The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 17 April 2013

Session 4

Wednesday 17 April 2013

CONTENTS

FINANCE COMMITTEE
11th Meeting 2013, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)
*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)
*Michael McMahon (Uddingston and Bellshill) (Lab)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Robert Chote (Office for Budget Responsibility)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 5

Scottish Parliament

Finance Committee

Wednesday 17 April 2013

[The Convener *opened the meeting at 10:00*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the 11th meeting of the Finance Committee in 2013. I remind everyone to switch off any mobile phones, tablet computers and BlackBerrys if they have not already done so.

The first item on our agenda is a decision on whether to take item 3 in private. Do members agree to take item 3 in private?

Members *indicated agreement.*

Economic and Fiscal Outlook (United Kingdom)

10:00

The Convener: Our second item of business is oral evidence on the United Kingdom economic and fiscal outlook. I welcome Robert Chote, who is chairman of the Office for Budget Responsibility, and invite him to give a short opening statement to the committee.

Robert Chote (Office for Budget Responsibility): Thank you very much, convener. It is a great pleasure to be here. Thank you very much for inviting me back.

I will say a little bit about the economic and fiscal forecasts that we published at the time of the UK budget and how those have changed since the previous forecasts, which we published at the end of last year.

I will start on the real economy. The outlook is slightly weaker than we had anticipated at the end of last year. The growth rate in the economy in 2012 was somewhat higher than we anticipated in December, but the economy seemed to have slightly less momentum coming into the final quarter of the year. That was partly because of disruption to production in the North Sea. There was a hit to gross domestic product from that specifically but, more generally, our sense was that, with factors such as weaker than expected average earnings growth and continued deterioration in export performance, there would be slightly less momentum coming into 2013 than we had previously anticipated.

As a consequence, we have revised down slightly our growth forecasts for 2013 and 2014. I would not overstate the scale of that, even though the proportionate change in the percentage change looks relatively large. Consider the combination of the fact that activity in 2012 was higher than we had anticipated and the fact that we have cut the growth forecast to 1.2 per cent from 1.6 per cent for 2013. That means that we anticipate that the economy this year will be about three thousandths smaller than we anticipated back in December.

On the forward outlook, we forecast a slightly weaker performance for 2013 and 2014 relatively widely spread across the components of GDP. For example, we expect a weaker contribution from consumer spending partly because average earnings will be weaker, which will mean less money in people’s pockets. The outlook for inflation in the near term is slightly higher, so what people can buy with their money will not stretch as far.

As I said, we have had weak export performance. If you were to go back over the whole of 2012 and look for the single factor that most obviously explains why activity has come in weaker than we anticipated a year ago, you would find that it was the deterioration in export performance. Some of that is relatively obviously explicable from conditions in the eurozone and other UK export markets, but there seems to be an additional, unexplained element to the deterioration in export performance, on which we and other forecasters will obviously keep a close eye.

I will give one slight warning on the data. We thought that we were in a similar position a couple of years ago when it looked as though export performance was weak relative to what we would have expected given how far the pound had fallen against other currencies. The Office for National Statistics then found some additional exports down the back of the sofa and revised the number and part of the mystery disappeared. There is always the possibility that we will find that history is rewritten to get rid of some of the mystery but, for the time being, export performance looks relatively weak compared to expectations.

We have revised down the business investment growth rate slightly. That is partly a reflection of the fact that the level back in 2012 has been revised upwards so, if we start from a higher base, less growth would be expected going forward to get us to what looks like a relatively plausible medium-term position.

If you look over the full five-year horizon of our forecast, you will see that, at the end of it, real GDP is 0.6 per cent lower than we anticipated back in December. Again, it will be six thousandths smaller in five years' time than we anticipated in the previous forecast. That gives you some sense of the scale of the change; it is not enormous.

On forecasting the outlook for the public finances, ironically although public attention understandably focuses on what we say about real growth in the economy, it is the growth in the cash side of the economy that matters much more for the state of public finances. If you are taxing incomes and spending as a proportion of incomes, it is a proportion of that cash amount rather than what the statisticians happen to say is real growth relative to whole-economy inflation. We have also revised down our view of whole-economy inflation in the longer term, partly because inflation in the Government sector has turned out to be different from what we expected. We have had a continued puzzle whereby, as cash spending plans have been cut, more of it has been showing up in inflation rather than in what statisticians judge to be the contribution of the Government's consumption of goods and services to real output. That means that, at the end of the forecast period, nominal GDP—cash GDP—will be about 2.5 per cent lower in 2017 than we anticipated at the end of last year.

That is the key driver of what is happening on the fiscal side. If cash spending and cash incomes are lower by that amount at the end of that period, we will expect cash receipts to be equivalently lower. We have therefore revised upwards our estimates of borrowing in cash terms over the five-year period, primarily because a weaker outlook for cash spending means fewer cash receipts coming in and correspondingly higher cash borrowing.

If we look at public finances in terms of share of GDP, the picture is more like a spending problem than a receipts problem, because the average tax raised—receipts as a share of GDP—does not change very much. Receipts are lower, GDP is lower and the share is not changed much. However, if you set out a lot of your spending plans in cash terms, such as linking welfare payments to consumer price inflation, and then lower cash GDP, those spending items will look larger relative to GDP.

There is therefore a weaker outlook for Government finances over the five-year period. Our view is that the Government is still on course to hit its fiscal mandate, which is borrowing no more than it needs to invest, adjusting for any remaining spare capacity in the economy at the end of that five-year horizon. However, we continue to take the view that the Government is more likely to miss its supplementary target of a falling public sector net debt as a share of GDP in 2015-16 by a slightly larger margin than we anticipated back in December. That reflects the fact that more borrowing will be done in the intervening years. That is the picture of the fiscal implications and the fiscal rules.

On the specific Scottish tax forecast for which we are responsible, most of the change between the previous forecast and the current one reflects the changes in the expected receipts UK-wide, of which we assume a particular proportion for Scotland rather than taking a different view about what that proportion is. Looking forward on income tax, you have weaker growth in average earnings, reflecting in particular the continuing disappointing weak growth in productivity. That has an impact on future expected income tax receipts for the UK and through the Calman wedge. Also, the starting point for income tax receipts is somewhat weaker. If you look at the numbers that came in earlier this year, pay as you earn receipts outside the financial sector—rather than the usual financial sector story—have been weaker than expected, which is in line with the relative weakness of average earnings. On the self-assessment side, the number of people who are self-employed has been rising quite rapidly but it looks as though fewer of those people than we expected are earning enough to be paying income tax, so the average effective tax rate on self-employment income is lower than we anticipated.

On stamp duty land tax, there is a weaker outlook for housing transactions. Price has a modest effect there, but I would have said that the income tax picture gives the clearest feed through to the devolved receipt streams. As I said, I think that that is primarily a story of UK numbers rather than a particular asymmetric UK and Scotland effect.

I will leave it there, but I will be happy to expand on any of that.

The Convener: Thank you for that interesting introduction. We have up to two hours for this session, so I will not ask a battery of questions and then allow colleagues to do likewise. I will ask three or four questions to start off with and will allow colleagues to come in again and again as they see fit, so that we will have a much more wide-ranging discussion that will benefit the full committee.

We had a pre-briefing on the Scottish rate of income tax from Professor David Bell, our budget adviser, before the meeting. That is a key issue for the committee and the Scottish Parliament. You mentioned that some of your predictions were three thousandths or six thousandths out. However, I am astonished at the huge changes that there have been in the OBR's prediction of the Scottish rate of income tax just over the past year, between March 2012 and March 2013. The prediction first had to be increased in December by around 3 per cent, and then between December and March it was reduced by 3.5 per cent for the year 2011-12. For 2013-14, there has been a 7 per cent reduction from your prediction between March last year and March this year. In your 2016-17 forecasts, you predict 13 per cent less income tax for Scotland than you predicted a year ago. Alarm bells are ringing because of the wide variance in those forecasts over such a short period of time. Can you explain those fairly significant changes?

Robert Chote: With these numbers—indeed, this is true of most receipts flows—we have a combination of new information from the recent data that has been coming in and whatever judgments we make about how things will evolve further out. In terms of the changes in the data that we have received recently, we get some of the most important information on income tax in the early months of the year, partly because that is when self-assessment receipts are coming in. Non-self-assessment PAYE receipts have come in relatively weak compared to our expectations, and some of that mechanically knocks through to the future years of the forecast as we apply growth rates to what we think will have come in in the previous year.

The unexpected weakness of PAYE is consistent with the fact that there has been weaker average earnings growth than we had anticipated. That has been the story for quite some time and seems to be partly linked to the productivity puzzle—the fact that productivity growth has continued to be relatively weak and people appear to be pricing themselves into jobs. That is one of the reasons for the puzzling, relatively impressive performance of employment relative to what is going on with the output of the economy. The PAYE element is probably where the explanation lies.

On self-assessment—the people who are filling in tax returns—there is a lag in the information that we get because people are paying that money in with a lag. The puzzle particularly on this occasion has been with self-employment. The level of self-employment has risen significantly, but the tax receipts from self-employed people have not risen as much as we would have expected had we known with confidence about that increase in numbers. That suggests to us that more of the increase in self-employment is coming in the form of jobs for people on relatively low incomes who are paying a low average tax rate, which pulls down the average tax rate for self-employment income as a whole. That is the primary story on the self-assessment side, with weak average earnings across the economy and weaker than expected average earnings across the economy on the PAYE side.

At the moment, the story of what is going on in outturn data is complicated at the top end of the income distribution by the announced changes in the higher rate of income tax, which is reducing from 50 to 45 per cent. One of the difficulties that are created in working out the underlying strength of income tax is that, in both cases, the previous Government, with the 50p rate, and the current Government, with the 45p rate, have announced those changes in advance. That has created an opportunity for people to shift income from future years into earlier years or from earlier years into future years in order to take advantage of the change in rates. That can happen if someone has the money sloshing about, as it were. In the case of the 45p rate, there is now a desire to push back some income—I am talking less about individuals who are on regular salaried income and do not have the flexibility to do that and more about people such as company directors, who have a choice about when to pay themselves.

