



Cynulliad Cenedlaethol Cymru **The National Assembly for Wales**

Y Pwyllgor Cyllid **The Finance Committee**

Dydd Mercher, 24 Medi 2014
Wednesday, 24 September 2014

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Cofnodir y trafodion yn yr iaith y llefarwyd hwy ynndi yn y pwyllgor. Yn ogystal, cynhwysir
trawsgrifiad o'r cyfieithu ar y pryd.

The proceedings are reported in the language in which they were spoken in the committee. In
addition, a transcription of the simultaneous interpretation is included.

Aelodau'r pwyllgor yn bresennol
Committee members in attendance

Peter Black	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Christine Chapman	Llafur Labour
Jocelyn Davies	Plaid Cymru (Cadeirydd y Pwyllgor) The Party of Wales (Committee Chair)
Mike Hedges	Llafur Labour
Alun Ffred Jones	Plaid Cymru The Party of Wales
Ann Jones	Llafur Labour
Julie Morgan	Llafur Labour
Nick Ramsay	Ceidwadwyr Cymreig Welsh Conservatives

Eraill yn bresennol
Others in attendance

Robert Chote	Cadeirydd y Swyddfa Cyfrifoldeb Cyllidebol Chair of the Office for Budget Responsibility
Wim Suyker	Arweinydd Rhaglenni, Canolfan CPB yr Iseldiroedd ar gyfer Dadansoddi Polisi Economaidd Programme Leader, CPB Netherlands Bureau for Economic Policy Analysis
Laura van Geest	Cyfarwyddwr, Canolfan CPB yr Iseldiroedd ar gyfer Dadansoddi Polisi Economaidd Director, CPB Netherlands Bureau for Economic Policy Analysis

Swyddogion Cynulliad Cenedlaethol Cymru yn bresennol
National Assembly for Wales officials in attendance

Richard Bettley	Y Gwasanaeth Ymchwil Research Service
Bethan Davies	Clerc Clerk
Claire Griffiths	Dirprwy Glerc Deputy Clerk
Joanest Varney-Jackson	Uwch-gynghorydd Cyfreithiol Senior Legal Adviser

Dechreuodd y cyfarfod am 8:59.
The meeting began at 8:59.

Cyflwyniadau, Ymddiheuriadau a Dirprwyon
Introductions, Apologies and Substitutions

[1] **Jocelyn Davies:** Welcome everybody to this meeting of the Finance Committee. I have no apologies or substitutions, but I would like to welcome Nick Ramsay as a new

member of this committee, although I think you have been a member in the past, so you are well-versed with the work we do. I think that all Members will want to thank Paul Davies for the work he did. I will write on behalf of the committee and thank him. I am sure that we will miss him, but he is ably replaced, no doubt, by Nick Ramsay.

09:00

Papurau i'w Nodi Papers to Note

[2] **Jocelyn Davies:** Before we go on to take evidence from the Netherlands via video link we have a few papers to note. One of those is the letter from the Minister for Finance. I thought that maybe we could discuss that in our private session a bit later on. Is everybody happy to note all those papers? Okay.

Ymchwiliad i'r Arfer Gorau Mewn Prosesau Cyllidebol—Rhan II: Sesiwn Dystiolaeth 1 Best Practice Budget Processes Inquiry—Part II: Evidence Session 1

[3] **Jocelyn Davies:** As I mentioned earlier, we are having a video link with the Netherlands this morning. Unfortunately, our witnesses cannot see us via the video link, but they can hear us; perhaps Members will bear that in mind. We have as our witnesses CPB Netherlands Bureau for Economic Policy Analysis. Would you like to introduce yourselves for the record and then I will go into the first question?

[4] **Ms van Geest:** Okay, that is fine. My name is Laura van Geest. I am the director and head of the CPB.

[5] **Mr Suyker:** My name is Wim Suyker, I am programme leader of public finance at CPB.

[6] **Jocelyn Davies:** Thank you very much. Do you think that you could summarise the main purposes of CPB, how it operates, and who it reports to?

[7] **Ms van Geest:** CPB is an institute that provides independent economic analysis and forecasts in the economic area. Our main task is to provide economic forecasts for the Dutch Government and to provide assessments of the budgetary stance, but our work is not limited to that. We also provide analysis on a broad range of topics, varying from cost-benefit analysis of infrastructure projects to reports on the financial markets and on healthcare. So, it is a very broad scope of topics, and not only the classical work of an independent fiscal institute. Our main task is to provide this type of analysis and we provide this type of analysis for the public at large, not just the Government. Most of our analysis is publicly available, for everyone who would like to read it, on our public website. We also provide analysis for the Government at its specific request, but also political parties and various other parties like social partners, so, unions or employers' organisations can also pose specific questions to us and then we can provide analysis if and when we have both resources and knowledge available. So, in broad summary, we provide economic analysis and forecasts, which are publicly available, we give tailored answers to the Government, but also tailored answers at the specific request of other people involved in Dutch policy making.

[8] **Jocelyn Davies:** Thank you. What is your relationship with your Parliament?

[9] **Ms van Geest:** The CPB is an independent organisation, but we are, in a formal sense, part of the Executive; we are part of the Ministry of Economic Affairs. Our wages and

such are determined by the general rules for Government employees, but there are specific rules that state that we cannot get instructions from the Government. So, in that sense, we are independent, but, unlike the Congressional Budget Office, we are not part of Parliament, we are part of the Executive.

[10] **Jocelyn Davies:** Obviously, you are aware that, in the UK, we have the Office for Budget Responsibility. How is your organisation different from that?

[11] **Ms van Geest:** Well, I think the Office for Budget Responsibility in the UK has a more limited scope, because it basically aims for fiscal analysis, while the CPB also does analysis on a broad range of other topics. So, that, I think, is the main difference. The other difference is that the Office for Budget Responsibility formally has only 19 members or employees and, at the CPB, there are over 100 employees. So, that is also a difference. Focusing on the fiscal part, we both make forecasts for macro-economic items and, in the Netherlands, the Government has to use those forecasts when it rolls out the budget. We assess the budget and we also give our own estimate of the Government's overall balance or the economic and monetary union balance.

[12] Unlike the Office for Budget Responsibility, basically, we give a point estimate; we do not give an assessment of what the chances are that they will hit a certain target, so we do not give a range of possible outcomes. What we do is make an assessment of sustainable public finance in the long term, like the Office for Budget Responsibility. In the Netherlands, only the CPB makes those types of estimates—so, whether Dutch Government finances are sustainable in the long run, which is what we call the 'ageing sums'. So, that is something that we also share with the Office for Budget Responsibility. However, basically, we also do other things than it does.

[13] **Jocelyn Davies:** Okay, thank you. Peter, shall we come to your questions?

[14] **Peter Black:** Yes, thanks. Looking at the Netherlands' performance budget process, could you describe the VBTB performance-based budget process that is used in the Netherlands?

[15] **Ms van Geest:** Let me make two points. First, the CPB is not involved in the VBTB process, because, basically, we look at the economic effects of the budgetary process and not so much at the more Court of Auditors type of questions. Secondly, the Dutch Government did change. I worked at the Ministry of Finance, so I have some knowledge of those times. The Dutch Government changed from the VBTB process to what it calls the VB process, or account budgeting, which is, basically, a major slimming down or trimming down of the performance budgeting process that it had. It used to be a very extensive process where you communicated what outcomes you would like to have with lots and lots of indicators, and, I think, also a kind of overstatement of to what extent the Government can influence certain outcomes, and it basically trimmed that process down to highlighting the goals that the Government would like to attain, or the items that it found important to steer on, but also indicating to what extent the Government has an influence on that.

