the Met Office is forecasting it is going to be cold and everyone suddenly puts their coats on, people are not putting their coats on because of the Met Office forecast, they are putting their coats on because it was cold yesterday and it is likely to be cold tomorrow. It is a reasonable response to the environment that you are in. The OBR is just communicating that in a technical way, through its models and forecasts, to policymakers.

Fiscal policy in this country is constrained because we have debt approaching 100% of GDP and a deficit of 5% of GDP. It is not because of the OBR's forecast. The OBR's forecast shows it coming down. The reason we are constrained is because we have a lot of debt, and we are borrowing more than almost any other advanced economy at the moment.

Q101 **Lord Liddle:** As a brief follow-up, you said you are by statute not allowed to propose policy. Should we not be thinking about whether that is right? It seems a possible institutional model. The Conservatives tried, and I was very in favour of, setting up an economic strategy council with Andy Haldane, to come up with bold ideas for how we promote growth in this country, for which there is a wide political consensus that this is the top priority of the Government. Would it not be right for the OBR to tell the Government, "Look, if you're serious about promoting growth, you should be doing this, this and this, because that is what our models tell us"?

Richard Hughes: Parliament, in its wisdom, has prohibited us from doing so. It was a good and prescient decision, in that I have seen and worked with fiscal councils in other countries where they provide precisely that function: providing policy advice to government about what to do about the fiscal situation. What tends to happen is they become just another voice in the cacophony of voices feeding into fiscal policy. In the UK, we are already blessed with a number of very good institutions which come up with policy ideas, such as the Institute for Fiscal Studies, NIESR, the Resolution Foundation and the CPS, which all have good policy ideas which feed into the policy-making process. I suspect if you

asked people in the OBR what their ideas would be, they would sound an awful lot like what you would hear from those institutions, depending on the topic.

Therefore, I do not think people who work in the OBR are particularly privileged in knowing what the right policy solution to a given societal problem is. They also have no legitimacy in providing that kind of advice, because they are not elected, and they do not work closely with Ministers. What they are good at, and have proven themselves good at, is forecasting the economy and costing the ultimate policy decisions of Government. If the OBR started providing policy advice, I do not think it would add very much to the policy debate, which is already enriched by these other institutions.

Q102 Lord Davies of Brixton: I wanted to ask about the Budget Responsibility Committee and whether it is right that it should have three members. I understand that this is an issue you have thought about. Before directly answering the question, could you just give some idea about how the committee actually works in practical terms? Are there other people present who make substantive contributions, as well as those who have the final vote?

Richard Hughes: One thing to remember about the OBR by comparison with other independent bodies in the macroeconomic policy-making space is that the OBR is a forecaster, not a policymaker. One of the most important things to remember about the OBR is that it needs to produce a consensus forecast. So the BRC comprises three members: the chair, the economic expert and the fiscal expert. They all have to agree on every single number in the forecast, because if you think about it, the alternative would be that you had three different forecasts from three different members of the BRC. The Government would almost certainly choose the most optimistic one and say, "We're going to base their fiscal plans on that because we really like that person's view of things". The Opposition would almost certainly choose the most pessimistic one and say, "This shows how the country is going to the dogs under this Government's fiscal plans".

It is in the process of discussion and deliberation within the BRC, which is always informed by expert advice from our excellent staff about where we think things should go. Obviously, when I was there, David's voice had a lot of weight on the economic forecast side because he is a much more experienced macroeconomist than I am. Tom always had more weight on the fiscal side because he was much closer to the fiscal details. But all the decisions we made, we made collectively. Every number in the forecast we stood behind as a group of people.

Therefore, if you were to expand the number of people on the Budget Responsibility Committee and tried to make it more like the Monetary Policy Committee of the Bank of England, with nine different perspectives and voices, none of those nine people has to sign up to the bank's forecast. It is kind of a staff forecast, but they all have their own individual views about where they think the economy is going and how

interest rates have to respond. They have to make a decision about one thing, interest rates, whereas the OBR has to operate by consensus. It has to form that view among a number of people around which you can get a consensus, and it has to have enough time and enough input to arrive at that.