10:15

In the case of the 50p rate, there was a temptation to pull a lot of money forward. It is estimated that about £16 billion was pulled forward. With the 45p rate, money is now being pushed back. Therefore, there is more uncertainty than there would usually be about how we interpret current outturns in income tax receipts. The uncertainty will continue for a time, because obviously we cannot predict with confidence how much income people will be willing and able to move from one year to another, before we get back to a steady state.

On the outlook going forward—that is, the growth rates that we apply to incomes, heading into income tax receipts, from where we are starting—the major factor is that we are assuming weaker nominal earnings growth, that is, weaker cash growth in earnings. That is basically a reflection of the fact that, as I said, we have had a surprise, in that productivity growth has been weaker than anticipated. More people are employed, but there has been no corresponding growth in output. The assumption that there is probably a relationship between improvements in productivity and the willingness of employers to increase cash earnings, and the fact that we have had more gloomy news on that, has led us to assume that there will be weaker growth going forward. Of course, as we go further forward, the effect accumulates and therefore the level difference between the two increases.

Under those circumstances, it is not particularly surprising that there is volatility in forecasts, even though we would wish the situation to be otherwise and it is unfortunate for people who are trying to plan. Once we get out of the intertemporal adjustments in relation to the 45p and 50p rates, things will be a little clearer.

In relation to the Scottish impact, as we look further forward another uncertainty is what the Scottish share is. As you know, at the moment we are basing estimates on the survey of personal incomes—the SPI—which is basically a sample of tax returns across the UK, the Scottish share of which can be identified. That will become better, and I hope that the forecasts will therefore be less volatile and less erratic when we get to the point at which HM Revenue and Customs flags particular taxpayers as Scottish taxpayers or not, on the basis of the definition that it is using.

My understanding is that it is unlikely that the flagging will be done much in advance of the devolution of the flow. I do not think that we will be in the position that we would ideally be in, whereby that flagging had been set up and we had had chances to look at a series of annual forecasts on the basis of the flagging. I think that we will probably have to rely on the SPI and that the flagging will be done shortly before devolution of the flow comes in. There will therefore be additional uncertainty, but I hope that in the longer term there will be greater stability.

The Convener: December 2015 is the latest date under the Scotland Act 2012 for the Scottish Government to set income tax from April 2016. What impact will setting the rate so early or even earlier have?

Robert Chote: In relation to the difficulties that that will create for forecasting, the crucial point is that it will depend on how different from 10 per cent the rate is. Clearly, if the rate is 10 per cent, there are all the uncertainties about the outlook for income tax receipts anyway, but if it is significantly different from 10 per cent there will be the additional issue to do with trying to judge how people will respond to the differential. The larger the differential—whether the rate is higher or lower—the greater the uncertainty, I suspect, in trying to judge how people will behave.

The Convener: To what extent does your forecasting take account of issues such as immigration to Scotland relative to the rest of the UK and the comparability of income tax receipts? We are talking about only a certain element of taxation. Are you looking specifically at those points?

Robert Chote: We are not looking at those points specifically, in the sense that when we embarked on the process that we discussed with the Scottish Government when the methodology was set up, we were struck by quite how stable the Scottish share of the UK whole had been. Given that, and the variations in those things in the past, it did not seem that we would be able to learn much that we could be confident about, in terms of micromanaging from that relatively broad stability. As you can see in the forecast, the share will settle down at a lower percentage than it has been—the 3.1X per cent at which it has been fairly stable. That is a reflection of policy changes, not a response to non-policy influences on the share. In essence, policy measures are increasing the income tax burden on the relatively well off, and the personal allowance is benefiting people at the bottom. The relative income distributions between the UK and Scotland suggest that there will be a lower steady-state Scottish share than we have had on average in the period prior to the changes. There is that effect, as well.

Flagging will allow us or revenue Scotland not to rely on samples, with all their implied variation and measurement error, but to have a much clearer administrative link with Scottish taxpayers. It may then be easier to look at those sorts of effects than it is to do so through the dividing-the-cake approach that we are using by necessity now.

The Convener: I will ask a couple more questions before I let colleagues in. One is on the reduction of the block grant associated with the devolution of SDLT and landfill tax. Do you think that the reduction should be fixed in nominal or real terms? Does OBR have a view on that?

Robert Chote: No; it is outside our remit to say what that process should be. Our job is to provide forecasts. It is for the UK and Scottish Governments to decide what if any use they want to make of those in determining the block grant reduction. I have looked at the debate over that and it is my sense that there needs to be a shared view of what is a fair basis of doing it. Are you trying to have a block grant reduction that is linked to what you would have expected the existing system of SDLT to raise in 2015-16, or do you want to take a broader, holistic view and make a fairness comparison between the flow of receipts that is being foregone and the flow of receipts that is being taken in replacement from 2015-16 onwards? You have to consider whether you want to look backward only or to look forward as well.

It is not for us to say what the fair way to do it is. I am not even clear—perhaps I have just not read it anywhere—whether there is a shared view about what the question is to which the answer is the amount of money by which the block grant will be reduced.

The Convener: Absolutely. It is unbelievably complicated and everyone around the table appreciates that. However, is it your view that the Scottish budget would be enhanced if the reduction was fixed in nominal or real terms?

Robert Chote: With a one-off change, you would assume that the amount of revenue stream that you will forego will fall as a share of GDP, given what will happen to public expenditure as a whole and the share of that that will be allocated to Scotland. Obviously, we do not know yet what the rates and rules of the proposed new transactions tax will be, but I presume that, in common with the existing system of SDLT, it will be dependent on a combination of house prices and the number of transactions in the property market. At the moment, transactions are relatively weak by long-term standards, which partly reflects the difficulties in credit conditions and so on.

We might therefore expect that any transactions tax would raise a rising share of GDP if house prices roughly move in line with cash GDP as a whole and there is a simultaneous rise in the number of transactions back to something like a more normal level. However, the open question is of course what the eventual normal level is to which we will return. If we take a very forward-looking approach, are we trying to weigh not just how much money comes in and goes out in a particular year but what the likely trends are in the future? That is why I presume the negotiations will be so interesting when they take place.

The Convener: I have a final question. The UK and Scottish Governments have agreed to utilise the indexed reduction method known as the Holtham method—in fact, Professor Holtham will be at committee next week—for adjusting the block grant following the introduction of the Scottish rate of income tax. However, Professor Holtham has suggested that that might not be in Scotland’s interests if our tax base grows more slowly than that of the UK. What is your view on that?

Robert Chote: I would defer to him on that. I have not looked at it closely, but I think that the aim of the Holtham system is to create an incentive to encourage the growth of the tax base relative to that of the UK as a whole. If he is less confident that Scotland could get its tax base to grow more rapidly, then perhaps that is where his concern is coming from. Presumably, there will be others who would say that the greater policy flexibility and the ability to design policies would make the opposite likely to be the case. However, it is not something that we have taken a view on.

The Convener: Thank you. I open up the discussion to colleagues.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): My question follows on from the convener’s one about the block grant adjustment in the light of the devolution of certain taxes. How is the OBR equipped to forecast accurately receipts from devolved taxes such as the land and buildings transaction tax, which is the replacement for stamp duty land tax, and landfill tax?

Robert Chote: In producing the baseline forecasts for tax receipts at a UK-wide level at the moment, we have discussions with HMRC on each of the tax bases in the run-up to each budget and autumn statement. HMRC will come to us with a paper setting out its view of what all the particular determinants of the tax receipt are. In the case of SDLT, the particular interest is on the residential side—house prices and housing transactions. HMRC crunches the numbers on the basis of what we think are reasonable assumptions to make about the changes in the number of transactions and house prices. HMRC has information on the distribution of houses by different value and the likelihood of sales and so on, so we then come back with a number.

As I understand it, revenue Scotland will manage and administer the new system. There will be separate registry data from Registers of Scotland that will enable that to be done. What we will need to do is talk to revenue Scotland about setting up a similar arrangement to the one that we have with HMRC, because we will have to have our own forecast of what those things are going to produce. I am not sure whether the Scottish Government will produce its own forecasts, whether a Scottish OBR will be created or whether revenue Scotland will publish things itself. That may have been decided, but I am unaware of it. If revenue Scotland manages the system and has the data available to it, we will have to talk to it about what it thinks are reasonable assumptions to make for the determinants and about what it thinks is the best way to model things. It will be for us to reach a view on whether we are happy to use that for our own purposes. Generally speaking, the conversations that we have had with HMRC and with other Government departments in the rarer cases when other taxes fall under their remit have worked very well and happily.

Jamie Hepburn: Clearly, you are saying that you need to get the information from revenue Scotland, Registers of Scotland and the Scottish Government. I think that you more or less hinted that revenue Scotland could do the job of forecasting. Might that not make more sense for us in relation to the devolved taxes? Certainly, although we act with the best will in the world in speaking to the OBR, the committee will be able to speak to revenue Scotland and have it before the committee a bit more readily.

10:30

Robert Chote: I am not sure that I see the distinction. For our own purposes and for producing UK-wide forecasts, we will have our own estimates of those things and we will want to discuss them with revenue Scotland. In the UK context, the Government used to publish estimates of what all its taxes would raise, but it no longer does so. I do not know whether, under the new system, the Scottish Government would intend to publish its estimates of what taxes would raise. Would the Scottish Government leave it up to us to talk to revenue Scotland and use the numbers that we publish? Is there any intention to have an independent scrutiny body to examine the forecasts and to be responsible for publishing or overseeing them? There are a variety of ways in which that model could work, and we are happy to talk to the Scottish Government and revenue Scotland about how best to do things as painlessly as possible for everybody concerned.