[16] For instance, if you look at unemployment, everyone would like to have unemployment as low as possible, but, of course, there are more parties involved in getting unemployment down than just the Government. You cannot just produce jobs, for instance. So, basically, you focus on the contribution that the Government can make instead of just looking at performance indicators, which can sometimes be misleading in terms of whether you attain a certain goal and whether that is a good thing or a bad thing. For instance, one thing that is always asked is: if your aim is to have financial stability, if one bank goes down, is that a good thing or a bad thing? That really depends on whether you think that all banks should be saved, and then introduce moral hazard, or on whether you think, sometimes, the

bank can fail, but under certain conditions. So, just having an indicator is not always very informative and, basically, with VB, it has changed the focus from having lots and lots of indicators to having sound arrangements to make sure that evaluation will take place—so, whether the policy that you have in place is effective and efficient.

[17] **Peter Black:** So, as I understand it, you have moved from looking at indicators to outcomes.

[18] **Ms van Geest:** Well, basically, what we have said is—. However, like I said, you should ask the Ministry of Finance on this item, because this is its field of expertise, and it is not the field of expertise of the CPB. We do not look into performance budgeting. We are interested in the economic outcomes and not in the way that the budget is derived. However, what it has, basically, said is that you indicate why you have undertaken certain policies and then you evaluate whether the policies that you have in place are effective and efficient. That is a different scope. It is not a scope of whether you hit the target perfectly, but whether the policies that you have in place really contribute to getting near that target.

[19] **Peter Black:** So, when you are looking at economic outcomes, are you able to link the budget process to those outcomes and actually follow through what the impacts of those budget processes are on the outcomes that you monitor?

[20] **Ms van Geest:** At the CPB, that is not the way that we look at these things. We evaluate, on occasion, certain policies, such as the education policy, for instance, and then we do a micro-economic analysis of whether certain policies are effective. However, that is not the same as going exactly from the £10 billion or the £10 million spend on programme x and following that exactly through to the outcomes. So, basically, we look at a certain type of policy, whether it is effective, and of course we are not unaware of the money or the budget involved. It is not so specific that you can dot all the i's and cross all the t's. However, at the CPB, we also undertake effective deliberations.

[21] **Peter Black:** So, how do you measure the effectiveness of a policy?

[22] **Ms van Geest:** For instance, if we look at labour market forces, we see that there is sometimes a policy given, and then we assess it with an economic analysis or econometric analysis, as to whether we see an effect. Basically, we try to do it on the basis of micro-economic databases that we get from the office for statistics. So, we try to assess the effectiveness of policies through an economic or macro-economic-based database analysis. I am not sure whether that answers your question.

[23] **Peter Black:** Would the Government take your analysis into account as part of its budgeting process?

[24] **Ms van Geest:** Yes. Of course, it is not required to take our analysis into account. Basically, what we always say is that we provide an analysis—we sketch the pros and cons—and then it is up to the Government and the Parliament as to whether they would like to act upon it. However, because our analyses are widely available, the Government does tend to have a—. There is a burden on it to prove that there are good reasons not to follow the conclusions of the analyses. There may be reasons. There is always a trade-off between income, inequality and the number of people employed. Of course, there is a political assessment as to how you would like to go about it and what you think is the proper balance between the two, but our analyses are available. We always publish our analyses. If an analysis suggests lots of pros, very few cons, and then the Government decides not to act upon it, it is up to Parliament and the media to ask the Government what the reasons were not to follow up on this type of analysis. Basically, we provide transparency.

[25] **Jocelyn Davies:** Chris, shall we come to your questions?

[26] **Christine Chapman:** Good morning to you both. Could I just follow on from that? You talked about transparency. Do you think that the new budget document is more understandable to the general public?

[27] **Ms van Geest:** I think that budgets are always difficult to understand for the general public, to be honest. I think that, if you really would like to delve into it, there is more information available in the VB format, because there are more data available on the programmes that are being used. So, I think that, for parliamentarians, it is a more worthwhile document; but for the general public, at large, I do not think that this is on the reading shelf of every Dutch citizen, to be honest. [*Laughter.*]

[28] **Christine Chapman:** How are the performance measures in the budget used by Government and Parliament?

[29] **Ms van Geest:** Sorry; the beginning of your question fell away.

[30] **Christine Chapman:** How are the performance measures in the budget used by Government and Parliament?

09:15

[31] **Ms van Geest:** I think that the performance—. Like I said, they have trimmed down this process. I think that the best effect you can have is to make sure that the policies that are being enacted get evaluated. If you do enough evaluation, you can then see whether it is useful to continue with the policy. I think that that is a far more worthwhile route than looking at specific performance indicators as such, because that is basically an exercise that does not get the best out of politicians, to be honest—everything that is ticked off as sufficient is ignored and things that go wrong are being highlighted. In fact, just the fact that it went wrong is being highlighted, not the reasons behind it. So, to give an example, say that you had a performance indicator for unemployment and then, in 2008, there was the major financial crisis, then, yes, of course, the unemployment figures were not hit as planned, but there were very good reasons and understandable reasons why that did not happen. You then have the wrong debate, I think. So, the proper debate would be—. You would have policies in place to make sure that the unemployed find their way back into the labour market, or policies to make sure that people have some income if they are not able to earn a living. You should evaluate whether you obtain the goals with those policies—whether the policies are useful and well developed and whether they are as effective and efficient as they could be. I think that that would be the proper way forward, more than just having a performance indicator and ticking that off.

[32] **Christine Chapman:** On the long-term evaluation, how is performance that spans several years measured? For example, spending in one year that is not expected to produce outcomes until the future. I wonder whether you could comment on that.

[33] **Ms van Geest:** Could you please repeat the question?

[34] **Christine Chapman:** Yes. I am looking at performance that is long-term—performance that spans several years. How is that performance measured, for example spending in one year that is not expected to produce outcomes until the future? How would you evaluate the long-term impacts?

[35] **Ms van Geest:** I think that that is basically what you do if you undertake an evaluation. You basically do not just look at the effect of the policy in one year, but you

assume that the policy is in place for a number of years. That takes time, because you need the data on which to evaluate the result. So, basically, if you spend the money in year 1, you will have the data in year 2 and, to make sure that you have a proper assessment, you would probably like to have observations for more years than just one year. So, you take a longer period and then you evaluate on the basis of the microdata, generally speaking, whether the policy has been effective or not. So, you do not look at just one year or one period. You evaluate a policy that has been in place over a longer period and then you evaluate the results over a longer period. If you have an evaluation process instead of an indicator list, you are able to do that type of analysis.

[36] **Nick Ramsay:** You clearly have an established and respected reputation for ensuring transparency in what you do, which is one of the reasons why this committee was eager to speak to you today. Can you tell us how you ensure that the spending ministries under your remit or guidance are taking ownership of their own processes?

[37] **Ms van Geest:** That is not our responsibility at the CPB, because we basically evaluate the forecast of what the Government is undertaking. It is the role of the Ministry of Finance and individual Ministers to execute their budgets in line with the budgets as allocated by Parliament. In the Netherlands, every Minister is in and of themselves responsible for his or her budget and has to present and defend his or her budget in Parliament. So, that is unlike the UK, where I think the Treasury is basically in charge in the end of all the budgets. In the Netherlands for all budgets, the Minister has to defend their own budget in Parliament. Of course, the Ministry of Finance has a special role. It co-ordinates the budgetary process and if a Minister really misbehaved it has an oversight instrument where it can prohibit a Minister from spending money unless granted permission. However, I must say that this instrument has not been used over the whole period of my experience, which is basically 20 years. It is more something that you can threaten with than something that is being used. In the Netherlands, where we have a coalition Government, which is different to the UK, I think, basically people agree with one another on a coalition agreement with a financial paragraph. Then, the parties and the Ministers are held to this financial agreement. So, all the budgets are being presented to Parliament in line with this coalition agreement and it is very difficult for Ministers to step outside those type of boundaries. So, there are various ways to make sure that Ministers stay within budget or at least, if they go over it, it is done after proper consultation.