If you expanded the number of people on the committee significantly, because it has to produce a consensus forecast, you would inevitably just empower the most outlandish view because they would have a de facto veto on the consensus. You would end up pulling the forecast to one or other extreme, depending on who wanted to hold out, until they got that particular view of where they thought the economy, the public finances or a particular costing was going. You have to keep the BRC down to a manageable number of people so that you can all get behind a consensus forecast, as informed by the analysis that staff do.

We do not do that at all in isolation. We have an advisory panel of 25 macroeconomic and microeconomic experts, including City forecasters, academics, people who work in think tanks and people who work in business. We regularly consult experts on topics which we are not au fait with. When we had a big energy crisis, we just rung up people who knew about energy markets and how they operated and asked them to come in to talk to us about where Britain gets its gas from, how much it costs, how it feeds into the commercial and retail price of gas and how we feed it into our inflation forecast. We regularly try to engage experts in the outside world in those deliberations and discussions. It is not at all a closed ivory tower where we just talk to ourselves.

However, the number of the people on the committee has to be kept to a manageable number, with a reasonable tenure. If you are constantly changing the composition of the committee, you are going to have a very volatile forecast, because every newcomer is going to have a slightly different take on how things are going; or, if you are bringing new people on all the time, you run the risk of them not being up to speed on what was in the last forecast, and they will take a few forecasts to figure out quite where things are going. Then, by the time they have figured it out they are moving on and making space for the next person to rotate on.

Lord Davies of Brixton: Remind us of the rules on length of membership.

Richard Hughes: They are five-year terms, nominated by the Chancellor, approved by the Treasury Committee and renewable for another five years, so a maximum of 10 years. I should say that now I have departed, the whole of the BRC will have turned over, over the last five years. None of the members who were running the OBR in 2020 is still there.

Q103 **Lord Petitgas:** My question is about the characterisation of the relationship between the OBR, the Treasury and the Government. I am not suggesting that we go over your statement again, but, harking back to your five-year tenure, during that time, how would you characterise

that relationship? Clearly, the level of transparency and a good relationship are paramount to the underpinning of the quality of the information you get in order to build the forecasts. Certainly, we got from the staff of the OBR in some of our inquiries very positive feedback and there was a general consensus that things went well. Having said that, obviously there were two mishaps that were pretty well advertised. One was the Hunt debate about the £22 billion black hole, and of course the timing of the productivity change—or update. So maybe those two represent some dissonance compared with what we have heard. Generally speaking, what is your characterisation of the last five years, and are there lessons to be learned from all this and things that you would suggest should be changed?

Richard Hughes: For me, the biggest exception was the period leading up to the mini-Budget in the autumn of 2022. Basically, there was no relationship between the Treasury and the OBR at the time, but then it then very quickly got re-established in the aftermath of the mini-Budget.

Setting that period to one side, during my five years running the OBR, our relationship with the Government has been characterised by professionalism, mutual trust and a high degree of necessary collaboration in putting together the forecast. The OBR has 52 staff and the Treasury has 2,000, and there are also thousands of other people occupied in other parts of government who help us to put together our forecasts. We make all the judgments ourselves, and ultimately, everything that goes into the *Economic and Fiscal Outlook* is the OBR's content, but we draw on information and expertise from all around government.

The decisions and judgments that we make about things such as productivity are ones which we make in discussion with the Treasury. When we were conducting our supply-side review over the summer, that process included a series of exchanges with Treasury economists. The Treasury has a lot of excellent macroeconomists, who shared their analysis of where they thought the trajectory of the UK economy was headed. We also talked to lots of other experts in the City and in academia about what they thought and then came to our own view in the light of what we had heard. So we collaborate very well with the experts in those sorts of areas.