Jamie Hepburn: I turn to the issues around the oil and gas sector. I understand that Malcolm Webb from Oil & Gas UK wrote to you on 13 March, setting out the level of investment by the sector in the North Sea over the past year and in this coming year, and the organisation's expectations for the production rate. In his letter, Malcolm Webb said:

> "the most recent forecast commentators are using is your Autumn Statement forecast, which is based broadly on last year's Activity Survey. This information is now over 12 months out of date."

How do you respond to the industry view?

Robert Chote: When we do each forecast, we use the available data that we have at the time. Those are data produced at the time by Oil & Gas UK. The Department of Energy and Climate Change has twice-annual surveys of producers and what they are producing, and it makes its forecasts on the basis of those. We have to consider the combination of information that is available and we will produce the numbers that we think are central.

If you think that predicting economic growth is difficult, predicting North Sea receipts on a year-to-year basis is extremely difficult. They are highly volatile, and I expect them to continue to be highly volatile. If we go back over the past few years, we see that falls or increases of 40 or 70 per cent from one year to the next are not unusual. That reflects the complex combination of determinants for North Sea receipts. There are oil and gas production levels to consider, and the prices for both. As those prices are typically set in dollars on the world markets, there is the sterling-dollar exchange rate to take into account. There is then the level of expenditure, which the industry can set off against tax, and there may be changes in the tax system.

Those factors are all moving around in different ways, and that helps to explain why we might end up with such a volatile path. The current estimate of what North Sea receipts came in at in 2012-13 is a good deal lower than we anticipated it to be in the first forecast that we produced back in 2010. If memory serves me right, it is about £6 billion rather than £10 billion. That goes to show how large the variations and the forecast errors can be from year to year. I am afraid that that has long been the case for North Sea receipts.

Jamie Hepburn: You make a great deal of the price volatility, but the industry is saying that your figures are 12 months out of date. The same letter from Mr Webb sets out that the industry invested nearly £25 billion in capital infrastructure investment in the North Sea over the last year and this coming year. Those are hard-headed businessmen, who are presumably investing that money because they expect a return.

Robert Chote: Yes. That is the reason why we are expecting production to flatten out, having fallen for 13 years in a row.

Jamie Hepburn: Is the view of Oil & Gas UK that your figures are 12 months out of date correct or not?

Robert Chote: We do our forecasts on the basis of all the information that is available to us at the time. I think that DECC produces its numbers with higher frequency than Oil & Gas UK. It would be fair to say, looking back at those organisations' production forecasts over the past few years, that they have both tended to be overoptimistic relative to the outturns.

Jamie Hepburn: Let us look at the oil price, then. You are forecasting that the price will drop from $112 a barrel in 2012-13 to $93 a barrel in 2017-18, but the Organisation for Economic Co-operation and Development, with all its expertise, has suggested that oil prices could exceed $150 a barrel by 2020. What is your organisation's view on the OECD forecast?

Robert Chote: If you look at a range of oil price forecasts over the next five-year period, you will see a very wide range, with some prices going up and others going down. In making our assumption, we have said that we do not claim to be experts in the oil market so we will take the prices that are implied by futures prices.

For example, the International Monetary Fund "World Economic Outlook" publication that came out yesterday contains a chart that shows the oil price futures. The basic pattern is the same—although the IMF produced the forecast a bit later so it is a bit lower—as it shows Brent oil prices falling, while pointing out what a huge fan chart of uncertainty one would place around that.

There are some forecasts that are higher than ours over a five-year horizon, and there are some that are lower. If you look at the set of price forecasts that were compiled in the Scottish Government's "Oil and Gas Analytical Briefing", and the forecasts from the Centre for Public Policy for Regions, you will see that one set contained some forecasts that were above our own and above the futures price, while the other set contained forecasts that were lower. Once again, that underlines how uncertain the situation is. The oil price is now down to $100 from $113 when we started, and it is clear that the market is very volatile.

Jamie Hepburn: You say that you are not experts in the area of oil and gas. Do you accept that Oil & Gas UK and the OECD probably are experts?

Robert Chote: As will be all the other people who have produced forecasts that go in the other direction. As you said, hard-headed people are making judgments on what to buy and sell in the futures market, so there will not be a perfect answer, but for the time being that forecast seems to us to be a reasonable one to go with. We will certainly keep it under review—we want to look, for example, at how liquid the market is at different time horizons. You just have to look at the range of forecasts over that five-year period and accept that the profile of receipts over that horizon will be very uncertain for anybody to try to predict.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): I was going to ask about oil. Your explanation was helpful, but you will understand the political sensitivities of it. When would you next be revising your estimates for oil? Is that done on a regular basis?

Robert Chote: We do it for each of the economic and fiscal outlook publications that we produce. The date depends on when the Chancellor of the Exchequer sets the autumn statement on the budget, but typically it would be late November and early March. We also produce a fiscal sustainability report in July, which is a much longer-horizon publication over 50 years, so we will need to return to the subject then. There are therefore two views—or three, depending on how you look at it, but it is the November and March publications that are linked specifically to a detailed forecast of oil receipts.

Malcolm Chisholm: So, is the March one out now?

Robert Chote: Yes—that is the budget one that we are talking about here.

Malcolm Chisholm: Okay. Your explanation is useful—I am sorry that I have not read the document, but does that type of commentary on how you arrived at those particular estimates in relation to the futures prices appear in the bulletin to which you have just referred?

Robert Chote: Yes. One of the things that I wanted to do when I came to the OBR was to provide a more detailed breakdown of why forecasts for particular receipt streams—not just oil and gas—were changing from one forecast to the next. Rather than simply providing a brief textual description that says that one forecast is a bit higher and one is a bit lower, we show the previous forecast and the current forecast, and break down quantitatively the contribution for those different elements, which include—as I said—production, oil and gas prices, expenditure and other changes. That is all in the publication.

Malcolm Chisholm: The different views of various organisations seem to be the main currency of debate; Jamie Hepburn was talking about the OECD, and somebody else might quote the Bank of Norway in the opposite direction. Do you source it in that way, or not really?

Robert Chote: We have not done so at that stage. We have to make a central assumption to come out with a particular forecast. If you come to the talk that I am giving this evening, you will find a chart that contains a selection of different oil prices.

Malcolm Chisholm: That may be what I do this evening.

Obviously, if we go down the independence route, oil will be very important. If we stick with any form of devolution, the block grant adjustment will be very important, which is why people have been asking about that. I accept that it is not for you to make decisions about the mechanism for that. However, your chart shows that the Scottish share of income tax has recently gone down slightly, and you explain the reasons for that. I wonder whether that will be a problem for any block grant adjustment. Will that be indexed to some overall UK income tax receipts, presumably the equivalent 10p receipts? Could the changes that you describe be a problem?

Robert Chote: It comes back to the shared view of what is a fair size for the block grant. We can try to conceptualise this. One view of fairness, which I am not advocating, is to ensure that the block grant reduction takes place such that you would not anticipate there to be a net fiscal transfer in either direction—Scotland or the rest of the UK. It involves looking at the expected future value of the block grant versus what you would have got if you had continued to have the SDLT system.

You could achieve those answers by having different starting points for the block grant reduction and then moving it in different ways in future, which could theoretically end up with the same sort of results. Presumably some trade-off will have to be made between a relatively simple system and one that is broadly accepted as fair, given the uncertainties, because no one is entirely confident what the SDLT would generate in future years nor indeed what the path of broader public expenditure, and therefore the size of the block grant reduction, would be.

Malcolm Chisholm: But do you think in principle that it is possible to have a fair system of indexation that does not involve random changes for which no one is really responsible in economic terms?

Robert Chote: Clearly, it is desirable to have a negotiation that ends up with a view that everybody ex ante believes to be fair at the time that the deal is made. The difficulty is that if things turn out differently ex post, people may not think that it is fair. That brings us back to the issue about whether you want to be able to revisit this after the event, which is above my pay grade.

Malcolm Chisholm: On the SDLT situation, you say on page 2 of "Economic and fiscal outlook—Scottish tax forecasts":

> "Once final decisions have been made on these new taxes, we will produce forecasts based on the new tax regimes."

I think that you have answered this in part already, but do you anticipate that you will do those forecasts anyway or are they related to the block grant adjustment for that tax?

Robert Chote: As I understand it, they are not related to the block grant adjustment. That is the new system that will come in, which it is for the Scottish Government to design.

My understanding, which I may have read in a briefing for the committee, is that the current expectation is that the rates and bands for the new land and buildings transaction tax are unlikely to be set much in advance of the beginning of the fiscal year in which they will take effect. That suggests that there will be a relatively brief period to look at that and check the sensitivities.

One of the questions that we would want to ask revenue Scotland is what work we need to do in advance of the introduction of the new tax so that we come up with a set of forecasts that we are happy with for our purposes. As I say, it depends whether the Scottish Government wishes to publish other numbers in addition to the ones that we will need to publish for our purposes. However, having a good discussion with the Scottish Government ahead of that would be quite important because, presumably, the bands and rates will be set initially, given some view of what the Scottish Government wants to raise from this tax, which does not necessarily need to be exactly the same amount that was raised from the existing SDLT system. The sooner that the parameters of that are known, the more time you will have to crunch the numbers and think about the uncertainties.

Malcolm Chisholm: I move to a couple of areas of more general forecasting. You referred to business investment being revised down, but you were quite low key about that. You said that some of that was because it was a higher base and then you said that business investment would be okay in the medium term. In table 1.1 of the Scottish tax forecasts document, the percentage change figures for business investment are -3 in 2013, -2.1 in 2014, -1.6 in 2015, -1.5 in 2016 and -0.9 in 2017. Those are the figures for the next five years. It looks as if the situation is a lot more problematic than your commentary suggested.

