



House of Commons
Treasury Committee

**Budget 2011: Government
and Office for Budget
Responsibility Responses
to the Tenth Report from
the Committee**

Sixth Special Report of Session 2010–12

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The Treasury Committee

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Sixth Special Report

The Treasury Committee published its Tenth Report of Session 2010–12, *Budget 2011*, on 9 April 2011, as House of Commons Paper No. 897. The Government Response was received on 27 May 2011 and is published as Appendix 1 below. The Office for Budget Responsibility Response was received on 9 June 2011 and is published as Appendix 2.

The response from the Government is in plain text and the Committee's conclusions and recommendations are in bold text.

The Government has not taken the opportunity to respond to our comments in paragraph 4 of our Report about any leaks or advance briefing of Budget measures. We call upon the Government to do so. Good reasons have lain behind Budget purdah. The Government's response should contain a clear undertaking that the Government will not anticipate Budget measures by means of press briefing, and that it will deal with any leaks of Budget measures with the utmost seriousness.

Appendix 1: Government Response

General issues

1. There may well be good reasons why the Finance Bill also contains provisions extending the period for which all Budget Resolutions have statutory effect to seven months, but we recommend that our colleagues on the Finance Bill seek a full explanation for this change. (Paragraph 3)

The Government is making changes to the Provisional Collection of Taxes Act (PCTA) to maintain its practical effect following changes to the parliamentary timetable.

The Tax Information and Impact Note published alongside the Budget explained that the Government's objective in making these changes was to maintain the practical effect of the PCTA, ensuring the appropriate safeguards are in place and allowing sufficient time for parliamentary scrutiny of the Bill.

In line with these objectives, the Government has given careful consideration to the length of time for which the PCTA resolutions should have effect.

Prorogation of Parliament, the Queen's Speech and the debate on the Loyal Address will fall within the Finance Bill timetable following the move to spring to spring sessions. Without these proposed changes, the time available for parliamentary scrutiny of tax legislation would be reduced.

2. It has been noticeable over many years under successive Governments that measures appear to have been trailed, sometimes accurately, sometimes in a way designed to place them in the most favourable light. Whether particular press reports are leaks or briefings or merely press speculation, we have no view, but we deprecate both leaks, and any advance briefing. Such activities are corrosive of good government. We will return to this issue at future autumn statements and budgets. (Paragraph 4)

Inflation

3. The combination of high inflation, some derived from external factors, and weak income growth is affecting the living standards of many in the UK. At the moment, the costs to the Government are rising with inflation-linked benefits but revenues—such as from income tax—are not keeping pace, as wage growth remains subdued. (Paragraph 13)

The OBR published an assessment of inflation at Budget. They noted that the recent level of CPI inflation “reflect a number of factors, including higher energy and world commodity prices.” These global pricing pressures, combined with the temporary impact of the rise in VAT, are set to keep inflation above target this year—the OBR warned that CPI inflation is expected to “remain between 4 and 5 percent over most of 2011...” But the OBR has also argued that inflation is to fall back sharply in 2012 and return to target in 2013 as “upward pressure from higher inflation energy and commodity prices will gradually fade while disinflationary impact of spare capacity continues to bear down on inflation.”

This is also the view of Bank of England who argued in their latest May Inflation Report “inflation is likely to fall through 2012 and 2013 as the impact of external pressures and the increase of VAT dissipates and some downward pressure from a margin of spare capacity persists.”

The Government recognises household budgets are under pressure and is taking action to help the most vulnerable:

- Budget 2011 announces a £630 cash increase in the personal allowance for under 65s, taking it from £7,475 in 2011-12 to £8,105 in 2012-13.
- The basic rate limit will fall by £630 in cash terms, taking it from £35,000 in 2011-12 to £34,370 in 2012-13. This leaves the higher rate tax threshold unchanged and means Budget 2011 will not create any additional higher-rate taxpayers.
- Recognising the impact of record pump prices, the Government has announced a £1.9 billion package to ease the burden on motorists. This includes a cut in fuel duty of 1 penny per litre at 6pm from Budget day.
- To support pensioners, the basic State Pension will rise by 4.6%—equivalent to RPI—in April 2011 (rising from £97.65 to £102.15 a week). In 2012-13, the triple lock—

uprating the basic state pension by the highest of earnings, CPI, or 2.5%—is forecast to increase basic state pension spending by £1.1bn compared to the previous indexation rules.