From time to time, bits of the fiscal framework come under stress and reveal weaknesses in the fiscal framework which need to be addressed. The issues around the planning and forecasting of public spending that came to light in the run-up to and in the aftermath of the last general election was a good example of that. The forecasting of public spending and spending on public services was always a lacuna of the UK's fiscal framework. It is more straightforward to forecast tax and benefits, because policy is clear; if you leave it unchanged, you just run tax policy through how many hours are being worked and you figure out what that means for income taxes over the next five years. There are many fewer parameters to go on when you are trying to look at the health service, defence spending, asylum and policing, because ultimately those are

complicated machines delivering public services to people. Governments can try to tell you that those machines are getting more efficient and that they have plans to bring spending down, but what was revealed in the run-up to the last election was that the Treasury was aware of risks and pressures on those budgets, which it should have disclosed to us at the time we were doing our March forecast but it did not.

However, I would say about the Treasury that we did a review of that episode and the Treasury committed to a much more transparent approach to its planning and forecasting of departmental spending. We moved to what I think is a much better system for doing that, which has a more bottom-up element on the OBR side, where the OBR asks a lot more searching questions and also has the outright discretion to disagree with the Treasury's view of public services spending, as it did in its last forecast. So, where weaknesses in the framework get revealed, the OBR and the Treasury are quite good at getting back together and figuring out how to close them.

The same was true about how to close the gap revealed by the mini-Budget, which was the ability of Governments to basically announce major fiscal policy decisions without an accompanying OBR forecast. The introduction of the fiscal lock was a very good innovation which closed what was a very apparent and costly gap in the way in which we run the public finances. So, in that sense, from time to time the system comes under stress and reveals a set of weaknesses, but, more or less, in the fullness of time, we have been pretty good at closing those gaps.

Q104 Lord Londesborough: I have just a quick follow-up question. You mentioned the 52 staff; I just wanted to quickly come back to your opening comments about the fact that human beings make mistakes. There are only 52 staff and a budget of £6 million. Is there not an issue around the resourcing of the OBR? You are saying that from time to time it comes under particular levels of stress, but that seems a low level of resourcing for an organisation that, as we have already discussed, has a very high profile.

Richard Hughes: The OBR is the right size for the job that it has at the moment, and I should say it is grown quite a bit since it was first established. It started out with around 17, so it is significantly larger than it used to be. It is a much smaller than the CBO in the US or the Dutch version of the OBR, the Centraal Planbureau, which has several hundred. I think that the way in which we prepare our forecasts, which is drawing on analysis and expertise from across government but coming to our own judgments, works. We have taken on new responsibilities, such as to produce the *Fiscal Risks and Stability* report to be more transparent about the way we score supply-side effects.

One thing I would say about the Treasury is that it holds the purse strings on the OBR; it decides how much funding the OBR gets over a given three-year period. At no point when the OBR has been given new responsibilities in legislation has the Treasury not provided the resources that go along with that. So I think that the OBR is reasonably well

resourced for the job that it is given and that the Treasury has been good about resourcing the OBR where it gives it new responsibilities to undertake.

I would worry about the OBR getting too big and too unwieldy in the sense that it would make it more difficult to arrive at those kinds of consensuses and to have a good understanding of what every person in the organisation is doing at any point in time within the management structure. We try to do things as cheaply as possible because when you are called the Office for Budget Responsibility, you want to make sure that you manage your budget responsibly, even when it is only £6 million.

Q105 Lord Turnbull: In an earlier answer, you said that people are getting a better understanding of the work of the OBR. I would say maybe, but I still do not think that we are where we really want to be. So there are still questions to look at about how it reports and how those reports are analysed and debated. There are some clear improvements: the expanding of the fiscal margin is definitely an improvement. There is also something which is not yet achieved, which is that we should be working towards a world in which the FRS gets more prominence relative to the economic outlook, and that can be worked upon.

However, all this has to come into another change we have not yet talked about, which is the one-two. The one-two is one fiscal event and two forecasts. How is that going to work, and is actually workable? One situation which I am worried about is that there is a Budget and an outlook, and the two kind of cohere, and some fiscal prospects are laid out. Some months later—we have not decided how many months it should be—it becomes apparent that we are not really on that trajectory, but this time, the Chancellor says, “I’m not going to respond to that as I’ve often done in the past; I am actually going to wait until the next report”. That requires a kind of a patience and maturity from all sorts of people—the media, politicians, markets, and so on—to wait and see. If we can achieve that, we would get away from the knee-jerk responses to some very small changes in very small margins. But are we going to achieve that, or do you think that once anything is produced which shows that something is not going in the right direction, the pressure for an immediate response will be overwhelming?