10:45

Robert Chote: With business investment you are dealing with a number that is extremely volatile from quarter to quarter. The revisions to the numbers can be quite large. Annual growth rates can often be changed quite significantly because the Office for National Statistics will take a different view about what the level of business investment was at the tail end of the preceding year, as it were.

We have a chart on this somewhere in the report. If you look at the broader picture—the real-terms figures—you can see that, perhaps surprisingly, the net change in business investment from the point at which the recession started has not been dramatically different from the experience of the 1990s. There was a rather sharper fall and a bit more of a pick-up. Looking forward, we are anticipating that that will be weaker. We are not expecting a 1990s-style recovery in business investment in real terms, given that we will not have a 1990s-style recovery in the rest of the economy. We have a weaker profile for that looking forward. At the moment, going back, things have been closer to the 1990s than you might have anticipated, but all those numbers could be revised. Looking forward, we are more pessimistic.

Malcolm Chisholm: I am told that the figure is down 19 per cent from 2007, which I think is a lot worse than in the 1990s and in previous recessions. Irrespective of that, surely even if the figure fluctuates from quarter to quarter, it is going down significantly over the next five years. Anyway, I suppose that the more general point is that you expected in previous reports that a revival in exports and business investment would be crucial to rebalancing the economy away from financial services. Why is that not happening? It is not as if companies are short of cash, is it?

Robert Chote: That latter point is interesting. You would draw a distinction between smaller firms that are likely to be more affected in their ability to invest by credit conditions and difficulties getting the money from banks and larger companies that are less reliant on banks for that. As you say, corporate cash piles are relatively large. Our view, which I think we discussed when we were here last year, is that perhaps not as much of that money is in the hands of firms that are likely to do plant and machinery investment as the official statistics might suggest. More of it might be in the hands of hedge funds, for example, which is one reason why we have taken a relatively cautious view compared with what we would have been saying back in 2010.

Page 58 of the economic outlook report shows you the comparison with the path in our forecast versus the path in the 1990s. You can see there the peak-to-trough fall. Roughly 20 per cent is what you are looking at, of which roughly half has been recovered. In the 1990s the trough was slightly higher and the expansion was slightly less. Nineteen quarters from the pre-recession peak, you are in roughly the same position. Looking at the picture, the numbers might be revised. As the old joke goes, the past is as hard to predict as the future in this particular area.

Malcolm Chisholm: That is a good quote for tomorrow's debate. Thank you very much.

My last question is on the targets. You said that the UK Government would meet its first target, but it would miss its supplementary target. On page 15 of your executive summary you say:

> "PSND in 2017-18 is now expected to be around 7.5 per cent of GDP higher than we forecast in December."

That seems a very big increase over a very short period.

Robert Chote: That reflects a combination of factors. The fact that we have higher borrowing over the intervening period in cash terms clearly means that the cash value of debt in 2015-16 would be higher than we anticipated back in December. I also pointed out earlier on that we had revised down the estimated total cash size of the economy.

If we look at debt as a share of GDP, we find that the numerator has gone up and the denominator has gone down, because the cash amount of debt is higher than anticipated and the thing that we divide it by—the cash size of the economy—is smaller. Therefore, there is a mutually reinforcing effect, which pushes up the level. There is also a change in the assumptions that we make about the way in which the Debt Management Office sells gilts, which has another contribution, but I will not complicate the issue or bore you by going into that. The previous two factors that I mentioned—the higher numerator and the lower denominator—are the main factors.

Malcolm Chisholm: The Institute for Fiscal Studies suggests that perhaps there should be a new rule that targets the total level of public debt, which I presume would avoid some of the problems that you have emphasised. The institute has even suggested measuring the fraction of future tax revenues that has been precommitted to meeting liabilities accrued by current and previous Governments. Would you support such a change or is it not your business to comment on those issues?

Robert Chote: It is not my business now but, given that I wrote that proposal for the IFS green budget some years ago, it would be churlish to dump on it from a great height at this stage. The argument behind the commitments proposal is that we would be happier with a higher level of public debt if it is relatively cheap to borrow and vice versa. So, basically, if there was a commitment on how much we would devote to servicing debt in future, that would allow a higher level of debt when interest rates were relatively low, but when it became more expensive for the Government to borrow, there would be more resistance to that. As I said, that matter is not at all within my purview now, but that is what I would have said if you had asked me three years ago.

Michael McMahon (Uddingston and Bellshill) (Lab): Malcolm Chisholm asked some of the questions that I was going to ask on SDLT, but one remains just for clarification in my mind. You talked about the forecast for 2017 changing by six thousandths. Certainly, when we talk about the overall economy, that is a small figure, and when we look at specific taxes such as SDLT or the aggregates tax, the difference in growth or the marginal change becomes even smaller. Even across the UK, the figure is not particularly significant. Will you consider what the marginal change will be in the Scottish economy in relation to the change from SDLT to LBTT and other changes and how significant it will be?

Robert Chote: It is certainly not surprising that we expect a tax on property transactions to be relatively volatile and to have larger swings than the economy as a whole or taxes such as income tax, which, broadly speaking, move in line with movements in the economy as a whole. That is because a tax on property transactions is determined partly by house prices and partly by the level of transactions, both of which are affected not simply by the amount of income that is sloshing around in the economy but by people's expectations of where house prices will move.

One reason why we predict relatively strong growth in SDLT is that, at the moment, the number of housing transactions—the number of purchases and sales—is low relative to long-term averages. That is understandable, given credit conditions and the difficulties that people have with getting deposits and relatively high loan-to-value ratio mortgages and so on. Over time, we would expect that number to move up. We try to anchor the figure in the long term by saying that, in the past, people have on average stayed in a given house for 19 years or thereabouts, and there is a level of housing transactions each year that is consistent with that being the case.

If housing transactions stay at the current level, people will move a lot less frequently than once every 19 years, but it does not seem plausible that that will be the case once the credit conditions improve, which is why we have a trend of improvement. Exactly how quickly the figure rebounds, what the new normal is and whether in the future people will move once every 19 years or something different are all sources of uncertainty. In each forecast that we produce, we might have to make new judgments about where that will end up.

On house prices, basically, we take the average of outside forecasters' expectations of where house prices will move in the near term and then assume that house prices will move in line with cash income in the economy over a longer period. That is a relatively simple approach.

Over time, there will be the issue of whether the design of the new transactions tax means that there will be more or less of an adjustment to receipts, depending on how quickly prices move. I presume that it will make a difference to the distribution of whether house prices rise more quickly at the top of the market than at the bottom. I suspect that the new system will have to be up and running for quite a period and the bands and rates will have to be relatively stable before people can start to get a grip on how the system is working. If they are moved around early, that will make the position harder to work out.

Until the system has been seen in operation, it will be hard to know whether it will be more or less volatile as a revenue stream than the system that is in place, leaving aside the question of whether the Scottish economy as a whole will be more likely to be volatile. As you know, we do not have the resources to do a separate Scottish macro forecast, although others might do that.

Michael McMahon: I have a separate issue, although it is fine if you do not cover it. The Secretary of State for Work and Pensions has said that he is trying to manage the growth in welfare payments, and he clearly wants to reduce the amount of money that is spent on welfare. However, over the whole economy, the chancellor will not meet his borrowing targets, according to your figures.

The reductions in welfare spending will take £19 billion out of the overall economy, but borrowing will still increase. Will that have an impact on the amount of money that can be spent by people who are on welfare in the local and wider economies? You talked about a reduction in oil revenue forecasts from £10 billion to £6 billion, but we are talking about £19 billion being taken out of the economy and people's potential spend at the same time as the Government increases its borrowing. Have you factored any of that into your equations?

Robert Chote: We have tried to take account of existing policies as best we can. The feedback to the economy can be noticeable on occasion. The relative strength of household disposable incomes during the past year, which has a feed-through effect to consumer spending, partly reflects the fact that we had a relatively high inflation rate in September 2011. That rate was used to determine the increase in the generosity of most benefit payments in the subsequent financial year and that is one reason why, in that year, disposable income and consumer spending were perhaps slightly higher than would otherwise be expected.

I cannot give a figure for how different the position will look if we take out the set of measures that you mentioned, but what I have said illustrates the fact that there can be some sensitivity to such measures. We will obviously look with interest at how the Government frames the target for what it wants to do about the control of welfare spending.

At the moment, we forecast the spending on particular benefits and tax credits on the basis of the rules and eligibility in existing policy. I suspect that we will continue to do that. It remains to be seen whether the Government will make a commitment on the total amount of welfare spending and therefore a commitment to pulling some levels down if others are higher than expected. We would have to look at what we wanted to do if the Government came out with such a policy but, at the moment, we look at rates, eligibility and what we think will happen to earnings, unemployment and so on, and we come up with forecasts accordingly.

At one level, the idea of targeting welfare or thinking about welfare payments as controllable is a sort of back to the future idea. There used to be a thing called the new control total, under which central Government tried to manage total spending, minus the bit of social security spending that goes up and down with the ups and downs of the economy and minus local authority self-financed spending, debt interest and so on. The idea of targeting welfare might not be a dramatic departure from past systems of public expenditure control, but we will have to see the concrete detail of what the Government is planning to do on that.

11:00

The Convener: I have a supplementary on what Michael McMahon talked about with regard to SDLT. Relative to March this year, the OBR's forecasts in March 2012 have been adjusted downwards by 13 per cent, yet you still predict that, over the next five years, there will be an 85 per cent increase in receipts in Scotland. The Scottish Property Federation has denounced that prediction as being "wildly optimistic".

Given that you have already had to make a significant readjustment for the financial year 2011-12 over the past year, how can you possibly be confident? You talked about the number of times that people move house and so on, but how can you possibly be confident that such dramatic growth can take place in the current economic conditions?