- An above-indexation rise (3.3%) in Pension Credit’s standard minimum income guarantee in 2011-12 ensures most low income households benefit from the basic state pension rise. No single pensioner need live on less than £137.35 a week, and no couple on less than £209.70.

The Government is also committed to tackling price volatility. The UK’s G20 agenda in this area is to identify and agree steps to ensure that global commodities markets are open, transparent and efficient, and that in the long run demand and supply are responsive to price changes.

Furthermore, the impact of high inflation on the public finances is likely to be temporary. The OBR’s assessment is that the Government is on course to meet its fiscal mandate, with the cyclically-adjusted current budget restored to balance in 2014-15.

Forecasting general government employment

4. We understand that the collection of workforce planning data across Government is difficult, particularly when radical changes are in progress. The Government is the best source of workforce plans to enable bottom-up forecasting of general government employment. Such information, if collated, would be of use to the Treasury in monitoring implementation and achievement of the consolidation, as much as it would be of assistance to the OBR in employment forecasting. We recommend that the Treasury does what it can to collect this information in a timely fashion, so that more is available before the next OBR forecast round. (Paragraph 27)

The Government has confidence in the OBR’s forecast as the best estimate of general government headcount reductions over the Spending Review period, based on aggregate spending plans.

The Government agrees with the Committee’s comments regarding the difficulty of bottom-up estimation of workforce impacts given that workforce change will be an evolving process over the next four years and beyond. It is for public sector employers to determine the workforce implications of their settlements, and the actual impact on employment will depend on allocations of funding by departments and the ongoing workforces decisions of hundreds, if not thousands, of employers up and down the country. The public communication of plans is an issue for employers, and must be handled sensitively, giving due regard to fair and appropriate engagement with staff.

Output gap

5. We recognise the importance of estimates of the output gap for assessments of the size of the structural deficit but we note the risks inherent in overreliance on this uncertain and imprecise measure as a basis for fiscal policy. (Paragraph 32)

The OBR is responsible for independently determining all key judgements relating to the Government's achievement of the fiscal mandate. In particular, it assesses and forecasts the cyclical position of the economy, which determines estimates of the structural position of the public finances. The amount of spare capacity in the economy is an unobservable variable, so the significant uncertainty as to its current and future size is inevitable. But as the OBR state in their November Economic and fiscal outlook, it is nevertheless necessary to form a judgement on the size of the gap:¹

"[...]we cannot assess the prospects for economic growth over a five-year period without taking some view—implicit or explicit—of the level of economic activity that the economy can sustain, how that level is likely to change, and how far above or below it the economy is currently operating. So some view of the likely evolution of potential output and the output gap is necessary to judge progress towards any medium-term target for the public finances, not just a cyclically-adjusted one."

The OBR highlights the current size of the output gap and the projection of its future path as one of the key parameters affecting the evolution of the public finances over the medium term. The OBR's March Economic and fiscal outlook compares OBR estimates of the output gap with those of external forecasters, and includes sensitivity analysis showing how a different output gap would impact on the Government's chances of meeting the mandate. Since the Budget, the OBR has published a Briefing Paper on Estimating the output gap. This is a transparent and detailed explanation of the two 'cyclical indicators' methods used by the OBR to estimate the output gap: aggregate composite estimates and principal components estimates. Later in the year, the OBR will publish a paper exploring methods of estimating a historical output gap series, which will allow the reassessment of the cyclical adjustment coefficients.