Richard Hughes: It is easier to achieve if you have more headroom against your fiscal rules; in the spring forecast, you are less likely to be at risk of missing them.

More headroom gives the Government more time and space to deliberate about policy without facing those immediate pressures about what they will do about the fact that their rules are either on track to be missed or are close to being missed. Having a bigger margin against any rule you set for yourself has to be part of the answer.

It must be possible because nearly every other country in the world does it this way. Every other advanced economy produces at least two

economic and fiscal forecasts a year, and almost every other advanced economy has just one budget a year, usually in the autumn. They treat the spring forecast as a mixture of a health check on the economy and public finances on the way to a set of decisions in the autumn, and a firing of the starting pistol on a longer preparation of the budget between the spring and autumn.

A challenge we have in this country at the moment is that there is quite a short gap between the autumn forecast and the spring forecast, which means you then have a very long gap between a spring forecast at the beginning of March and a Budget in the autumn, whenever it happens. Most other countries spread it out so that it is more like six months, but those timings can move around.

Thinking about the spring forecast provides the context and framework for thinking about fiscal policy-making over the summer and into the autumn. It provides the Government with the opportunity to do something they do less and less, for reasons I do not fully understand, which is consultation on policy options and choices, as opposed to making policy decisions very rapidly, with relatively little consultation, in fiscal events. Part of that was driven by shocks, but if you have a period of relative peace in the economy and in the fiscal outlook, that gives you more time to consult on and think about options, and then implement and announce the final details in the Budget.

Using the spring forecast to set the framework and context for a discussion and dialogue with Parliament and the public about policy options for addressing whatever fiscal challenges are revealed in the spring is how the budget process works in other countries, and I do not see any reason why it could not work that way here.

Lord Turnbull: Is there a need, before the next spring forecast, for someone to say something about how this system is intended to operate, along the lines of, "Do not expect me to simply respond as people have done in the recent past"? If you wait until you get there, people will still not have an understanding of why you are changing it in this way and what benefits you can extract from it, which you have just set out.

Richard Hughes: It would be helpful. It is always helpful when Governments explain how processes are going to work, because lots of stakeholders have a stake in the outcomes. The OBR has been clear that in the spring, it will continue to produce forecasts for the current balance and for net financial liabilities, so you will be able to see the trajectory of those things. The Government have said that they will not treat the spring forecast as a formal assessment of those rules, so they will not feel obliged to respond with policy to any changes in those forecasts.

That is the way that fiscal policy-making works in most other countries. They consider that to be a sort of interim check, and they then reconcile and bring things into line with their fiscal targets in the autumn. If the spring forecast reveals a bit of breathing space, they have a think about how they might use it up. If the spring forecast reveals a deficit against

where they want to be, they have a process for thinking, between the spring and the autumn, about how to fill that gap with policy. Clarity about how that process will work will help to make it more predictable. In my experience, the more predictable processes are, the better they tend to run and the more satisfied people are with the outcomes.

Q106 Baroness Wolf of Dulwich: My question relates to the OBR's recent experiences with dynamic scoring of the supply-side effects of fiscal policy. It is a return, in a way, to the discussion that you had with Lord Liddle about the OBR's role in recommending or affecting policy. I totally accept that your job is not to propose policies, but I would like your view on how important the scoring is and whether it is appropriately important in determining the policies that Governments adopt.

I do not think this is anything you can avoid, but I would be very interested in your views on this. For example, when we had Robert Chote and Andy King here, they talked about how the process of scoring can make for quite a difficult OBR-Treasury relationship, because clearly the Treasury wants you to score stuff and say that it will have a wonderful effect, and you might disagree.