Robert Chote: We cannot be confident. That is the central estimate around which there is huge uncertainty. The uncertainties concern what will happen to house prices and the number of transactions. That is linked to what will happen to people's incomes, people's expectations about future incomes and people's expectations about whether now is a good time to buy or sell, given where they think that house prices will go. It reflects people's ability to build up deposits at a time when lenders require larger deposits. It depends on the extent to which we see a return to the availability of relatively large loan-to-value ratio mortgages.

There are a huge number of uncertainties, so I am not at all confident that things will turn out exactly as the prediction suggests, but that is the central forecast that we have produced. It underlines the fact that with your transactions tax—the LBTT—there will presumably be similar volatility issues that you will need to manage. If that tax is still fundamentally dependent on house prices and on transactions, the uncertainties in the current system will be in the new system.

The Convener: We are all aware that it is not an exact science but, given that economic growth is sluggish and that there are barriers to people buying houses—such as the size of the deposit that they have to pay, the willingness of banks to lend and so on—how closely do you liaise with organisations such as the Scottish Property Federation and its UK equivalent to produce figures? A projected 85 per cent increase in revenue seems pretty optimistic by any standards. After you reduced the forecast in 2012 by 13 per cent, you are still projecting an 85 per cent increase in receipts.

Robert Chote: We mechanically use expectations from outside forecasters for house price movements in the near term, so that is an automatic link. On prices over the longer term, there is no guarantee that linking house prices to cash growth in incomes in the economy will turn out, but it is a relatively simple and relatively defensible central assumption to make.

On the changes in transactions, there is the puzzle of what the long-term return is. I do not know whether the SPF has a view that, fundamentally, we will move to a world in which people just move house half as frequently as they previously did. That would be a perfectly reasonable conclusion for the SPF to make. Working from that conclusion, you would end up with a lower number.

We have a relatively long transition as credit conditions improve and the banking system unglues to get back to that, plus a relatively mechanistic assumption about house prices moving broadly in line with incomes, but there is huge uncertainty over that.

The Convener: Many people in the property industry still think that house prices are overvalued in parts of the country. Although people may move as frequently, that does not necessarily mean that house prices will increase. For example, if there are the same number of transactions, house prices have to increase significantly in order to get 85 per cent more income. Surely there is not really any evidence that house prices—certainly prices in Scotland—are likely to grow with such rapidity.

Robert Chote: We have produced a forecast for the UK; the Scottish share is particularly volatile. The alternative would be to have a much more sophisticated econometric model, which would try to bring in determinants. On the basis of the discussions that we had with HMRC, in which the Scottish Government was involved, the imperfect approach of assuming a constant share seems to be the best way to go.

As I said, over time, it will be interesting to see the effect of having the new data sources. Depending on how the system is designed, its outcome might end up being more or less predictable.

It is not my job to talk about the merits of individual tax systems but, in my previous job, I would have said that SDLT is the year-after-year winner of the title of worst-designed tax in the British tax system—you will have to ask Paul Johnson whether he is of that view. I understand that one thing that the land and buildings transaction tax will do is get rid of the slab structure, which means that transactions bunch at particular levels. Over time, it will be interesting to see whether that move produces a smoother and less volatile path for receipts. I do not have a view on that yet.

The Convener: You said that Scottish house prices were particularly volatile. Surely those in London are much more volatile. I do not think that Scotland's house prices are particularly volatile in a UK context.

Robert Chote: It is the Scottish share that is volatile, partly because of the movements in prices in London.

John Mason (Glasgow Shettleston) (SNP): After listening to all this for the past hour or so, I wonder whether we are expecting too much in the way of the accuracy of forecasts. A chart tells us that UK income tax receipts will grow by 6.81 per cent in 2017-18. In reality, the figure will probably be higher or lower than that. I like the fan charts that you produce, in which the gap between the predicted maximum and the predicted minimum gets wider in later years. Are we and the media being unfair in pinning you down to one figure when, in fact, you tell us when you come here that the figure might vary?

Robert Chote: I would not complain about unfairness; that would be like sailors complaining about the sea. That is the world that people who do forecasts live in.

If you have read the report, you will have seen that there is a high degree of precision and that an awful lot of figures are given to one decimal place, with changes in receipts being broken down into various areas. It could be argued that that creates a spurious sense of precision. For example, although it contains a great deal of quantitatively informed analysis, the Bank of England's inflation report is not full of forecast numbers—it has a couple of fan charts and it does not have point estimates for what will happen to exports, consumption and so on. Its argument for that would be that providing those point estimates would give people the impression that we can be unduly precise about those issues and that it is better to produce a broader picture and say that there are uncertainties about various factors, which will help people to focus on the wood rather than the trees.

I have gone in the other direction since the OBR's creation because the office was created out of a desire that public finance forecasts should represent the best professional judgment, with which people can and will disagree regularly, and should not be infected by politically motivated wishful thinking. My view is that, to achieve that, we have to show our working, which means that we have to be transparent and provide more detail on how things are moving.

I have aimed to do that, even if it means inflicting a relatively thick document on you as a result. That is not because I believe that I am smarter than the Bank of England and better at forecasting things to one decimal place than it is; it is because the nature of the job that we have been given makes it incumbent on us to show our working to the maximum possible degree, so that people can reach their own judgments about whether our views are sensible.

As you say, we try to underline the uncertainty in our forecasts in a number of ways. One way is to use fan charts. Basically, if someone who came from Mars saw only the forecasts that we have published today and was made aware of how accurate, on average, such forecasts have been in the past, they would know how much confidence they should place in those forecasts. That can be done at a relatively high level for overall Government borrowing and economic growth.

It would be hard to take that approach for individual taxes, because the details and policies change so much. For example, oil and gas receipts involve five or six volatile individual determinants that must all be added together to produce the end forecast.

We use fan charts to pick out some of the features of the economic forecast that are crucial to the judgments that we make about whether the Government will hit its target. We ask how different its ability to hit the target would look if, for example, the recovery was stronger or weaker, there was more or less spare capacity or the amount that the Government had to pay to borrow was higher or lower.

The tyres of the forecast can be kicked in that way, and we can say in which bit of the forecast the Government is most vulnerable to errors that would knock it off course from hitting the targets that it has given. For example, on the fiscal mandate and the deficit target, it is our view of how much spare capacity is in the economy and therefore how much of the borrowing is structural and persistent and, alternatively, how much of it is relatively temporary and will go away as the economy recovers. We also use scenarios to pick up and reflect particular issues in economic debate that people are interested in.

We provide as much information as we can. People may disagree with our view of the economy or its particular drivers. However, if they were more optimistic about oil prices or less optimistic about production or whatever it might be, they would be able to see more clearly from the detail that the OBR has given how much difference that would make.

There is then the issue of what policy makers do with the information. It is not my job to tell them what they should do but, clearly, policy needs to be made in full knowledge of the uncertainty and difficulty of economic and fiscal forecasting.

All the debates that I gather that you have had about oil receipts and whether there should be a stabilisation process in a world in which an independent Scotland would have a much higher proportion of its receipts from a relatively volatile source than would be the case elsewhere are exactly the issues that policy makers necessarily and rightly wrestle with. That is also what forces the UK Government to decide, for example, that it will not just aim to hit a target exactly—and have a 50 per cent chance of hitting or missing it—and to decide how much wriggle room it wants to include. Those are difficult additional choices that policy makers must make above and beyond what we pointy heads have to do to give the numbers that we hope will allow people—and the rest of the world—to make those decisions.

John Mason: I agree largely with what you are saying. It is better to have more rather than less information out there. However, as a result, you get beaten with a stick if you said X in December but in March it looks quite different, even though you have given the reasons when people have asked you for them. I do not know whether that has an effect in the long run. People have a lot of respect for you as an individual—

Robert Chote: It is diminishing all the time—that is what you mean.

John Mason: The organisation tends to get slated a bit when the forecasts do not turn out quite right.

Robert Chote: I have a regular and enjoyable appearance on "Newsnight" in which Jeremy Paxman says something along the lines of, "Last time you said this. Now you're saying this. How do we know that you are going to be right this time?" I say, "You don't," and the interview proceeds accordingly.

John Mason: It sometimes comes across better in person than on paper.

You used the word "vulnerable", which was a good word to use. Obviously, certain forecasts are more important than others for the Government and the economy and so on. I want to ask you how vulnerable we are—in a positive and negative sense—in two areas, one of which is exchange rates, which you have mentioned, and exports. Although the exchange rate has been going down—some people would say that it has been going down since the 1950s—that has not led to the boost in exports that we might have expected. Are we vulnerable to that decrease in the future, too?

Robert Chote: I mentioned that one way in which we look at uncertainties is to do scenarios. The one that we chose for that forecast considers what issues people would need to worry about if there was a further 15 per cent fall in the exchange rate, for example. When some of the uncertainties are highlighted, it is hard to know even what direction—up or down—the economy would go in as a consequence.

As for the recent fall in the exchange rate, which you rightly pointed out, people have if anything been surprised by its relatively modest impact on export performance. However, they have probably also been surprised by how much it has weakened economic activity by pushing up import prices, which has squeezed consumer budgets and reduced the contribution from real consumption.

11:15

The question is: if there were to be a further fall in the exchange rate, would the story be more like the recent situation, with its disappointments and surprises, or would we go back to the early 1990s, when we were surprised by how little the fall in the exchange rate after 1992 fed through to inflation and by the more upbeat exports response? Clearly that is a source of uncertainty.

As I said, it has been particularly difficult to interpret what is going on with exports, and it is possible that, as happened a couple of years ago, we will receive revisions to the data that suggest more of an exports response to the relatively weak exchange rates than we currently think will be the case. It is also quite useful to look at exports performance in a slightly more disaggregated way. Disappointments are showing up more on the services side, where deterioration has been more dramatic, rather than on the goods side, where the fall in the exchange rate seems to have arrested the trend loss of market share.

John Mason: Is the problem that our goods side has fallen so much that we are actually trying to grow from a low base?