[38] **Nick Ramsay:** I think you are very astute there with your assessment of the role of the UK Treasury compared with some other treasuries across the world. From what you have just said, am I right in thinking that the Ministry of Finance would not have the ability to veto the spending plans of other ministries? Or, if it thinks that they are going off track, could the Ministry of Finance say, 'No, we're not going to accept this'?

[39] **Ms van Geest:** In the Netherlands, in the end, all of these types of decisions are undertaken first in the council of Ministers. There is a specific rule, or law even, that says that Ministers have to consult with the Minister of Finance before they undertake certain spending. If they want to do new spending, they have to consult the Minister of Finance. If they do not come to an agreement, the ultimate forum for decision is the council of Ministers. That is the way it is organised in the Netherlands, which is logical because, in a coalition Government, you cannot just have one party—the Minister of Finance, of course, is from one party—having the final say. My experience is that most Ministers would follow the Minister of Finance in the council of Ministers if there is a major disagreement, basically because, if one Minister is being helped, the others are the ones to help this Minister. So, if the Minister for healthcare would like to spend more, it is obvious that one of the other Ministers has to cough up the money. There is not that much enthusiasm for—

[40] **Nick Ramsay:** It sounds to our ears more like a process of cajoling and warding off problems than coming in with an axe to veto at the end of it.

[41] **Ms van Geest:** In the end, the council of Ministers decides. So, if Ministers have new ideas or they want to undertake new policy, they have to go to the Minister of Finance, there is an extensive process—as a director general for the budget I have been in charge of that process at the Ministry of Finance, although not at the CPB, just to be clear—and most of these things are resolved between the Minister in question and the Minister of Finance. Very few of these discussions go to the council of Ministers. That is one thing. The other thing is that, sometimes, Ministers, if they have overruns or are really misbehaving, you can say that, before they spend, they have to pass the Minister of Finance. However, this is a very cumbersome process that you basically like to avoid, because it takes an enormous number of civil servants to check all of these types of things. Basically, as I said, in the last 20 years, we have not used this instrument, as far as I know. What we do have is a Minister of Finance who is clearly in position and most Ministers not willing to help another Minister out, which also helps his position. In order for the Minister of Finance to be really effective, you need to make sure that you have a good relationship with the Prime Minister. If the Prime Minister and the Minister of Finance are agreed, it is very difficult for another Minister to get his way. Generally speaking, in the Netherlands, the Minister of Finance and the Prime Minister have different political colours, so you have basically covered the mainstays of the coalition.

[42] **Mike Hedges:** Bore da. We previously took evidence from Dr Joachim Wehner, which I may have pronounced incorrectly, who stated that there were concerns in the Netherlands about the lack of transparency created by the need to aggregate budget headings within performance-based budgeting. Do you recognise that problem, and do you see a way of solving it?

[43] **Ms van Geest:** I think that what you are asking is outside my field of expertise, because performance budgeting is not my field of expertise, to be quite honest, and it is not the field of expertise of the CPB. However, like I said, the move from the VBTB process to the VB process led to more transparency in terms of budget area items. So, more programmes were itemised, and people who really would like to know what money is spent on can find it over there. I am not sure whether—

[44] **Jocelyn Davies:** No, your answer is very clear. I call on Ann Jones.

[45] **Ann Jones:** What are the strengths and weaknesses of the current budget process, please?

[46] **Ms van Geest:** I think that the Dutch budget process has two aims. One is to make sure that you get sound outcomes in terms of the economic and monetary union balance, and the other wish, of course, is to have efficient and effective spending. I think that the current strength of the process is that there is a proper structure, in the sense that it is well designed. In the Netherlands, we have coalition agreements. In theory, at least, Governments are in place for four years. Before they start a Government, in the Netherlands, they have lengthy discussions and negotiations about what the Government will undertake in terms of policies, and that is laid down in the coalition agreement. This coalition agreement then has a financial translation in what we call the financial annexe. So, basically, we have a plan for four years, and that makes the process predictable and easier to manage. The other things that people do at the time of the coalition agreement is to decide not only the headings, or what they want to spend their money on, but also clear budgetary rules on how to act if things go differently than expected. I think that that is also a major advantage of the Dutch process. In the Netherlands, if there is a coalition agreement, we at the CPB have an evaluation of the likely outcomes of the programme. So, the Government starts with a clear idea of what the budgetary policy that it is going to undertake will lead to in terms of growth, unemployment and the EMU balance. So, that is also an advantage. It is kind of technocratic, but it is an advantage to know what you are going to aim for.

[47] In the Netherlands, to look at how all these plans are managed on a daily basis, you have expenditure ceilings, which basically make sure that expenditure stays at a certain level and does not go higher and does not allow for automatic stabilisers, because the unemployment benefits are underneath these ceilings. There are also rules for tax policy. Those rules are basically aimed at changes in the tax policy, and they allow the automatic stabilisers to work within the economy. I think that, basically, these are the strengths of the process.

[48] The weaknesses of the process are that this type of process works very nicely when you are in safe economic waters, but, in the last period, of course, we have been running close to or going over the 3% ceiling of the Maastricht treaty. That makes for more uneasy policy making, because then you are told by the Commission that you should reverse your budgetary balance at a certain pace with a certain speed and, sometimes, the speed is at a higher level than anticipated in the coalition agreement, for starters, and, secondly, this nice policy for four years, the ceilings, the steady policy and automatic stabilisers are then being kicked to the side or being crossed because of these additional demands by Brussels. However, of course, that is something that the UK does not have to undertake because you are not within the EMU, or at least not in the third stage of EMU.

09:30

[49] I think that the other advantage of the Netherlands is that we have these spending reviews. In terms of the economic outcomes, I think that having a long-term view based on sound macro-economic variables or estimates, which are being provided by an independent institute like the CPB, and having a clear assessment of how to deal with unexpected items along the way, are a strength of the system. Then, in the Netherlands, not only is the medium-term outlook being taken into account, so what will the EMU balance be at the end of the Government period, but also the issue of whether public finances are sustainable. So, we have ageing sums and then we calculate whether the budgetary finances under unchanged policies will still be able to provide services as presently. I think that this is also a major advantage of the Dutch system.

[50] What is unique, I think—at least, we have not heard any other colleagues talk about it—in the Netherlands, is that, before the elections are undertaken, we provide medium-term projections for political parties to know what the medium term will look like. They present their election platforms, which are assessed by the CPB in terms of whether we think that the costings they have made for certain items are likely and what the economic result will be. So, we have an ex-ante test, but we also have an ex-post test on what the economic result will be if the policy of party X is undertaken.

[51] In the same period, there is also advice by the study group on the budget margin. It is a group of civil servants, which I think is an unusual phenomenon, and it provides advice on what a budgetary stance should or could be in the next Government period, and what the budgetary rules could or should be in the next Government period. This advice is being undertaken at the request of the Minister for Finance, but it is being offered to all political parties to take advantage of—or not, of course, because it is up to politicians to see whether they want to take advantage of this type of advice. In the Netherlands, we have a really technically based budgetary process, in that sense. So, that is the macro-economic side of it.