The fiscal mandate is based on a cyclically-adjusted aggregate in order to allow some fiscal flexibility at a time of economic uncertainty. It is supplemented with a target for debt, which requires public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16, ensuring that the public finances are restored to a sustainable path in the medium term

Changes within the Budget

6. In 2010 major decisions regarding public spending and tax were made in the Chancellor's Budget and Spending Review. It is therefore to be expected that the net fiscal effect of the policy changes announced in the 2011 Budget was minimal: to have done anything else would have contradicted one of the Chancellor of the Exchequer's stated objectives in the Budget. (Paragraph 37)

Fiscal consolidation is necessary to reduce risks in the short-term, restore private-sector confidence and underpin sustainable economic growth. The ongoing global economic uncertainty in the wake of the financial crisis, including from ongoing sovereign debt

¹ *Economic and fiscal outlook*, Office for Budget Responsibility, November 2010 (p. 29).

concerns, reinforces the case for stability in the Government's plans for fiscal consolidation.

Budget 2011 announced discretionary policy decisions with a neutral impact on the public finances. The costs of policy decisions announced in the Budget are broadly offset in each year by measures to raise revenue. This balanced judgement reinforces the fiscal consolidation plans announced in June Budget 2010 and Spending Review 2010.

7. In this Red Book, as in the last, the Treasury has included a considerable amount of additional analysis of the distributional impact of the Budget measures, in response to our requests. We are grateful for the Chancellor's responsiveness. This has become a regular feature of the Budget documents. (Paragraph 41)

8. We note that the majority of the consolidation has yet to begin. In the coming year, for example, the total consolidation will increase over fourfold to £41bn in 2011–12 from £9.4bn in 2010–11. The consolidation of spending is £5.5bn in 2010–11 and £22bn by 2011–12. One concern expressed to us was that these future spending cuts may prove too difficult to implement. We agree with the Chancellor that it will be important to strive 'to spread the burden fairly' as the consolidation begins in earnest. Being seen to do so is important. (Paragraph 42)

The Government welcomes the response of the Committee to its published distributional analysis. The Government will continue to seek to enhance the analysis it publishes at Budgets and welcomes all feedback that helps achieve this. The Government is committed to increasing transparency and enabling the effective scrutiny of policy making at future fiscal events.

Fairness is integral to the Government's fiscal strategy and to sustainable growth. Tackling the deficit will ensure that future generations are not burdened with unsustainable levels of debt. The Government has a vision of a fair, simple and efficient tax, benefit and pensions system which rewards work, saving and personal responsibility.

The analysis published at Budget shows the top fifth of earners is expected to make the greatest contribution towards reducing the deficit as a percentage of their income and benefits in kind from public services.

Meeting the fiscal mandate

9. The scenario and sensitivity analysis done by the OBR in trying to understand the risks surrounding the meeting of the fiscal mandate is welcome addition that will assist in explaining the thinking behind whether or not the fiscal mandate will be met. We welcome the fullness of the OBR Economic and Fiscal Report. It will be the task of the newly created and independent OBR rigorously to examine and explain progress in meeting the fiscal mandate and hence reinforce the fiscal plan's credibility. (Paragraph 48)

The Government welcomes the scenario and sensitivity analysis undertaken by the OBR. Recognising the risks and uncertainty about the future, the Government has taken a cautious approach to the structural adjustment of the public finances; based on its central, median forecast which takes into account all of the Government's policies, the OBR are forecasting that the Government will meet its fiscal mandate a year earlier than required, in 2014–15. The OBR state that, given past forecast errors, there is roughly a 70 per cent chance that there will be a structural current surplus in 2015–16.

Alternative strategies

10. Markets need to be confident that the Government is committed to its fiscal policy. A Government which talked of a Plan B as a substitute for that policy would prejudice that confidence. However, as we explored in our evidence, a responsible Chancellor is likely to have contingency plans to deal with a variety of scenarios where economic circumstances are fundamentally changing. Those plans should not be made public unless and until they are needed. (Paragraph 53)

The Government set out a plan to reduce the deficit over a credible timeframe at the June 2010 Budget and set out further details in the Spending Review which took place in October 2010. The plan has been welcomed internationally with support being received from the IMF, OECD and European Commission.

In the March Economic and Fiscal Outlook, the OBR judged that the Government's plan is consistent with economic growth across the forecast period to 2015 and that the Government has a greater than 50% chance of meeting both its fiscal mandate and supplementary target a year earlier than required, in 2014-15.