Robert Chote: That could be the case but, as we have not specifically looked at whether we would expect a differently sized response with the starting level as a share of GDP, I do not know the answer to that question.

On the services side, there has been a particularly sharp fall in financial services exports. Interestingly, United States financial services exports have also declined, so the question is whether there is less global demand for the sorts of financial services that the UK and the US tend to provide. That might be part of the explanation for that fall.

There is also the difficulty of measuring financial services exports. If financial institutions are reducing their balance sheets and their exposure overseas—and if we assume that financial services exports form a proportion of the size of that overseas balance sheet—one might conclude that it is a rather more automatic response to what is happening to the global exposure of financial institutions.

As for why the economy has not grown as rapidly as we expected two or three years ago, I have to say that, interestingly, it has been an exports story more recently, whereas earlier it was all about inflation. In other words, a given amount of cash consumer spending did not go as far as it had previously with regard to the goods and services that were produced and consumed.

John Mason: The other area of vulnerability that crossed my mind was interest rates. It has been said that borrowing might not be so important relative to GDP, but I believe that you or someone else pointed out that interest rates are part of the equation. After all, if interest rates are higher, people can afford only to borrow less. I still fear for individuals who are used to low interest rates; some of us remember the quite high rates that we had in the past. If the country loses credibility and its triple-A ratings on such matters, might we have to pay higher interest rates in the future? If so, what would be the impact of that?

Robert Chote: There are two issues in that respect: the interest rates that businesses and companies pay and the interest rates that the Government pays, both of which have different implications. With regard to the interest rates paid by the private sector, one potential source of reassurance is that if—[*Interruption*.]

The Convener: There appears to have been a power cut. I suspend the meeting.

11:20

Meeting suspended.

11:22

On resuming—

The Convener: Okay, folks. I reconvene the meeting and apologise for that interlude. Mr Mason—the floor is still yours.

John Mason: If I remember correctly, I had asked a general question about interest rates and Mr Chote had drawn a distinction between the interest rates that are paid by companies or individuals and those that are paid by the Government.

Robert Chote: That is right. As far as the private sector is concerned, there would clearly be concerns about vulnerability if interest rates began to rise, given the consequences for mortgage payments and so on. At a macro level, one might take comfort from the fact that interest rates will—I presume—start to rise at policy level once incomes and economic activity begin to rise and people are in a better position to deal with such increases. At aggregate level, however, some people will be more vulnerable than others.

One uncertainty about a rise in policy rates is the proportion of the change that will feed through to the interest rates that people actually pay. The interest rates that people actually pay did not fall as much as the policy rates, so I presume that the same would be true if we were to move in the other direction, which would mean that there would be some offset.

As for the interest rates that the Government has to pay, one of the parameters by which we test the Government's ability to hit its targets is to ask what would happen if those rates were to change. If they increase, that makes the fiscal position more difficult. However, the UK has been relatively insulated in that respect because the Government's borrowing tends to have relatively long maturities, compared with borrowing by most other Governments. That acts as a bit of a shock absorber if interest rates rises, because it means that the Government is not rolling over a lot of debt all the time and, as a result, it does not feed straight through to the average interest rate that is paid on the stock of debt.

It is also worth bearing it in mind that, although a rise in interest rates increases the amount of money that the Government must pay out, if it is associated with a rise in the interest rates on other instruments the Government also gets additional revenue. It is not as much as it must pay out, so there is still a negative hit, but it is partially offset.

John Mason: We will leave it at that. Thank you very much.

Gavin Brown (Lothian) (Con): I want to ask a few questions about the Scottish tax forecast that you have produced. On page 9 of your paper, you try to project what you think that we are going to get from stamp duty land tax. For residential property you use the outturn share of the latest year, but for commercial property you use a three-year average of the Scottish share and you project that. Why is there a difference between the numbers of years that you use for the residential and commercial sectors?

Robert Chote: It is about looking back to see whether there is a trend or whether there is volatility in the numbers going back. If the figure bounces up and down from year to year but with no obvious trend upwards or downwards, it is sensible to take a number of years to smooth that out when we make a projection. However, if there was a trend that was moving steadily upwards but we took the average of the past three years, the figure would look slightly lower than expected if the expectation was that the trend might continue. I do not have the back data on me, but I suspect that the difference is down to whether the figure is volatile on a year-to-year basis or whether the past year is probably a better guide in forecasting.

Gavin Brown: Okay. Thank you. On page 10 of the same paper, in table 1.7, you give a breakdown of residential and non-residential SDLT. SDLT is a fairly volatile tax, as we have all acknowledged, but is it fair to say that residential SDLT is quite a bit more volatile than non-residential SDLT? Non-residential SDLT still goes up, but the trend seems to be slightly flatter than that of residential SDLT, which seems almost to double over a five-year period.

Robert Chote: I suspect that that is down to the fact that the residential forecast incorporates the belief that transactions are at an historically low level. We have basically assumed an average number of transactions per year, consistent with average duration of tenure, and there is less commercial property turnover over a particular period of time—we are not dealing with a house that looks much the same now as it looked 50 years previously. We use a different approach, on that score.

Gavin Brown: So, in your view, the number of residential transactions at the moment is way below trend, but you anticipate that, at some point, it will return to trend.

Robert Chote: Yes. I cannot remember the precise number, but if the current level of transactions were to continue, people would move roughly once every 30 years rather than roughly once every 20 years. We may be moving to that new world, but it does not seem to be the most obvious central expectation. I am not sure that 30 is the right number, but it is something of that order.

Gavin Brown: I get your point. However, although the number of non-residential transactions is below trend, you do not think that it is significantly below trend, which is why the annual increases are much smaller.

Robert Chote: I think that that is right.

Gavin Brown: Okay. Thank you.

The next tax that you cover in the paper is the landfill tax. I have a couple of questions about that, and the committee will come on to the issue fairly soon. In your forecasts, you see a 10 per cent rise in the tax take—give or take 1 or 2 per cent—over a five-year period. How likely is that, given that the Governments north and south of the border are pushing hard to reduce the amount of waste that goes to landfill? I know that the tax rate will go up, but do you think that the tax rate will go up more than the reduction in tonnage so that we will end up with an increasing tax take?

Robert Chote: Yes. As you said, there are two things pushing in opposite directions and the receipts are rising over time. There are some pre-announced increases. We assume, for the purposes of the forecast, that the rate will rise in line with inflation thereafter, which pushes the cash number up.

On the other side, tonnage is declining. The main reason why we are less optimistic than we were previously about receipts from that source is that we have assumed that the historical downward trend in tonnage will persist. What we have not taken explicit account of are the views of the Scottish Government or the UK Government on their targets for waste, which—certainly those of the Scottish Government—are quite stretching.

Similarly to how we look at targets on carbon emissions, we do not base our forecasts on the assumption that Governments will do whatever will be necessary in order to achieve those targets. We say, "Let us look at the rates and rules that there are at the moment and not constrain ourselves at that." However, as you said, there is a declining trend that is reflected and which is offsetting the changes in the rates.

11:30

Gavin Brown: That is helpful. Thank you. I have a narrow question, which has been prompted by what Malcolm Chisholm asked, about the money—what some people have described as "piles of cash"—that companies are sitting on waiting to invest. It reminded me that we had a similar discussion last year. I think that you said that either the Treasury or the Bank of England assumes that 80 per cent of that money is held by companies that could invest it, and the other 20 per cent is held by, I presume, hedge funds or others that could not invest it. I think that you said that 80 per cent is not the correct amount, and that the amount is lower. Do you or the OBR have a view on what the correct, or more likely, percentage is?

Robert Chote: The ONS, which is the body that has to make that assumption, is considering that and we will wait and see whether it comes out with a different view. It is aware of the issue, because both the OBR and the Bank of England have raised it, so as part of its business it is considering whether there is a sensible allocation.

The figure comes down to companies holding money in overseas bank holdings and allocation of that. The 80 per cent figure is from some years ago—before the rapid growth of non-bank financial institutions in the intervening period. The ONS will consider whether it needs to make adjustments on that basis.

Jean Urquhart (Highlands and Islands) (Ind): I want to ask about employment. Figures in the report suggest the likelihood of there being over the next seven years, I think, 2.8 million fewer people employed in the public sector.

We talk about "the private sector", but you refer to "the market sector". Is it a general change to talk about the market sector as opposed to the private sector, which would include social enterprises and the increasing number of other organisations that are set up to undertake work that might previously have been undertaken by people who are no longer employed in the public sector?

Robert Chote: That is right. The definition is total employment minus general government employment; the sorts of institutions that you are talking about would be among those that different people would place on different sides of a line if they were asked whether the body was public sector or private sector. Even in those definitions there have been changes of mind over whether, for example, people who work in further education are part of general government or part of the wider market sector. That has made some comparisons difficult.

Behind all that is an approach to forecasting general government employment that asks what we can discern from the Government's spending plans about the pot of money that will be available in future years to pay the wages and salaries of general government workers, and what information we have about the changes in pay bill per head—for example, whether there is wage drift. From that, we distil a view about how many people the public sector will be able to employ, based on the pot of money that the Government is currently implicitly allocating to that. At the end of the forecast horizon, we look at where we started and say that we emphasised those two numbers and if people want to assess what happened in between, they can take a ruler, join the two lines up and get there.

We consider private sector employment and employment in total in the context of our broader macroeconomic forecast. Persistently through the recovery—or non-recovery—the puzzle has been how robust employment growth has been in the private sector, given how little output has increased. That is the so-called productivity puzzle. If you had told me in June 2010 what economic growth rates we would see over the intervening period, I would probably have told you then that I would have expected unemployment to be about 1.5 million higher now than it actually is. That gives you some sense of how remarkable the difference has been.