[52] There is also the side of whether it is efficient and effective. I think that, in that sense, it is a typical Dutch phenomenon. Like I said, there are evaluations that you have to do in line with the VB model, but there are also the spending reviews, which are reviews that are also being undertaken by civil servants. They provide an opportunity to look at a large field of policy, like student loans or infrastructure, and to assess whether the money that is being

spent there is being spent in a proper way, or whether this could be done more effectively or efficiently. These types of studies are called IBO in Dutch, and ‘spending reviews’, I think, would be the closest translation in English. These are undertaken by civil servants independently of Government, and, once this report is available, the Government provides a policy response and both are then sent on to Parliament.

[53] **Julie Morgan:** It is very interesting to hear what you say about the amount of access that is available to opposition parties before an election. I just want to ask you a bit more about that. Do the parties all take that up, and how long before an election is that information available?

[54] **Ms van Geest:** The CPB offers this opportunity to have your election platform assessed to all parties. On the last occasion, it was offered to all parties that had a presence in Parliament. Now, let me be specific. I think that there were 12 parties, and 11 parties took advantage of this offer. So, in the Netherlands, we have a Party for the Animals, which I think the literal translation would be, and it has a very specific goal in life, so it did not see the need to have its platform assessed by the CPB. However, all other parties, all 11 of them, had their platforms assessed on the last occasion. Having this platform assessed is one way to provide information to political parties. Also, opposition parties that have Members of Parliament can always come to the CPB if they have a certain major reform that they would like to undertake and they would like to know what the exact effects would be and what would be the proper way to tweak the plan. They can come to the CPB and have the proposal assessed on a confidential basis. Our assessment will remain confidential as long as parties remain silent about them. The moment they quote from this paper or from our notes, then, of course, we provide a full note, because parties tend to provide only that part of the information or the note that is advantageous to them and skip the other parts. So, just to make sure that it is transparent, we then publish the confidential note. However, it is also possible that a party has a bright idea—or at least it thinks it is a bright idea—and then it comes to get it assessed and decides, ‘Well, it’s not as bright as we thought’, or, ‘It doesn’t have the effects we wanted’ or ‘It has unexpected side effects we hadn’t anticipated’ and it skips the plan. That is possible. Then, it remains confidential. If they do not talk about it, we do not talk about it either.

[55] The timing of the evaluation of the election platform depends on when the elections are anticipated. In the Netherlands, there is not a fixed scheme. Well, there is a fixed scheme in that, every four or five years, there is supposed to be an election. So, the next election is anticipated to be in May 2017. If this is done in the normal way then, starting in 2016, at the CPB, we will make our medium-term projections for the next Government period. So, that would be 2017-21. We will do that in the spring of 2016, so there will be a report of the study group on the margin in the spring of 2016. Then, political parties will come up with their election platforms over the summer. We will assess these programmes over the summer, and these will be available in the autumn of 2016, I think. Then, there will be an election campaign that will lead to elections in May 2017.

[56] This is the normal—. Well, this is not the normal process, but this is the regular process. The normal process, unfortunately, is that Governments in the Netherlands fall before the end of their formal period and you have interim elections—for the whole country, so it is not like a by-election. On those occasions, there is of course the question of how much time there will be between the moment the Government leaves office and the next election. So, depending on how long this period is, we have a less or more fully fledged assessment of the election platforms. So, ideally, we would start the process a year before the election. However, on the last occasions, we had less than six months.

[57] **Julie Morgan:** Thank you very much. That is very interesting. May I just ask you whether you think that any changes will be required to your budget process in the future?

[58] **Ms van Geest:** I think that, in the Netherlands, the process is working reasonably well. However, I think that, in the Netherlands, we still have to find a way to dovetail the European process and the Dutch process. Everything will be all right the moment you hit the medium-term objective. However, the moment you do not hit the medium-term objective, it is difficult to combine our Dutch process and the European process, because the European process is being geared by changes in the structural balance, which is an item that is very difficult to assess, by the way. That is quite different to the way that the Dutch system is now being undertaken. So, that is one of the challenges for the Dutch Government.

[59] The other thing is that, in the Netherlands, we now have a very detailed process with lots of budgetary rules. For instance, if a Minister has a setback in terms of a programme costing more money than he had anticipated, he has to redress that himself. So, if he has overrun in one programme, he has to cut another programme within the same budget. That is the basic rule. If, on the other hand, he has a windfall, then he should give the windfall to the Minister for finance. These types of rules only work to the extent that people accept those rules. So, the longer you have these rules, the more detailed the interpretation of the rules. At the moment, we are getting close to a point where the rules are so tightly defined that it becomes a question of whether our politicians will really adhere to the rules. I think that that will lead to a change in the budgetary rules. In a sense, they are perfect, but maybe too perfect or too strict to have people really adhere to them at all times. Then, of course, rules become less effective.

[60] **Julie Morgan:** Thank you very much; that was a very full answer.

[61] **Alun Ffred Jones:** Good morning. I would like to pursue the issue of the pre-election process. Do you have any difficulty in responding to 11 political parties asking for an analysis of their programmes?

[62] **Ms van Geest:** Do we have difficulty doing what?

[63] **Alun Ffred Jones:** In responding to 11 political parties asking for analysis.

[64] **Mr Suyker:** It is true that having 11 parties means that it is a lot of work, but we manage to do that. It is not easy, but it is manageable. Given that the number of parties has been increasing over the past decades, we have also become a bit stricter on the measures that we take into account. Before, there was not a minimum amount for a measure, but now we take into account only those measures that have a budgetary impact of at least €100 million. So, we do not take into account the very tiny measures that could create a lot of work for us. It is really more on the major measures.

[65] **Alun Ffred Jones:** Are your services available to opposition political parties throughout the parliamentary period?

[66] **Ms van Geest:** Yes.

[67] **Alun Ffred Jones:** So, am I right in saying that you do two things: you evaluate past policies, but also you forecast the effect of policies in the longer term for the future?

[68] **Ms van Geest:** Yes. We provide an economic forecast, which is on a no-policy-change scenario, and then for the Government we take into account the policies that it undertakes. We also forecast when we assess the Government's coalition agreement and when we assess platforms by individual parties and the way in which their programme will work out. That is what we basically do. With regard to the evaluation of the election platforms, the last time we had a very intense process and a very short period to undertake this for 11 parties. So, we decided not only to raise the level of the impact of the programme to at least

€100 million, we also assessed the ex-ante budgetary impact of the programmes, the ex-post budgetary result, the effect on growth, unemployment, Government sustainability and the effect on structural employment. We assessed these things, and we will continue to assess those. However, we also assessed the programme effects. So, we looked at the effectiveness of certain education policies, what would happen to carbon dioxide emissions and whether it would be easier or whether you would have more congestion on the roads, or not. We decided in the next round of the evaluation of the election platforms to skip that part of the analysis, because it was just too much work.

[69] **Alun Ffred Jones:** Right. So, you respond to requests from the political parties or the Government, but you also do your own analysis, depending on the fields that you decide are important.

[70] **Ms van Geest:** Yes. Every year, we draw up a work programme, which summarises the required macro-economic forecast and assesses the budgetary stance of the Government.

09:45

[71] We also outline other research areas such as cost-benefit analysis, the financial markets and innovation policies, and that is basically at our own initiative. Apart from the research that we can do at our own initiative from our own budgetary allocation, we also sometimes undertake research at the request of certain departments or ministries, when we think that these are research questions that are worth while to pursue.

[72] **Alun Ffred Jones:** Diolch yn fawr. Thank you.