The Plan for Growth

11. We examine some of the proposals in The Plan for Growth later in this report; we urge colleagues on other Committees to evaluate the benefits of those within their terms of reference. (Paragraph 74)

The Government welcomes the Committee's interest in the measures set out in the Plan for Growth, and the implementation of these will be a priority across Government. The Government has also announced the second phase of the Growth Review, to examine new issues and new sectors, and to be published at the time of the Autumn Statement.

Tax reform and corporation tax

12. We welcome the reduction in the headline rate of corporation tax and note the evidence provided that this has boosted business growth and tax revenues elsewhere. We will monitor closely the impact of this policy on corporation tax revenues in the UK. (Paragraph 81)

The Government welcomes the Committee's support for the reduction in the headline rate of corporation tax. This policy will be monitored and assessed alongside other measures in the Government's package of Corporation Tax changes.

Enterprise Zones

13. Enterprise Zones may have some effect in reviving particular areas, but we note that almost all the evidence received is unsure about the extent to which they will contribute to UK growth. It is clear that there is still much to be done on the details of this policy. We expect that our colleagues on the Business, Innovation and Skills Committee and the Communities and Local Government Committee will want to scrutinise this policy carefully as it develops further. To aid them in this, we recommend that the Treasury provide an analysis of the overall economic impact, including measurement of any frictional and deadweight costs. (Paragraph 93)

The Government will work with Local Enterprise Partnerships to put an appropriate evaluation framework in place.

The Government recognises that the evidence base for previous Enterprise Zone policy represents mixed success and some important lessons to be learnt. Building on these lessons, new Enterprise Zone policy will be focused much more on tapping into the potential of places than trying to turn around the most extreme examples of market failure.

There is also a much stronger focus on the longer term viability of these zones, through improved infrastructure including transport and broadband. The Government has deliberately designed Enterprise Zone policy to give local authorities and Local Enterprise Partnerships strong incentives to minimise local displacement by linking the policy closely to wider policy objectives on the local retention of business rates being taken forward through the Local Resource Review. Local areas will directly benefit through increased net rate retention where local displacement is minimised.

Housing and planning

14. The Plan for Growth contains measures to stimulate demand from first-time buyers through the FirstBuy scheme, whilst also undertaking reform of the planning system, which may, in time, increase the supply of housing. If successful, the combination of these measures should both increase the supply of houses, and assist first-time buyers. However, if the Chancellor's expected supply side response fails to materialise, additional demand from FirstBuy could merely stimulate house prices. This could take house purchase out of the reach of more people. We recommend that the Treasury assess the impact of both the FirstBuy scheme and the wider planning reforms, and report back at each Budget. (Paragraph 98)

The FirstBuy scheme will assist over 10,000 households to buy a new home of their own. Because the scheme is intrinsically linked to the supply of new-build homes it supports new supply and will not put upwards pressure on house prices.

More broadly, the Government will assess the impact of its overall planning reforms through a Regulatory Impact Assessment. This will be published alongside the draft consultation on the National Planning Policy Framework this summer. Other RIAs will continue to be published on specific policy proposals, such as the proposal to allow

commercial properties to be re-classified residential through the Use Class Order regime.

The moratorium on new UK regulation

15. The plan to boost micro businesses and start-ups by a moratorium on new domestic regulation is intended to reduce the burdens on business. The Committee has taken limited evidence on this. We have however received evidence that the proposal may create problems. Several lists of regulatory exceptions and some administrative complexity could however be created by this apparently attractive proposal. Furthermore, if the Government succeeds in reducing new regulation overall, there may be less scope for the exemption of micro businesses and start-ups from such measures. Nor is it clear—where such an exemption is merited on welfare grounds—that it should be time-limited, rather than related to the size of the company. (Paragraph 106)

The Government's aim is that micro-businesses and new start-ups should be subject to no new regulation for three years from April 2011. A rigorous process requiring agreement from the Economic Affairs Committee and Reducing Regulation Committee has been set up to manage exemptions from the moratorium where they are necessary. When seeking a waiver, departments must demonstrate that they have taken concrete steps to mitigate the potential impact of new regulations on micro-businesses and start-ups such as exempting micros from written procedures or reducing the number of forms to be completed.