That increase in market sector—or private sector—employment partly reflects short-term and part-time working. Some people would say, "Ah, yes—but that is not real job growth." However, even the total hours worked in the economy, which would take account of such patterns, has been surprisingly on the high side, given the weakness of output. It has not been as high as total employment, so there is partly a story about a move to greater short-term and part-time working. However, even between our December forecast and the current one, the short-term growth news on GDP has been bad but the short-term employment news has been better than expected.

There is huge uncertainty about how long that will continue to be the case. Will we get to a point at which there is some shake-out and productivity rebounds? If that happens, even if the growth rate of the economy picks up, there might not be that much change in employment. There might be a more dramatic shake-out. It is probably the biggest single structural uncertainty with which any economic forecaster who is trying to understand what is going on at the moment wrestles.

Jean Urquhart: Are you privy to the evidence for the forecast on the change in employment?

There is a mystery—although it is not all a mystery—about the jobs that people were doing and the jobs that they are now doing.

Robert Chote: We use the ONS's view of what employment is. Sometimes, the situation can be complicated because we get different pictures of the path of employment depending on whether we ask individuals whether they are in work, or we ask companies how many jobs they have or are supporting. If individuals have more than one job and there is more or less of that going on than would normally be the case, we can get a change in the amount of individuals who report that they are employed versus the amount of jobs that employers report. That can confuse things slightly, but we are not estimating for ourselves the past path of employment; we use the same national statistics as any other forecaster or academic would when examining what is going on in the labour market.

Jean Urquhart: Does the Office for Budget Responsibility have any observation on tax not collected?

Robert Chote: In every set of forecasts that we do for any particular receipt, we implicitly—and, in some cases, explicitly—think about the amount of avoidance or evasion activity that goes on. It is possible to do that more quantitatively for some taxes than it is for others. For example, we have an explicit estimate of what is called the VAT gap. Given our knowledge of what is going on in consumer spending, we can have a sense of the theoretical amount of money that we ought to get in as a consequence of consumer spending and compare it with the amount that actually comes in. There is a gap of roughly 10 per cent between the two.

For other taxes, we base our forecast on what receipts have come in to date and over the recent past. We often implicitly assume that there will be roughly the same proportion of avoidance or evasion activity in the future. By basing forecasts on what has actually come in previously, rather than on what we think ought to have come in if everybody was paying, we can fill some of the gap.

Another issue around evasion and avoidance concerns particular policy measures that the Government may announce; for example, it might announce a measure that is designed to reduce avoidance in a particular area. When we decide whether publicly to endorse estimates and whether to include them in our forecasts, we consider whether it is reasonable to assume that the effectiveness of the anti-avoidance measures will erode over time. There will be a built-in assumption that people will find another way through the maze, and we do not necessarily assume that all the money will continue to come in over time.

That means doing things on a case-by-case basis. With some of the measures that are in place and some of the international agreements that have been made, you can imagine how difficult the evidence base is to deal with. One example of that is judging how many receipts will come in as a result of having done a tax disclosure deal with Switzerland. There are lots of uncertainties about whether such a disclosure agreement will make people change their behaviour; there is also, inevitably, a huge amount of uncertainty about how much UK citizens have in Switzerland in the first place.

When that deal was done, we took the view that the original estimate that ministers and HMRC brought to us of the amount that it was likely to raise was probably a bit too high. For our forecasts, we said that we wanted to assume a lower amount. That was largely on the basis of a judgment, in a very uncertain world, on a central assumption about the amount of money that was out there, as opposed to having a difference in view about how people would respond to that policy change, per se.

Jean Urquhart: The Westminster Government recognised that stamp duty land tax is vulnerable in certain respects. You mentioned an allowance of 10 per cent for VAT being lost. That is a given. What would your figure be for the land tax?

Robert Chote: With VAT, it is possible through consumer spending to calculate with relative confidence what the difference would be—I emphasise that it is just relative confidence. With SDLT, if you base your expectations of how receipts are likely to grow in the future on what has come in in the past, you are implicitly taking on board the amount of money that you might not be getting, even if you do not know that quantity. You are not just taking a theoretical view of how much we should be bringing in, but which is not in line with what has actually been brought in in the past.

If there are particular policy measures that are designed to reduce the amount of avoidance, we try to take explicit account of those. In some cases, the Government identifies a mechanism for avoidance that it does not think people have yet taken full advantage of. If it announced a change to such a mechanism, that might raise some extra revenue but, in a sense, that is just protecting the revenue that is already included in the forecast. We do not want to double count that. The Government might say that a measure will bring in £X more: if we think that that figure looks reasonable, and if some proportion of it is money that would otherwise have been lost but is not recorded in the forecast, we would credit that amount twice in our forecast. There are different ways to approach the matter, given that there are different types of measures and different types of forecast.

Jean Urquhart: There has recently been publicity about a coffee shop chain that was clearly felt not to be paying the taxes that it should have been paying. Does that not exercise your organisation with regard to tax estimates?

Robert Chote: Certainly, it does not exercise us in terms of individual companies. We have to respect the confidentiality that HMRC has with individual taxpayer firms. When we talk to HMRC about receipts, it does not say that a specific firm is producing a specific amount or that it thinks that a firm can be badgered into producing an additional amount.

There are areas of the economy in which a relatively large amount of receipts comes from a relatively small number of firms, which can be awkward. In that context, we must rely on the large business service at HMRC, which deals with those firms; we have to decide whether we are persuaded by the information that it brings to us, which is necessarily anonymised, in incorporating information into the forecasts that we produce.

11:45

Malcolm Chisholm: The pace of recovery has slowed. You said that it is constrained by slow growth in productivity and incomes, and that earnings growth is weaker than expected. I presume that that is in the private sector. We know about earnings growth in the public sector, do we not? Is not that well controlled?

Robert Chote: We are talking primarily about the surprising weakness of productivity and productivity growth in the private sector. Private sector employment has risen substantially, while output of the private sector has not been picking up as much.

In the public sector, the surprise is that the impact on economic growth has, rather counterintuitively, moved in the opposite direction. The cash growth rate of spending on public services has slowed dramatically to about 1 per cent a year, compared to 5 per cent a year prior to the crisis. What has been somewhat surprising is that the contribution to whole-economy GDP from that Government activity has not fallen by anything like the same amount; the fall has been much more modest.

I am talking about Government spending that contributes to the production and consumption of goods and services and which is therefore a contributor to GDP. I am not talking about welfare payments, which move money from some members of the population to others; I am talking about the spending that contributes to GDP. The effect seems to be partly down to the fact that, to a greater degree than we had anticipated or taken into account, the direct measures of Government output that the ONS feeds into the national accounts have not responded much to the cut in the generosity of cash spending.

Let us take education as an example. Roughly speaking, the Government counts the output of education as being the number of pupils who are educated and the exam results that they get. As the amount of cash spending that goes into education has been cut, that combination of the number of pupils being educated and exam results has not moved by anywhere near as much as the cash spending has moved. If the Government had decided to implement spending cuts in education by announcing that children whose name ends in M or later in the alphabet would no longer be allowed to go to school, we would have seen a much more direct line.

The way in which the Government chooses to measure output therefore means that the Government sector's contribution to GDP has held up much more than we anticipated that it would do as cash spending was squeezed. We can argue about whether that is a sensible measure of value added in the Government sector; it might be that the fall in cash spending is showing up in the quality of education, in a way that is not picked up in measurements of pupil numbers and exam results. However, that is not taken into account when output in the Government sector is measured.

The ONS has a whole different stream of work, which Professor Tony Atkinson led off some time ago, which is trying to look at productivity in the public sector by focusing more on quality issues. However, the issue does not show up in the national accounts, which is one reason why, paradoxically, Government spending on goods and services is currently still contributing to, rather than subtracting from, economic growth. I draw the distinction between the private and public sectors.

Malcolm Chisholm: I understand the productivity difference between the public and private sectors, but what about earnings growth? What is happening to that? You said that earnings growth is weaker than expected; is there any earnings growth at all?

Robert Chote: I think that the rate is about 1.5 per cent at the moment. New numbers are out today, which I have not seen.

Malcolm Chisholm: Is that growth in real terms?

Robert Chote: No, that is in cash terms.

In considering what is needed to get the economy motoring again, because consumer spending accounts for 60 to 70 per cent of spending in the economy, a key issue is to get back to a position in which earnings are once again growing healthily in excess of inflation. The fact that earnings growth was very disappointing in the 2011 period helps to explain why forecasts tended to be overoptimistic. The issue was not just that earnings were relatively weak, which helps to explain why people have priced themselves into jobs and why employment has remained relatively strong, but that inflation was high, too. I do not think that we forecast a return to really healthy growth in real earnings until 2015 and beyond.

Malcolm Chisholm: That is what I was going to say, because earnings growth is not going to happen any time soon in the public sector. Do you envisage that happening in the private sector?

Robert Chote: For the public sector, in our forecasts of Government sector employment, we take published pay policy as far as it is known and explicit. On overall wage behaviour, one reason why we continue to have a weak path for the economy relative to average growth rates in the past is that it takes some time to get back to the position of having earnings growing in real terms. Some people would place more emphasis on a balance sheet deleveraging story, but we think that we should focus on the fact that we cannot expect the economy to really motor until we are back to a position in which we have consistent significant real earnings growth as the key to the story.

Malcolm Chisholm: You suggest that the economy will begin to recover from next year at 1.8 per cent and that the figure will reach 2.8 per cent by 2017. What will bring that about? To what extent will that be due to earnings growth, or will earnings growth come only after, or will it be due to a bit of both?

Robert Chote: There is a growing contribution from consumer spending as we return to positive real earnings growth, which we hope will improve consumer spending and have that benefit. As we discussed earlier, we have investment rising as a share of GDP and therefore contributing to growth over the period. That is typical for recoveries, because you expect to see investment rising as a share of GDP, although we assume a slower recovery in real investment than was the case in the 1990s.