You referred to the fact that you try to be as transparent as possible and look at the evidence, but, of course, academic, statistical and recent history is always going to be partial, and there will be a lot of uncertainty. This also has a knock-on effect not just on direct relationships with the Treasury but on what the Treasury basically encourages Ministers to propose or not propose.

As I said, I do not have any solution for this, but I would be very interested in your comments on your experiences and the fact that, for example, you have upped the bar and lowered the bar, and whether you have any conclusions about this going forward—including whether there is perhaps too much transparency, or whether one should just make the bar very high, or any general conclusions about this.

Richard Hughes: We are talking about assessing the economic effects of policy measures—usually fiscal policy measures, but sometimes also regulatory policies and other kinds of changes. The OBR was always very transparent about how it calculated the demand-side effects of fiscal policy. It used a set of fiscal multipliers that have been around since Lord Burns was in the Treasury. They are pretty standard. They are re-estimated from time to time. They take the package as a whole and then apply it to aggregate demand. The effects are always temporary because ultimately you cannot stimulate demand for ever; at some point, you start pushing up inflation, there is an interest rate response, and that brings demand back into line with supply.

We are talking here about dynamic scoring. Back in 2022 we decided to be much more transparent about the economic effects of policies on the supply side of the economy. We made a decision early on that we could not do it for everything and that we had to be selective, but that it was important to be more transparent, for a number of reasons. One is that it

was it sometimes came as a surprise to the Chancellor when we said, "That particular tax change is having this effect on labour supply, which may or may not offset what you think you are doing", so we needed to be more transparent about that. We had also made a very big judgment about the supply side of one very big economic policy decision, which was that to leave the European Union, which we estimated was going to reduce potential output by 4% in 15 years. We were very transparent about how we made that judgment, but it raised a legitimate question about other things that might affect the supply side of the economy in a negative or positive way in future.

We decided to embark on this approach of being more transparent about supply-side effects. It was also designed to respond to criticism that we cannot be supply-side nihilists as forecasters. If Governments want to produce pro-growth policies, they have a right to understand what might be the growth impact of the policies they are pursuing. But we did set four criteria: they had to be significant, additional, durable and evidence-based. That was a way of trying to filter out what could potentially be hundreds of policies whose supply-side effects we had to think about.

It has been highly instructive to look at what has happened since then. We were presented with 19 policies by the Treasury over the course of five fiscal events, which we reflected in the supply side of our forecast. The most striking thing that we have learned about them in the process is basically just how small the growth impacts of most of these policy changes have been. The average effect of those 19 policies was to change potential output by 0.04% on the level in five years' time, and by an even smaller amount on the growth rate over those five years. Generally speaking, a lot of what Government was announcing as growth initiatives were too small to actually be able to change the roundings on any of the OBR's GDP figures in five years' time.

But you have the biggest positive impact from a set of tax changes, the changes to NICs both up and down, from the reforms to planning, from the big increase in public investment that the Government announced in their first Budget. Those were more material, in the order of 0.2% to 0.25% on the level of potential output in five years' time. So it was clear that there was a large number of very small measures which were not really making that material difference to our economic forecast and a small number of quite significant measures which were probably slightly moving the dial on potential output in five years' time.

What concerned us was that setting up this framework quite quickly spawned a cottage industry across government of just trying to come up with anything you can to try to move the supply side of the OBR's forecast because, in principle, it is sort of free money if you can get it in the forecast. We felt the need to spare the analysts in the department, and spare the pressures being put on the OBR as a forecaster, to say we are going to define "significant" much more clearly to mean 0.1% in five years' time on the level of potential output. For anything we think is

below that, we will assume that its effects are broadly symmetric and offsetting in our forecasts, and we are not going to take account of them.

What was interesting was that as a result of that, in this most recent forecast, there were no growth measures that we scored on the supply side, positive or negative, not even the tax changes nor the further freezing of NICs and income tax thresholds for further years into the forecast. In that sense, it has refocused the framework on where it should be, which is where the Government are making significant and durable changes to the supply side of the economy.