Identifying which regulations apply to a micro business should be less complicated than being subject to the burdens of all new regulation. The Government will be clear who regulation applies to, in legislation and its guidance, and in its business support such as the guides on what regulation applies to each type of business on the Business Link website.

The Government will publish guidance on the application of the moratorium in due course. The policy will be reviewed before the end of the Parliament to assess its impact and effectiveness.

Taxation

16. The Budget may not lead to a net simplification in tax law—although this is difficult to quantify. We recognise that it is very difficult to simplify an already complex system and welcome the work of the Office of Tax Simplification and the establishment of a 'direction of travel' towards simplification. The rate of increase of complexity has certainly been slowed but much more work is needed on the tax system before it can be said to be moving towards simplification. We welcome the OTS's work in this area; however the primary duty for securing simplification should lie with the Government in its design and administration of the tax system. (Paragraph 131)

The Government is committed to simplifying the tax system. The Office of Tax Simplification (OTS) was established to provide independent advice on ways to simplify existing tax policy. Budget 2011 announced the first steps towards this aim. Following recommendations made by the OTS, the Government decided to abolish 43 reliefs; announced a consultation on integrating the operation of income tax and NICs and asked the OTS to produce a report that looked into simplifying tax administration for smaller business. As part of their review of small business tax, the OTS was also asked to look specifically at the issue of IR35. Following the OTS's recommendations the Government announced that it will reform and simplify the way IR35 is administered by HMRC. The focus of further OTS reviews will be announced in due course.

The Government also acknowledges the important role the tax policy making process has in supporting the move towards a simpler tax system. Following extensive consultation, the Government has made a number of changes to the way tax policy is developed, communicated and legislated. In December 2010 the Government took the unprecedented step of publishing the majority of Finance Bill 2011 clauses and guidance, in draft, for comment. Other changes include the publication of the finalised version of a Tax Consultation Framework on 31 March.

Respondents to the consultation for this Framework have generally welcomed it as a positive step towards creating a tax system which is predictable, stable and simple. Many of the suggestions made during the consultation process have been incorporated into the finalised Framework, while others will be addressed through the guidance and training provided to policy officials.

National Insurance and Income Tax

17. The Chancellor is not proposing to merge National Insurance and income tax. The consultation is on the alignment of the operational aspects of these two revenue streams. Whilst this is likely to generate some benefits, it falls well short of the more fundamental merger that had been anticipated in the press in advance of the Budget speech. This is a complex issue and we understand the Chancellor's desire to move cautiously. The change appears to have been anticipated as a radical measure but turned out, at second glance, to be a modest one. (Paragraph 136)

The Government believes that integrating the operation of income tax and NICs can remove distortions, reduce burdens on business and improve fairness. It will bring forward reforms to meet these objectives by reducing the differences between the current income tax and NICs systems.

The Government has announced that it will consult on reforms to integrate the operation of income tax and National Insurance contributions (NICs). This reflects the Government's view that income tax and NICs should remain separate in recognition of the entitlement NICs provides to contributory benefits and the Government's decision not to extend NICs to other forms of income, such as pensions, savings and dividends.

Disguised Remuneration

18. We draw the attention of colleagues dealing with the Finance Bill in Committee to the proposals on disguised remuneration. We urge them to ensure that the final legislation is properly targeted, proportionate, and achieves its desired impact without imposing undue burdens on businesses. (Paragraph 146)

The Government consulted widely on the draft Finance Bill legislation. The Government listened to responses and made carefully targeted changes to limit the impact on employers and individuals where it was possible to identify arrangements that could not be used for avoidance purposes.

Stability in the 2011 Budget

19. We recognise that it will not be possible or desirable to consult on every tax increase ahead of the decision being made. Moreover, if the Government wishes to adjust duty rates in order to dampen the effects of oil price rises on end users, compensating revenue will need to be found elsewhere. The decision to increase the supplementary oil and gas levy by 12% without warning, less than a year after the Government had undertaken to provide a “stable” tax regime in the sector, may weaken the Government’s credibility in seeking to establish a stable tax regime in this and other areas. Such reversals of policy in the absence of changes of circumstances that would warrant them is bad for business confidence and the credibility of government policy making. We note that the Government “is now talking to the industry quite intensively” and urge it to make sure that industry is properly consulted on the design of the “stabiliser”. Colleagues on other committees may well wish to keep the effect of this tax change on investment under review. (Paragraph 157)