[73] **Jocelyn Davies:** There is just one last question from me. I think that the evidence you have given us has been very useful, but would you say that a good budget process, including a proper evaluation of forecasts, needs to evolve over time, or do you think that it is possible to make sweeping changes quickly?

[74] **Ms van Geest:** Some changes are in either/or categories. For instance, as the UK Government did, moving from having your forecast done by the Treasury to having your forecast done by an independent institute is something that you do or do not do; there is nothing in between. Generally speaking, for all policies it is useful to have pilots or to experiment before you undertake major reform. Sometimes, reforms in and of themselves are inevitably major, but you can do pilot or test runs, and on occasion I think that that would be a useful way to operate.

[75] In the Netherlands, the Dutch budgetary policy with its expenditure ceilings and the measures on the tax side also evolved over time. It was started, I think, in the beginning of the 1990s, and although we still have the major outlines it did evolve over time. You notice what works and what does not work, so the next time you can change; you keep the main framework, but you open a different window or you build a different building next to it, so that you develop it slowly but certainly. You can experiment and find out whether you would like to maintain something that you thought was a good thing or whether, with the benefit of hindsight, it was not such a good idea. I think that sweeping reforms always have an attraction, but they are not without risks.

[76] **Jocelyn Davies:** Thank you. We will send you a transcript of the evidence. We would be very grateful if you could check it for factual accuracy before we publish it. Thank you very much.

[77] **Ms van Geest:** You are welcome.

[78] **Jocelyn Davies:** We will move into private session to discuss that evidence.

09:48

**Cynnig o dan Reol Sefydlog 17.42 i Benderfynu Gwahardd y Cyhoedd o'r
Cyfarfod
Motion under Standing Order 17.42 to Resolve to Exclude the Public from the
Meeting**

[79] **Jocelyn Davies:** I move that

the committee resolves to exclude the public from the meeting in accordance with Standing Order No. 17.42(ix).

[80] Does everybody agree? I see that you do.

*Derbyniwyd y cynnig.
Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 09:48.
The public part of the meeting ended at 09:48.*

*Ailymgynullodd y pwyllgor yn gyhoeddus am 10:01.
The committee reconvened in public at 10:01.*

**Ymchwiliad i'r Arfer Gorau mewn Prosesau Cyllidebol—Rhan II: Sesiwn
Dystiolaeth 2
Best Practice Budget Processes Inquiry—Part II: Evidence Session 2**

[81] **Jocelyn Davies:** We move to agenda item 4, which is our best practice budget processes inquiry, part II. This is our second evidence session and we are delighted to be taking evidence from the Office for Budget Responsibility. Before we move to the first question, would you like to introduce yourself for the record?

[82] **Mr Chote:** Yes, I am Robert Chote and I am chairman of the OBR.

[83] **Jocelyn Davies:** Thanks very much. Could you briefly summarise the main purposes of the Office for Budget Responsibility, how it operates and to whom you report?

[84] **Mr Chote:** Certainly. As you know, it was set up shortly after the UK general election in 2010 and our overarching remit is to report on and analyse the sustainability of the public finances at a UK-wide level. We have four main tasks within that, the first of which is that we produce, twice a year, five-year-ahead forecasts for the public finances and, associated with that, a five-year-ahead forecast for the economy. Those were forecasts that, previously, before our existence, the Chancellor of the Exchequer was required by legislation—the Industry Act 1975—to produce. That responsibility has now been transferred to us. So, the UK Treasury no longer publishes forecasts of its own. We produce the forecast and it is of course up to the Government to say whether it agrees or disagrees with that and whether it wants to set policy on the basis of that, or whether it has a better idea of how things might turn out.

[85] The second role that we have, using those forecasts, is to assess whether the Government is on course to hit the fiscal targets that it has set itself. As you are probably aware, it has two of those at the moment: one targeting a particular measure of Government

borrowing five years ahead and another to get the debt-to-GDP ratio falling in 2015-16. It is not our role to say whether those are the right targets or not; it is not even our role to say whether, if the Government is not on course to hit them, it should do something to ensure that it does. Our job is simply to give our best judgments on where things are going to go, whether you have a better than 50% chance of hitting the targets, and talking about some of the risks and uncertainties that lie around that. So, if you are on course to hit that, what are the risks around that? So, there is that element as well.

[86] The third thing that we do is scrutinise the costing of individual tax and welfare spending measures that may be announced in the budget or the autumn statement—so, the list of them; what is called the scorecard list, such as changing the 50p tax rate or some change to the generosity of particular welfare benefits. The Treasury publishes its own estimates; we say publicly, ‘Yes, we agree that that is a sensible and reasonable estimate’, ‘No, we don’t’, or, ‘You didn’t give us enough information or time to reach a proper judgment’. At the end of the day, we take whichever measure we prefer and include that in our forecasts to show where we think the public finances are going.

[87] The fourth main role is to look at the longer term health of the public finances. We do that, as it were, in two ways: one of which is by looking at the public sector balance sheet, which gives you a snapshot of the impact of fiscal decisions taken so far, and then we also do longer term projections over 50 years, which are necessarily much more illustrative than the near-term forecasts, but allow you to bring in things like demographic change, long-term prospects for oil revenues and student loans and those sorts of issues as well.

[88] So, in terms of the core functions, we have those. Then, obviously, in addition, there are the responsibilities under Scotland and Wales Acts for the particular receipts that are forecast here.

[89] In terms of how we are organised and to whom we are responsible, we are a Crown non-departmental public body, so we are a quango. I and my two deputies are the appointed budget responsibility committee, and we take formal responsibility for all the outputs and judgments that are made. We have a staff of about 20 civil servants working for us. As an arm’s-length body, we are part of the Treasury group for accounting purposes, but in practice we are jointly accountable and responsible to the Executive via the Chancellor of the Exchequer and to the Treasury Committee in Westminster. For example, the Chancellor cannot appoint or sack me without the formal approval of the Treasury Committee. I personally view our ultimate responsibility as being to the general public. We give our best judgments on that, whether the Treasury Committee or the Chancellor want to hear that or not, but we are accountable and responsive to both of them.

[90] **Jocelyn Davies:** Of course, some budget offices in other countries are parliamentary bodies, but you are not a parliamentary body; you are a quango, as you said. So, what is your interaction with Parliament? How does that work? You mentioned the select committee, but what about the Parliament as a whole?

[91] **Mr Chote:** It is primarily mediated via the Treasury Committee; it has the formal responsibilities in terms of the appointment hearings. The committee also asks us to give evidence to it after each forecast that we produce, so, typically, in the week after the budget or the week after the autumn statement, it will take evidence from outside academic or city economists. It will take evidence from us, and then it will take evidence from the Chancellor of the Exchequer, using what it has heard from us and from outside experts to help to motivate what the questions might be.

[92] In terms of the interaction with the remainder of Parliament, we do not get a lot of interaction there. Obviously, we respond to parliamentary questions if they are submitted

formally. We are obviously very happy to talk to people informally who want information about what we are doing. This, I think, is a reflection—and it is an interesting contrast with these bodies in other countries—of the fact that Parliament is less powerful relative to the Executive in budget-setting in the UK than it is in many other countries. After the budget statement, the leader of the opposition stands up and gives a response, and there is a debate before anyone has even had a chance to read the forecast that we have put out, which is the way that they choose to do it. In other jurisdictions, there might be a period of reflection on the data before you have the debate, but I am not sure how that works in different countries.

[93] **Jocelyn Davies:** Okay. Julie, I know you wanted to come in on this.

[94] **Julie Morgan:** We took evidence from the CPB Netherlands Bureau for Economic Policy Analysis just before this session, and it was very interesting to hear about how available they made themselves to all the political parties. Is there anything like that in your brief?