As forecasters, we take account of those, because that is important to having a good forecast—but we are not at all interested in being the arbiters of government growth policy, saying, “That is a good growth policy and it goes in our forecast” or “That is a bad growth policy and government should not go ahead with it”. We do not want to be in that position, and we set the threshold to make sure that we are focused on capturing the effects of policies that enable us to get our forecast right, rather than whether the policy itself is good or bad. That is not a judgment for the OBR to make.

Baroness Wolf of Dulwich: Do you think that the Treasury and the Government have understood how tiny the effects normally are, and that the cottage industry might be, if not exterminated, at least in fairly clear retreat?

Richard Hughes: I think so, because they were disappointed by the results. They tended to be crestfallen to discover that all the work they put in came up with relatively small changes to the level of output in five years’ time. One of the things which the changed framework still allows for is the Government to package together policies. The thing the OBR will need to police going forward is: how do you stop the Government putting together Happy Meals of policies—a hamburger, some French fries and an apple pie all going together and calling it a growth strategy? That is not really what you want to see in the future. That threshold needs to be applied to individual policies and their impact on the forecast.

Q107 **Lord Blackwell:** I am just wondering whether this econometric approach to evaluating policy options has the potential to underscore more radical policy changes that might be proposed. The modelling approach is, in effect, a bottom-up view of the economy, that there are millions of individuals whose actions contribute, and if you can model those accurately enough, it determines what the next phase of the economy is going to be. Then you can technocratically project that forward.

There is another view of the economy that says a few big decisions by a few people shape the economy and the way people react, that entrepreneurs who created Microsoft or Amazon change the way people think about investment. Those are big top-down shifts, not things that come out of the details in an econometric model. If you had a Government, as opposed to a cottage industry of small things, who were

proposing some fundamentally big shifts in the framework for the economy, how would you be able to accommodate this?

Richard Hughes: The OBR comprises technicians who are tasked with trying to think about how to forecast things. It is a good discipline on Governments to try to produce evidence for their assertions about the transformative effects of their policies. There would be nothing wrong with a Government who said, "We think this policy is going to have a transformative effect, and here is the evidence to support that assertion", rather than them just asserting it. We have always shied away from faith-based forecasting in the OBR. Rather than whether you believe in a particular direction or agenda, it is always about what can you actually demonstrate has made a difference in the past.

If it is an entirely novel policy, we will point to some analogy or mechanism through economic modelling, which shows how it would manifest either in this country or in another place. We have always had an open mind. We would definitely encourage more work on what kinds of policies have the right kinds of growth effects. Where Governments are going for a moonshot and trying things out because they just might work—"This could well completely transform entrepreneurialism and the investment climate in this country, and we expect that to happen", as a forecaster, when the Government announce the policy, you ought to see that reflected in business investment intentions, equity prices, and so on. In that sense, you ought to pick it up in your forecast anyway, because business sentiment is rising, investment intentions are going up, and you ought to capture those sentiment impacts in your baseline forecast. If it is a delayed effect, if it really is transformative you will probably pick it up in the next forecast in any case, so you should just be patient. Maybe that is a reason to announce it in the spring and implement it in the autumn when the transformative effect it is having on national sentiment is manifesting itself.

The OBR tends to rely on evidence for the effects of policies. It definitely does not try to second-guess the sentiments of businesspeople, entrepreneurs and the economy; it draws those from the best indicators that we can get of business sentiment and the sentiments of others.

Q108 **Lord Verjee:** Thank you for your contribution, Mr Hughes; it seems that we have lost a very good contributor to UK economic policy. Obviously, we have covered some of this in our evidence session with you, but my question is: can you tell us two or three important recommendations that you would like to see in our report, as well as any key issues that you would like us to emphasise?

Richard Hughes: The most important thing I can say is that this committee is asking the right questions in its inquiries, including in this session and in all the previous ones I have watched. You are exploring the right avenues, which concern how we can make our fiscal rules more binding on fiscal outcomes.