The Government welcomes the Committee’s recognition that it is not possible or desirable to consult on every tax increase ahead of the decision being made. The Fair Fuel Stabiliser, announced at the Budget, was a direct response to the significant increase in oil prices in recent months, which was both putting pressure on motorists, and leading to unexpected profits for producers in the North Sea. The Government will always need to retain some flexibility on tax policy to respond to priorities and immediate issues. However, the Government remains committed to stability and predictability in the UK tax system. It has made a number of substantive changes to the way tax policy is developed, communicated and legislated, with consultation on policy and scrutiny of draft legislation as cornerstones to the approach.

The Government welcomes the Committee’s recognition that the Fair Fuel Stabiliser allowed immediate support to be provided to motorists in a fiscally responsible way. The design of the stabiliser ensures that, should oil prices fall below a certain level, the level of Supplementary Charge will fall in a staged and affordable way. The Government is seeking the views of the oil and gas industry and motoring groups before setting the trigger price level, and has also committed to work with industry to identify ways to provide long-term certainty and stability on decommissioning relief.

Tax: practicality

20. We welcome the announcement in the Budget that HMRC's existing administrative burden reduction target will be expanded to include wider taxpayer compliance costs. It is crucially important that the wider costs placed on the economy by the tax system are taken into account and we will monitor the commitment that any increase in administrative burdens in the tax system will be met by equal reductions elsewhere in the tax system. (Paragraph 159)

HMRC is committed to further minimising the costs of customers meeting their tax obligations through simplification and streamlining delivered through the HMRC customer centric strategy and business plan. They are also working closely with the Office for Tax Simplification (OTS) to identify simplifications to the tax system, particularly in relation to small business taxation. For the future HMRC are:

- Modernising PAYE through Real Time information which will collect information about tax and other deductions automatically each time employers run their payroll with the potential to significantly reduce burdens on employers;
- From Autumn 2011, businesslink.gov will host a new start-up hub for businesses. This will provide a single point of access to services and support for new businesses, via personalised web pages. In support of the 'One Click' initiative, new tools will include a registration wizard, which is a single intelligent form enabling business start-ups and new employers (or their agent) to:
 - Register for multiple taxes, and the associated online services
 - Set up agent details and direct debit payment plans, and
 - Subscribe to receive targeted email updates and prompts from HMRC.

21. Whilst we welcome moves to allow businesses and individuals to handle their tax affairs online, making this mandatory without appropriate allowances being made runs the risk of leaving behind the significant minority who do not have reliable access to a computer or the internet. We agree with the Minister for the Cabinet Office, who has stated that "Every single Government service must be available to everyone—no matter if they are online or not", and expect that principle to be respected in the forthcoming consultation document. (Paragraph 162)

The Government recognise the concerns expressed here, but this has to be balanced with the need for the UK to compete in an increasingly digital world, where there is a shift away from a traditional 'multi-channel' approach. Following Lord Carter's 2006 Report, HMRC's business tax strategy has been to move to an online operating model and mandate the use of online channels for filing of business taxes.

The Government were and remain mindful that this should not disadvantage anybody and HMRC carried out a full assessment of the impact of those proposals including full public consultation and an Equality Impact Assessment in line with best practice. Respondents asked for help and support in going online and HMRC put in place a range of measures to address the concerns expressed and help those who may be

disadvantaged or have trouble accessing the internet. This has been very successful. By April 2011 75% of all VAT traders filed online including 380,000 who did so voluntarily and were not mandated.

‘One Click’ and particularly the new registration wizard will take this process to the next level, delivering online HMRC services ‘digitally by default’. We will continue our efforts to bring everyone along with us and HMRC will seek views on how best to achieve inclusion while staying within the spirit of Digital by Default.