[95] **Mr Chote:** There are two issues to that. One is about availability and the other is a formal responsibility to cost the proposals of other parties. On the formal relationship, our remit, which is very clearly set down by Parliament, is that we should only look at the current policies of the current Government; we should not pronounce on the overall alternatives. For example, if the different parties set out different views on what they want spending or borrowing to be, it is outside our remit to say, ‘Well, this is the sort of difference that we think that that would make to public finances’. It is also outside our remit to help—well, not necessarily help—or to scrutinise the costing of particular proposals that opposition parties make. That was debated when we were set up. Parliament decided it did not want to do it. The Labour party subsequently decided that it might be a good idea. There was a vote on that in the House of Commons and that was rejected. So, in terms of our formal relationship with other political parties, if Parliament wants to come back to that issue after the election, then that will be an issue for the next Parliament. I do not know to what extent the CPB went into it, but it is a much larger organisation than we are and it has an enormously challenging process. Ahead of the last election, it scrutinised the manifesto proposals of 11 political parties and 2,500 policies, and it took 80 people three months to do it, which is far greater than what we could do.

[96] On an informal basis, obviously, parliamentary groups from within parties and across parties have occasionally asked me to go along and talk to them about the sorts of things that we do and I am very happy to do that. As I say, there is a formal process of parliamentary questions and freedom of information requests that can come in and that involve a degree of formality. Often, it is easier for people just to send an e-mail and say, ‘I did not quite understand table 4.6; could you possibly help us with that?’ We are obviously happy to do that, given the constraints that we only have 20 people to do it with.

[97] **Jocelyn Davies:** Thank you. So, it is the legislation that created yourselves that prevents you from doing this other work that has been found to be very useful in other jurisdictions.

[98] **Mr Chote:** Yes, and when the Labour Party proposed, a few months ago, that it would like us to look at its and other policy platforms prior to the election, we did take independent legal advice to check whether that would require a change in primary legislation for us to be allowed to do that, and that was confirmed.

[99] **Jocelyn Davies:** So, how about the role of the Treasury, which you mentioned? Does it direct the work that you do or are you independent in terms of being able to please yourselves, apart from your statutory duties?

[100] **Mr Chote:** Pretty much. We have the freedom to basically do what we want to do within the broad remit that has been set out, which is quite a broad one to report on the sustainability of the public finances. There are requirements in the legislation and other subsidiary documentation that, for example, we should act in a way that secures value for money and that we are bi-partisan and things of that description. For example, if the Treasury were to set a new fiscal target that required us to forecast a new number because that is what it wanted to target, it could tell us, 'We want you to forecast that number so that we can run our fiscal target', obviously, we would be happy to do it anyway, but it would have a formal right to tell us, 'There is a minimum list of things that you must forecast for us because that is what we need to do our jobs.'

[101] However, we can also go beyond that should we wish to do so. My view is that we should do what is necessary in order to establish, in particular, the transparency of the work that we do. So, in addition to the reports that we are required to produce by legislation, we produce a lot of explanatory material and background notes, looking at the methodologies that we use and at particular issues. We are just starting a programme of rather more non-technical summaries of the public finances and things, which are for a more student and non-technical audience, for example. As well as that, we have just produced a paper, the week before last, looking at the big-picture evolution of the public finances over the financial crisis and the consolidation, which is not something that we are required to do, but I think that that helps us to understand what has been happening in the past so that we have a better chance of understanding what is happening in the future and also as a public education exercise. So, there are certain things that the Treasury can tell us that it wants us to produce, but we basically do the job within those parameters as we see best fit.

[102] **Jocelyn Davies:** What about your relationship with other Government departments other than the Treasury? Do they make requests of you? I understand that you are entirely free to look at what you want, but do other departments ever make requests of you?

[103] **Mr Chote:** They do so much more rarely, and there is not a formal basis. What we have is a memorandum of understanding with the key departments with which we have the greatest interaction. I think from outside, people sometimes assume that we have a primarily bilateral and hostile relationship with the Treasury or the Government and that there is a sort of dependency on them for information or data. That is not actually the case; our primary dependency is on the analytical resources of HM Revenue and Customs and the Department for Work and Pensions in helping us to turn our overall macro-economic judgment into detailed bottom-up forecasts for particular flows of receipts and spending.

10:15

[104] So, we had an independent review conducted of us over the summer by the former head of the Canadian parliamentary budget office. One of the most interesting things that came out of that is that he asked those other departments what time and resources they had devoted to producing the material that we needed, and, basically, he suggested that if we did all of it in-house, we would probably need 150 people. In effect, we are getting 60 people from HMRC doing quite a lot of the work that we need to do. The key point to bear in mind is that, at the end of the day, the forecasts that we produce are our forecasts. So, if HMRC comes to us with a new model for calculating capital gains tax or stamp duty, we can say, 'No, we don't want you to use that, we want you to use something else'. If they come to us and make a particular judgment, and say, 'Well, we think the rate of avoidance for this particular tax measure will be x or y', it is for us to say, 'Well, actually, we don't.' At the end of the day, it is our forecast. So, it is very generous with its time and effort and the assistance that it provides us. The model, which is quite unusual by international comparisons, of having a small team in the fiscal watchdog, but a legal and fleshed-out relationship with the departments that we require input from, is quite important. As you can imagine occasionally

happens, a Minister in one department might be interested in how policies could be run differently, for the benefit of his or her department relative to the Treasury, but we do not get into that sort of assistance, if you see what I mean.

[105] **Jocelyn Davies:** I should not think you would want to. [*Laughter.*] Obviously, forecasting UK taxes is going to change slightly, because you will be forecasting Scottish and Welsh taxes in the future. So, is there a case for Scotland and Wales being represented within the governance of your structure, perhaps on the advisory panel, having representation there among your economic experts?

[106] **Mr Chote:** I think, on the economic experts, the issues of the difficulties of particular forecasting areas are difficulties that would be there regardless of whether you were doing it at a national or subnational level. The advisory panel is, in a sense, a sort of academic panel, rather than a panel of representatives of particular stakeholders. I think, in terms of the responses you get, the way in which most of the forecasts have gone for Scotland so far—we are finalising this, but the methodologies, I suspect, will be similar for the Welsh ones—is looking at whether there is a reasonably robust relationship between the share of the UK for the particular country concerned, and that has to be approached on a tax-by-tax basis. Certainly, if we felt that there was a particular need to get in additional expertise in those sorts of areas, then that is something that we would look at on the advisory panel, or just by asking people anyway. For example, on the advisory panel, there has been an interest in something called computable general equilibrium, which is the—

[107] **Jocelyn Davies:** Oh, we talk of nothing else. [*Laughter.*]

[108] **Mr Chote:** Indeed, yes, absolutely. The Chancellor has used this particular technique to say that particular tax cuts are partially self-financing. We felt that it was helpful to have some additional expertise in that sort of area. So, we look at it in terms of, ‘Where is the expertise on the particular methodologies?’, rather than, as I said, either geographical or other stakeholder representation.

[109] **Jocelyn Davies:** Okay, Ann, shall we come to your question?

[110] **Ann Jones:** Thank you. The command paper that is alongside the Wales Bill notes that you will provide forecasts for Welsh taxes, which will then be used to make the deductions from the Welsh block grant. Is your decision on those figures final, or does the Welsh Government get to challenge those figures or discuss those figures before their publication with the UK budget?