Clearly, the UK is increasingly fiscally vulnerable and an outlier compared with all other advanced economies. We have the sixth-highest debt, the fifth-highest deficit and the second-highest borrowing costs among 35 advanced economies. That is not a good fiscal place to be. Our fiscal framework needs to deliver more binding and more sustainable fiscal outcomes. It is about thinking how you can do that through the design of rules. It is also about finding ways of building in, institutionally, higher amounts of headroom against those rules, commensurate with the risks in the forecast; that is a second thing that it is really worth thinking hard about in the UK context. As I said, other countries seem to have come up with institutional solutions to deal with those things.

Finally, it is really important that this committee is focused on how to bring more prominence, as well as public and government attention, to the management of fiscal risks and the maintenance of fiscal sustainability; how to get a stronger government and policy response; and how to encourage richer discussion of these issues, both in Parliament and in the wider country. I would encourage you down all those lines, but I would not be so bold as to offer specific solutions.

The only other thing I would say is about the importance of avoiding counsels of despair and thinking that these problems are somehow insoluble. All our fiscal problems are man-made, and men and women need to be their solution. In the past, this country and a host of other advanced economies have managed to get themselves out of fiscal difficulty and into more sustainable fiscal positions; some of them, including some countries in southern Europe, were in much worse positions than we are in a few years ago. So it is clearly possible to tighten up fiscal frameworks, deliver more responsible policies and get better fiscal outcomes. I am really pleased that this committee is focused on these kinds of question because they are of increasing urgency.

Q109 Lord Lamont of Lerwick: You have given us brilliant evidence this afternoon. I am just a little disappointed in the last answer you gave, I am afraid, because you declined to do what I was hoping you would do: give us a very specific architecture. We all know that the system is too easily gamed. It is absurd that you should have compliance with the rules when debt was falling in the last year but is actually higher than it was at the beginning of the period. Surely you can give us some specific ideas of how to bind in genuine reductions earlier on in the whole period of the forecast.

Richard Hughes: You can look at what this country has done in the past and what other countries are doing at the moment to make their fiscal rules more binding. One thing is targeting a level of debt rather than targeting it falling. If you want debt to be lower, target debt to be lower; do not target it to be falling in five years' time.

What other countries also do is have fiscal rules or guidelines that are more constraining on the path of the deficit, rather than on where it needs to be in two or three years' time; so it is more binding on the Budget being announced than on future Budgets. Other countries also

require misses against the fiscal rules to be made up in future years, so that you do not just get an upward drift in deficits. So there are mechanisms that one can use; they all have their advantages and disadvantages.

For some time now, our fiscal rules in the UK have been rolling in nature. The thing about rolling fiscal rules is that they make sense when you are in equilibrium and you want to stay there. When you are in disequilibrium, rolling fiscal rules never allow you to get there, because you always have a two- to three-year excuse for why you are not there at the moment. We need rules that are designed for a country that is running a 5% deficit and does not want to stay there but at the moment we have a set of rules that has allowed the UK to stay there for the past five years while other countries have brought their deficits down to something more like 2% or 3% in the time available since their last crisis.

Lord Razzall: Lord Lamont has moved you a little further. May I try to move you even further? When you turn on the “Today” programme, after we have produced our report, and you listen to our Chair, what do you hope his first sentence will be?

The Chair: Thanking Richard Hughes for his valuable contribution to our report.

Richard Hughes: I should not put words in the committee’s mouth about the recommendations it may want to make. You have had really great evidence from everybody in front of you; I have learned a lot from it. It is great that you have talked to a broad range of voices in the UK. It is also great that you have talked to people who work in fiscal councils and fiscal policy-making in other countries, because we have a lot to learn from them—especially because fiscal rules and fiscal councils are almost universal in Europe now, so there is a lot of experience to learn from. I would not presume to give you recommendations, but I certainly look forward to turning on the “Today” programme and hearing what you have to say.

The Chair: I am glad that one person does.

Lord Razzall: When we go off the record, will you tell us?

The Chair: We have no more questions. Richard, thank you so much. You have taken a huge range of questions—and not just on the OBR; as you were keen to point out at the beginning, this inquiry is looking at a range of issues around the fiscal framework, including, but not limited to, the OBR. I thank you for stretching the range of issues we are looking at; we are really grateful. With that, I declare this meeting closed.