Another source of growth is net trade. For the reasons that we discussed earlier, we assume a positive contribution from net trade through the forecast, although not a very big one, so much more is coming from investment in consumption going out than from net trade.

In thinking about the magnitudes of growth at the end of the forecast horizon and over the whole period, an important question to wrestle with is how much spare capacity there is in the economy now and how much ability or potential the economy has to produce goods and services without running into inflationary bottlenecks on which the Bank of England would feel the need to put a stop. We need to consider how that looks over time.

There is a huge range of views among economists as to how much spare capacity there is in the economy at the moment. Roughly speaking, we are working on the assumption that the economy is running at about 3 per cent below the level that would be consistent with keeping inflation stable in the medium term. Some forecasters think that the gap is about 1 per cent or less, and some think that it is 7 per cent. If you think that there is quite a lot of spare capacity, once you get spending in the economy motoring again, you would expect there to be the potential for reasonably large above-average growth rates for a time until that spare capacity is used up and you end up in a more stable long-term position.

The fact that we have a 2.8 per cent growth rate at the end of our forecast is partly due to our belief or central assumption—which, as with so many of these things, is hugely uncertain—that there is a reasonable amount of spare capacity still in the economy that provides the ability to do that. Some people argue that there is less spare capacity and that the potential growth rate of the economy will be particularly weak, so they might see less scope for that to be the case even if the Government or the Bank of England is able to get spending motoring again.

Jamie Hepburn: I have a question about the information that is presented in the UK Government's budget. I want to find out whether I have picked up something correctly, and perhaps Mr Chote can help me with it. I understand that, in last year's budget, information was provided about the total cost of fiscal consolidation by 2016-17, and there was some information about subsequent years. However, that information is not presented in this year's budget. Is that the case and, if so, do you have any information about why it is the case?

Robert Chote: I am not quite sure. Past Treasury documents have contained a sum on the contribution of tax and spending changes to the total consolidation. The Treasury often uses that to illustrate that, roughly speaking, there is an 80 to 20 split between spending and receipts. Is that the number to which you are referring?

Jamie Hepburn: Yes, that is related. In essence, the budget set out a figure for the total cost of fiscal consolidation measures by 2016-17, but that information is not in this year's budget. Do you not have any information about that?

Robert Chote: I am sorry, but I would have to look at the numbers, if you have them.

Jamie Hepburn: I do not have them in front of me.

Robert Chote: Certainly, we do not cover the size of the consolidation in aggregate in the material that we produce. When I have talked about that in explaining to people what is going on, I have tended to use the set of estimates of my old employer—the IFS—of the size of the consolidation over that period. Part of the problem with identifying the size of the consolidation is identifying the baseline, or what would have happened in the absence of those measures. The size of the disease and the cure look different, depending on which baseline we look at.

Jamie Hepburn: My next question was going to be about your predictions on that, but I suppose that you have just answered that by saying that the OBR does not particularly set out such figures.

Robert Chote: No, we do not. As I said, it depends on the baseline. On the IFS estimate, the size of the consolidation of the reduction in borrowing that is a result of all the tax and spending measures that were announced subsequent to the 2008 budget would be about 9 per cent of GDP. There is a separate question about the impact of all that on economic growth, but I do not think that the Treasury has said anything about that, so I presume that that is not the number to which you are referring. I am happy to have a look to see if I can identify it more clearly bilaterally.

The Convener: That appears to have exhausted the questions from other members, so I will ask a couple more to wind up the session.

When you spoke to the committee last year, the OBR was predicting growth in the UK economy of about 0.8 per cent. The following day, I met Stephen Boyle of the Royal Bank of Scotland, which was having a seminar here. He said that the figure was far too optimistic and that RBS's growth figure was 0.2 per cent. I remember thinking that that seemed to be on the low side, but it turned out to be more accurate than the OBR's figure. With all the access to figures that you have and all your contacts with the Treasury and so on, why was a company such as RBS able to predict more accurately than the OBR? I know that it is not an exact science, but there is a feeling that the OBR is often too optimistic with its predictions.

Robert Chote: There are two responses to that, the first of which is that we do not have any information on what is going on in the economy that is not available to anyone else who is trying to do an economic forecast. We have to do an economic forecast—much as I sometimes wish that we did not—because we need one that we can feed into our forecasts for particular tax and revenue streams. Unfortunately, we cannot use the Bank of England's forecast or the average of independent forecasts, because they do not break down national spending and income into the degree of detail and sort of categories that we need in order to drive forecasts for particular tax and spending streams. We do an economic forecast not because we think that we are likely to be better at it than the average of outside forecasters, but because we need a particular type of economic forecast.

In our publications, and in greater detail in the fiscal evaluation report that comes out in the autumn, we compare our forecasts with the other ones that are out there. We tend to be closer to the average of outside forecasts than to the top or the bottom of that range at any given time. Obviously, if the number comes in at one of those ranges, the person at that end of the range will look particularly smart on that occasion. However, history suggests that it is not always the same people who look smart each year.

12:00

The other thing to bear in mind is that the economic output data on which we base the judgments are very much a first draft of economic history. Whether the growth rate will be closer to 0.2 or 0.8 per cent when we look at it in 10 years' time is an interesting question. If you compare the path of the 1990s recession as it is depicted in the official statistics of today with the way in which it was depicted in official statistics in, say, 1994, you will see that the 1990s recession was about 20 per cent shallower and a year shorter, and that it no longer ends in a double dip. We must bear it in mind whenever we are judging how well we are doing in those sorts of things that if I came to you looking smug because every number that we had predicted was bang in line with the latest estimates of the outcome from the Office for National Statistics, I would ensure that I never came back again, because it is likely that history would be revised on a future occasion and I would not look as clever.

The Convener: Indeed.

To touch on landfill tax, to which Gavin Brown referred, your predictions of a year ago for the current financial year have been readjusted down by 27 per cent and the predictions for 2016-17 are down by 33 per cent. I know that you look at the share of UK receipts over three years for that, but surely it would be much better to look specifically at Scottish figures if you are going to make such predictions.

You said that you do not necessarily take into account policy, but surely that should be taken into account. You also mentioned that you do not have sufficient resources to do Scottish macro forecasts. Would it not therefore be better for the Scottish Government to produce such forecasts? I know that you are empowered by the Treasury or the UK Government, but surely you are in a position whereby you get the information from the Scottish Government and revenue Scotland to make predictions, but you do not take into account things such as policy changes, as the Scottish Government might. Therefore, how could you possibly provide more accurate projections than the Scottish Government?

Robert Chote: Following the devolution of the taxes, there might be a better evidence base because of the way in which the policies will be operated and the sort of data that the Scottish Government or revenue Scotland will want to collect. One difficulty with the aggregates levy is that there is not, even historically, a good basis for the Scottish numbers, given the way in which the total aggregates numbers are reported by companies across the UK as a whole. Presumably, revenue Scotland will be thinking about what data it needs to come up with a specific aggregates levy forecast for Scotland. We will be interested to talk to revenue Scotland about whether that looks likely to generate a better set of numbers and a better way of producing the information.

We have a statutory responsibility to come up with a central forecast with which we are happy. If that forecast is produced by revenue Scotland—just as we have forecasts for other things produced by HMRC—and we have useful interaction that is to everybody's benefit in thinking about the issue, that will be great.

The Convener: Over the past year or two, you have been optimistic on economic growth, SDLT receipts, landfill tax receipts and UK borrowing. However, as Professor Alex Kemp of the University of Aberdeen said—Jamie Hepburn touched on this earlier—you have been rather pessimistic on oil forecasts. You talked about volatility, but the very eminent Professor David Bell from the University of Stirling said in *The Times* on 10 March:

> "I find the argument about volatility a little bit over-egged because it is always possible to hedge against volatility. What matters is the average price over five to 10 years."

What is your comment on that?

Robert Chote: There is an issue about what the Scottish Government would want to do if oil was a much larger proportion of overall receipts. It might want to have a mechanism to smooth that out, depending on the sort of stabilisation discussions that it might have. In terms of the actual outturn, oil has been very volatile on a year-to-year basis. In 2010, we significantly overpredicted North Sea receipts relative to what looks likely to have been the outturn in 2012-13, so I think that it is reasonable to say, particularly in an environment in which that relatively volatile stream was likely to be a larger proportion of total available receipts, that that presents a slightly different challenge to policy makers than an admittedly volatile but comparatively much smaller revenue stream among a lot of other ones.

The Convener: Yes, but, to make a comparison, the share of the economy here would be only about half that in Norway, as you probably know. Do you agree with energy minister John Hayes's statement that, through enhanced extraction and new discoveries, there is a "bright future" for oil and gas?

Robert Chote: A lot of oil and gas is still there although, obviously, the industry and other experts have different views about the amount. The difficulty in forecasting on a year-by-year basis is clear from the outturn data that has come in and because of the succession of different, relatively volatile determinants on their own score. We would not want to be pessimistic about the fact that there will be receipts in the future, but we would want to be pessimistic about our ability to predict exactly how many will come in over the next 12 months.

The Convener: Indeed. Thank you very much for an illuminating session. I am sure that we all look forward to the next one. I will certainly be seeing you over lunch and I am looking forward to your lecture this evening.

That is the end of our public session. I will allow Robert Chote, David Bell and the official report staff to leave before we go into private.

12:07

Meeting continued in private until 12:13.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice to SPICe.

Available in e-format only. Printed Scottish Parliament documentation is published in Edinburgh by APS Group Scotland.

All documents are available on
the Scottish Parliament website at:

www.scottish.parliament.uk

For details of documents available to
order in hard copy format, please contact:
APS Scottish Parliament Publications on 0131 629 9941.

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@scottish.parliament.uk

e-format first available
ISBN 978-1-78307-797-7

Revised e-format available
ISBN 978-1-78307-814-1

Printed in Scotland by APS Group Scotland