Tax: coherence

22. The Budget contained a number of measures that have an impact on energy prices, ranging from the cancellation of the fuel duty escalator to the introduction of the Price Floor for carbon. Whilst we do not comment here on the likely impact of individual measures, we note that, as a package, they lack overall coherence. (Paragraph 169)

Given the high oil and retail prices the Government reduced fuel duty and as part of the oil fair fuel stabiliser increased the Supplementary Charge. Combined with increases in the taxation of fossil fuels used to generate electricity (coal and gas), through the introduction of the carbon price floor, a more equitable incidence of the UK’s energy taxes has been developed.

The Office for Budget Responsibility: process

23. Transparency about the basis on which the forecast is made is essential. The Treasury now has to deal with an external and independent body in constructing the Budget. It needs to make allowances for that. However, the timetable agreed for this forecast and Budget required all decisions which would impact on the economic forecast to be made at least a fortnight before Budget day. We recommend that the timetable should be revisited to provide more flexibility enabling economic shocks and late political decisions to be accommodated. It is understandable that a number of adjustments to the process and timetable will be needed, given that this was the first full forecast cycle since the creation of the OBR. (Paragraph 173)

As the OBR produce the forecast independently, the Chair of the OBR will write to the TSC in due course setting out more detail on the precise forecast process.

The Government welcomes the extra transparency brought by the OBR to the forecast, and accepts that the OBR’s new role will affect the timetable for Budget decisions. In the run up to Budget 2011 the Government ensured that the OBR was aware of policy decisions as far in advance as possible, and will continue to support the OBR’s forecast timetable in future Budgets.

The reliability of the forecast

24. In our earlier Report we noted “One of the ways in which we will judge whether the OBR is a success is whether there is greater public understanding of the purpose

and limitations of the forecasting process, and realistic expectations of what it can deliver.” While forecasts are useful tools, it is important that policymakers, and the public if possible, are aware of their limitations. It is important that the OBR plays its part by setting out as fully as possible each year the considerable limitations of the forecasting process and product. (Paragraph 175)

The Government agrees that it is important that the public understands the uncertainty around forecasts. The OBR is being transparent about the composition of its forecast and about the range of uncertainty around that forecast. The OBR has explicitly explained the assumptions and judgements made in each forecast in its Economic and Fiscal Outlook documents. The OBR uses fan charts, which illustrate the probability of different outcomes around a central, median forecast, to stress the uncertainty of prospects for the economy and the public finances. These are based on past Treasury forecast errors. The OBR has also explored alternative scenarios in its forecast documents, and explained how these scenarios would affect growth and the public finances. Finally, the OBR has a legislative duty set by the Budget Responsibility and National Audit Act 2011 to once a year produce an assessment of the accuracy of its previous forecasts, which will aid understanding of the limitations and vulnerabilities of forecasts.

25. We urge the OBR to reconsider the way in which asset sales are treated both in the Economic and Fiscal Outlook and in the forthcoming sustainability report. All economic forecasts deal with a number of specific and very uncertain outcomes to which numbers or assumptions are attached in the forecast. Asset sales are no different from many of these. We are concerned that caution in the treatment of asset sales may lead to a bias in the central forecast. A forecast is no longer central if decisions are made which have the effect of entrenching ‘upside risk’, a phrase used by Mr Ramsden. (Paragraph 180)

As the OBR produce the forecast independently, the Chair of the OBR will write to the TSC in due course setting out more detail on the precise forecast process.

Responsibility for the forecast

26. We understand the Chancellor’s desire to preserve the OBR’s independence. However, the uncertainty in forecasting means that the OBR’s work will indicate a range of probabilities, not a precise prediction for each economic variable. It is reasonable for a Government to accept and adopt the OBR’s forecast without necessarily agreeing with every single judgement in that forecast. (Paragraph 183)

The Government agrees that it would be reasonable to accept and adopt the OBR’s forecast without necessarily agreeing with every single judgement in that forecast. Paragraph 3.7 of the Charter for Budget Responsibility explains that, “The Government retains the right to disagree with the OBR’s forecasts and, if this is the case, will explain why to Parliament.”