[111] **Mr Chote:** Let me take a step back. In the process that we do when coming up with the UK forecast, in the run-up to a budget or an autumn statement, we produce a forecast of what happens if the Chancellor sits on his backside and does nothing, which is called a pre-measures forecast. It is based on what everybody knows about the current state of tax and spending policy, not including any of the measures that he may be thinking of announcing at the time of a budget or the autumn statement. We produce, as I said, a pre-measures forecast for the economy and a pre-measures forecast for the tax and spending elements, and then there is a separate process of scrutinising policy measures. Then, at the end of the process, you add the impact of the policy measures on to the pre-measures forecast.

[112] What we have done to date on the Scottish side, and what we would do as well on the Welsh side, is, when we are discussing the particular receipts—the pre-measures forecasts for the devolved administration receipts—the Government in question, the Scottish Government and, henceforth, the Welsh Government, is present either physically or virtually or telephonically at the meeting at which we are discussing that with, typically, HMRC. We, at that stage, are asking for input from anybody around the table as to whether they have

particular views and judgments or whether there are any additional data or information they think would be helpful in reaching those views. The Governments in question are present at those meetings and make useful contributions in those meetings. At the end of the day, we are an independent body. We reach the final view and I and my two colleagues take responsibility for that. It is for Governments to decide, nationally and otherwise, what they want to do with that. They can ignore that and take a different view if they want to. How you apply it, for example, in terms of getting from the forecast to what happens to a block grant, has nothing to do with us. Our job is to produce forecasts for what we are asked to forecast and then we leave it to others to decide what to do about that.

[113] Where we cannot bring the devolved administrations in is to discuss the set of policy measures that the Chancellor is thinking of announcing on the day of the budget. There, we have to take a separate judgment about whether we think those measures are likely to have asymmetric effects between the UK and the devolved administration in question. We are as transparent as we can be about that when it is published, but, for obvious reasons, the Chancellor will not share his proposals on stamp duty with other Governments prior to the budget. That is not us saying he should not; if he wanted to do that, fine. We are happy to have around the table whoever wants to be around the table for that and whoever the system is happy with. However, you can understand why that does not take place. Then, when we publish our final report—the tax forecasts alongside the budget or the autumn statement—we explain both the pre-measures forecast and any decision on what the long-term ones are. The most obvious area where you might get an asymmetric effect is where, for example, on income tax or stamp duty, you have measures that affect disproportionately people on relatively high or low incomes or with relatively expensive or inexpensive houses, because those are not distributed evenly across the UK.

[114] **Jocelyn Davies:** Before you go on to your next question, Mike, did you want to come in on this point?

[115] **Mike Hedges:** Yes. In fact, it is on the last point you were on and on stamp duty land tax. It is a highly cyclical tax, is it not? In Wales, at our lowest, it has been one third of our highest, approximately. My understanding is that, whatever you set it at, it will be locked into the Welsh block—it will be taken out of the Welsh block and then locked into the Welsh Government's budget. So, whether you take it out at the highest or the lowest, and your assessment at that stage, will have an effect on future expenditure for very many years. How will you decide? Will you take an average? Will you take a root mean square? Will you take your current prediction of what it would be in any one year and decide what you think is the amount that would be appropriate?

[116] **Mr Chote:** As I said, we produce the forecast. Whether that is an appropriate way to adjust the grant over a longer time period or for a particular time period is an issue for the Governments, not for us. That is outside our purview. You are absolutely right: stamp duty is a more cyclical tax than most. That is partly, obviously, because house prices move up and down more than incomes or spending does. The additional factor, which has been particularly important and which is a particular challenge for forecasting anyway, is that the level of transactions matters as well, because you only get the stamp duty when a transaction takes place. One of the consequences of the financial crisis was that transactions fell a very, very long way below their normal level, partly because of people's difficulties getting hold of mortgage finance. That means that you have to make judgments about whether we will return to the average frequency of people moving house that you saw prior to the financial crisis and how quickly that will happen. So, there are clearly a lot of uncertainties over that.

[117] What we have tended to do, if there are areas where you see greater volatility in the share, that is, the Scottish or the Welsh share relative to the UK, then, as you say, it looks—. We approach this on a case-by-case basis, and you would want to do that over a number of

years, rather than over the latest year, in order to see some of that variability. What has tended to happen so far, I think, is that you see rather more variability in the share for commercial stamp duty than for residential stamp duty. The other issue with the residential stamp duty is that there has been a trend of a lower share for Scotland, which is not a Scotland story but a London story. So, we would need to take that sort of thing into account. So, for example, one of the challenges that we will have when we come to do the next forecast is to say, ‘Well, given such evidence that there may be that the London market is cooling off, what is that going to do to the non-London UK versus London shares, and what implications does that have elsewhere?’ However, at the end of the day, we produce the best forecast that we can on the basis of the UK forecast that we produce, and a judgment on share that we are transparent about, but it is not our job to say how that should affect the block grant.

[118] **Jocelyn Davies:** So, you take many factors into consideration when you are coming up with your forecasts, such as—

[119] **Mr Chote:** We do. I mean—

[120] **Jocelyn Davies:** You do not have to detail them all, but I can see from what you are saying that—

[121] **Mr Chote:** Generally speaking, the approach is one of looking at the relevant share of the UK total. We do not have, generally speaking, enough of the long-run data that you would require if you were starting with a completely blank sheet of paper and doing different sub-national macro-economic forecasts, bolting them together, and then coming up with a UK-wide one. Similarly, on the public finances, you might approach this in a different way. However, certainly in terms of the available data and the capacity to produce a completely separate macro-economic forecast that could drive individual forecasts for the particular sets of tax receipts in the particular administrations, that is not the world that we are in. To be realistic, I think that, if you wanted to go into that world, you would need to spend a lot of money and a lot of time running those data and running those forecasts for long enough to be confident that they were telling you a great deal more than you could get by saying, ‘Well, let’s assume that it continues at around 4.5% of the UK total’, or whatever it may be.

[122] **Jocelyn Davies:** Ann, shall we come back to you?

[123] **Ann Jones:** Thank you. The OBR has agreed to begin forecasting Welsh taxes in the autumn statement of this year. Can you tell us what preparations you have made to implement this, please?

[124] **Mr Chote:** Well, we had a meeting a couple of days ago, at which the Welsh Government was represented, with HM Revenue and Customs and the Treasury’s devolved administration team to have an initial look at the methodology issues. Basically, as I have described, there is nothing obvious to suggest that there is a better way of doing it than the way we have been doing it with Scotland so far. We have been looking at some of the broad issues around that. One interesting question is whether, as you will be aware from outturn data, the Welsh share of the relevant income tax stream may have been on a declining trend, excluding policy measures, in a way that has not been the case for Scotland. That is one issue on which we will want to have a further prod around at the numbers before we reach a view. So, we have had an initial discussion there about those methodologies. We took the opportunity to ask Welsh Government colleagues whether there was any particular additional data or information they thought we should look at on those sorts of issues. So, that was a sort of ground-clearing exercise.

[125] Then, as I said, the next thing that we will do, when we get to the appropriate point in our pre-measures forecast timetable, which I suspect will be mid-November—the second

week of November or thereabouts—is to have an additional meeting at which we will have a clearer draft forecast. By then, we will have done a draft macro-economic forecast and we can give that to the relevant forecasting teams for income tax, stamp duty, landfill and aggregates, and we will discuss that again with Welsh Government being present and having any further interaction that it wants to have. Then, we go ahead and publish on the day.

10:30

[126] **Ann Jones:** Okay. So, do you intend to forecast income tax as well as the other devolved taxes?

[127] **Mr Chote:** Yes.

[128] **Ann Jones:** You do. Okay. Thank you. When you first did the forecast for Scotland, you produced a methodology note to accompany that first one. Is that your intention when you do it for Wales this year?