Review of the OBR

27. The review of the OBR's reporting performance provided in the Act is well short of our recommendation that there should be a fundamental review of the OBR's remit and operating model after five years. We welcome the provision for independent review of the reports from the Office for Budget Responsibility, and may well engage with the Non-Executive directors on the arrangements for those reviews. However, we continue to believe there is a need for a fundamental review of the Office for Budget Responsibility, which would not be confined to assessing the output of the new organisation, but which would consider whether the framework established by the Budget Responsibility and National Audit Act was the most appropriate one. A wide ranging review of the OBR is essential. There is, of course, no need for such a review to be statutory. (Paragraph 185)

28. We welcome the Chancellor's commitment, subject to consultation, that there should be such an independent, external review. It should be led by someone outside the OBR, appointed for the purpose after consultation with, and with the agreement of, this Committee. We would like the Chancellor to come back to us after he has consulted Mr Chote to confirm the arrangements for this fundamental review. (Paragraph 187)

The government agrees it is best practice for all public bodies to be subject to regular review, as required by the Cabinet Office. This ensures that all public bodies are delivering high quality services, efficiently and effectively and that they fit within the Government's overall delivery structure. Given the crucial and independent role for the OBR within the fiscal framework the Government has recognised the need for regular review of the OBR's performance. The Budget Responsibility and National Audit Act 2011 includes a duty for the Non-executive Committee to keep the OBR's performance against its duty under review. The Act also includes a requirement Non-executive Committee to arrange an external review of the OBR's reports at least once in every 5-year period.

The Government has announced, subject to consultation with the independent Chair of the OBR, to an independent and external review of the OBR after its first five years of existence.

Appendix 2: Office for Budget Responsibility Response

Thank you for inviting us to give evidence on our *Economic and Fiscal Outlook*, as part of your broader enquiries into Budget 2011. I am writing to respond to the Committee's recommendations on the role of the OBR in its report of April 9. These covered three main issues: external review of the OBR's remit and operations, the forecast timetable and the treatment of potential privatisation proceeds.

External review of the OBR

The report recommends that an independent, external review of the OBR's remit and operating model be undertaken after five years.

I very much welcome this recommendation. There will be much to learn from our experience over this period – and from the parallel experience of fiscal watchdogs in other countries that have different remits and operating models. The OBR, the Treasury and the Treasury Committee will all have questions that we would wish such a review to cover. I hope that we can agree appropriate terms of reference and membership to ensure that everyone's needs can be met from a single exercise.

The forecast timetable

The report recommends that the OBR and the Treasury revisit the *Economic and fiscal outlook* forecast timetable “to provide more flexibility enabling economic shocks and late political decisions to be incorporated”.

We revisit the forecast timetable with the Treasury ahead of each EFO, in part to take into account the timing of economic data releases and other inputs expected in the run-up to the Chancellor's chosen publication date. As in the case of the March EFO, we will need to complete a final full-scale economic and fiscal forecast iteration some days ahead of publication, so that we can provide the Chancellor with a stable basis for his final policy decisions. We can then prepare the final forecast numbers (including sensitivity and scenario analysis) and accompanying analytical material.

We do have some flexibility to adjust the final forecast for late policy decisions and economic information emerging closer to publication. But it is clearly in everyone's interests that, wherever possible, policy decisions are taken in a timely way that facilitates adequate scrutiny and incorporation in the full-scale forecast.

Treatment of potential privatisation proceeds

The report urges the OBR “to reconsider the way in which asset sales are treated both in the *Economic and fiscal outlook* and in the forthcoming sustainability report”, as “caution in the treatment of asset sales may lead to a bias in the central forecast”.

As I wrote in my letter to you of March 23, we are keen to examine how we can provide more detail on the impact of potential asset sales on the public finances in the forthcoming *Fiscal sustainability report* and future EFOs. But, in accordance with the requirements of the Charter for Budget Responsibility, we only include the impact of policy decisions such as asset sales in our central projections when the Government has made a firm and well-defined decision whether, when and how to sell an asset and where the impact of that decision can be quantified “with reasonable accuracy”. The potential asset sales listed on page 50 of the Treasury’s Budget 2011 Red Book did not pass that test at the time of our last forecast.

There is an important distinction to be made here between the uncertainty around the nature, timing and impact of future policy decisions and the uncertainty around many other variables and assumptions in the forecast, especially given Parliament’s instruction to us in our legislation that we should not look at alternative policy scenarios.

Robert Chote
Chairman