[129] **Mr Chote:** I think, as the methodology is likely to be broadly the same, what we will do instead is—. At the moment, we have a separate Scottish tax forecast publication that we put out alongside the budget or the autumn statement, which recapitulates, in briefer form, some of the discussion on the methodology that was in that earlier note. My intention at the moment is that we will produce a single publication that covers both Scotland and Wales, because a lot of the—. For example, the definition of non-saving non-dividend income is the same, so it is easier to explain the methodologies in that context than to have two completely separate notes. That, I think, will allow us to put in some additional explanatory material explaining why we have thought that the methodology does or does not need tweaking in particular cases for Wales, relative to Scotland. I think, in a sense, having the two of them together and explaining similarities and differences in a single publication is probably more helpful to people than pretending that Scotland does not exist and producing a separate note.

[130] **Ann Jones:** Okay. Thank you.

[131] **Jocelyn Davies:** Peter is next.

[132] **Peter Black:** Thank you. The OBR methodology for forecasting most Scottish taxes is based on Scotland's historic share of the relevant UK tax. Can you explain why that approach is necessary in Scotland and whether that is likely to be the approach adopted in Wales?

[133] **Mr Chote:** Well, it comes back to the point I made earlier about the fact that, even if you wanted to, the available data for producing a completely separate bottom-up macro forecast and a set of macro-economic determinants for England, Wales, Northern Ireland and Scotland—. The data are not there to suggest that—. Well, we could not, and, even if the data were there, whether that would actually be a more efficient way of doing it than looking at the shares and what might have been moving those shares over time—. So, I think, for some of the measures, the shares have been pretty constant. If you look at the Scottish income tax share, that appears to have been pretty stable, excluding obvious areas where you can spot policy changes that have affected this. It is hard to believe that, by producing some more sophisticated bottom-up approach, we could end up with much of a better answer to that.

[134] On the income tax side, one issue, which, for a while, will remain, is that in terms of working out the Scottish share—and the same will be true of the Welsh share—we are reliant on something called the Survey of Personal Incomes, which is a sample of the tax information that HMRC gets, and you can draw things out of that. One difficulty with that is that it comes with a lag, so the latest information that we have on that for Scotland's share, and the same

will be true for the Welsh share, is the outturn data for 2011-12. So, in addition to forecasting the future, we also have to forecast the present to get you to forecasting the future. So, that is a slightly more complicated process. We will be helped in the future by the fact that HMRC will identify people as Scottish, Welsh, or non-Scots or non-Welsh, taxpayers and then we will not be quite so reliant on this rather outdated survey. So, that will help matters and mean that we will have outturn data on the shares rather earlier than we otherwise would.

[135] I think the share is also quite a useful way of looking at this because, as I was saying to Ms Jones, when you move from a pre-measures forecast to a post-measures forecast, you can then look explicitly at particular policy measures that are being announced and ask whether there is any reason to believe that this is likely to have an asymmetric effect, primarily, as I said, because of relative distributions in income and relative distributions of house prices. You can then make adjustments on that basis.

[136] On the aggregates levy, essentially you are taking outturn data from the UK minerals handbook and producing a forecast, looking at the past relationship between aggregates extraction, construction output and GDP. Again, by doing that at a national level and taking a share, you are probably not going to add very much without a great deal more data being generated and collected if you were to try to do that at a more bottom-up level. However, that is one of the reasons why we find it useful, obviously, to have the administration Governments present, because if they happen to know that there is some better, more detailed information on those particular things, they can draw it to our attention.

[137] **Peter Black:** There are some parts of the country that extract more aggregates than others.

[138] **Mr Chote:** Yes, absolutely. If you look, roughly speaking, at the shares, you will see that the Welsh share of aggregates levy is considerably higher than the Welsh share of income tax or residential stamp duty, for obvious reasons.

[139] **Peter Black:** Does that methodology take that into account?

[140] **Mr Chote:** It does, yes, because you are basically looking at those shares, tax by tax. So, very roughly speaking, the Welsh share of the relevant bit of income tax is about 1.5%, the relevant share for stamp duty is about 1.5% for residential and a bit over 2% for commercial, it is 4.5% for landfill and 8% for aggregates. You can understand why you would have a higher share of aggregates than you would of residential stamp duty, for obvious distribution reasons.

[141] **Peter Black:** Are there any specific barriers to providing forecasts that are unique to Wales?

[142] **Jocelyn Davies:** Other than the ones—

[143] **Peter Black:** Are there data barriers, for example? Are the data available, disaggregated to Wales?

[144] **Jocelyn Davies:** There is no problem with sharing information or anything like that.

[145] **Mr Chote:** No, I do not think so. It varies. There are some—I think that it is either landfill or aggregates; I am trying to remember—where you have different organisations. There will be a different England and Wales data provider, a different Northern Ireland one, and a different Scottish one on some of the environmental sides. In other areas, if it is the Environment Agency, it might be more broadly encompassing. It depends on the particular information that you need for particular areas. In most cases, you are basing this not on an

assumed share of the outturn, but evidence on, ‘Well, there is this amount of aggregates produced here, that amount of aggregates produced there’. So, yes, there is. Clearly, you could have a lot more disaggregated information and produce a lot more disaggregated forecasts. That is not the world that we are in. I would not guarantee you that it would be any significantly more accurate if you did.

[146] **Peter Black:** We just touched on landfill tax, and clearly you have outlined the differences in terms of Wales. Landfill tax, of course, is fairly subject to policy changes, particularly the amount of tax and how much people recycle. Is there any particular methodology that you would use in relation to Wales, given that landfill tax is likely to fall over the coming years, because of various policies that have been adopted?

[147] **Mr Chote:** The same issue has arisen with Scotland. We have reduced the landfill forecasts reasonably significantly in the past couple of years. That is primarily because the UK-wide model was not taking into account the sorts of policy approaches that you are pointing to. On the question of whether Scotland would say to us, ‘Ah, yes, but we have a particularly good landfill policy’, Wales would say, ‘We have a particularly good landfill policy’, and England and others would also say that, I think that if you look at the way in which the shares are evolving, and if that started to indicate that there was quite a considerable difference over time, that is certainly the sort of thing that you would want to take on board. However, you have not seen a dramatic difference in the trend of landfill receipts for Wales versus the rest of the UK that would lead you to think that that is something that we would have a robust enough evidence base to adjust for now. However, we do look at that again as we come to each forecast.

[148] **Peter Black:** This is my last question. When you are looking at doing predictions for Wales, have you considered how taxes are forecast for sub-national Governments in other countries?

[149] **Mr Chote:** Not specifically. I think that the issue there is that, obviously, in different sub-national Governments different things are devolved. The availability of disaggregated data and their rules would be sufficiently different that I am not sure that you would gain a great deal from doing that. If we come across evidence that suggests that there are different ways of doing that—. I think that the idiosyncrasies of particular aggregates and landfill approaches, particularly the idiosyncrasy of stamp duty—we have a property transactions tax that I do not think many people have been rushing to emulate in other parts of the world—. However, I may be wrong on that. [*Laughter.*]

[150] **Peter Black:** We led the way in that. [*Laughter.*]

[151] **Jocelyn Davies:** Julie, shall we come to your questions?

[152] **Julie Morgan:** I understand from what you say that, even if the Welsh Government was to collect more economic data locally and increase its capacity for economic modelling, you would still use the same approach that you are using now.

[153] **Mr Chote:** Well, we would use whatever information was available to us at the time. What I would say is that I would be cautious about assuming that the amount of additional data and analysis that you would need to get you beyond the point at which, given all the sampling and forecasting errors around individual forecasting analysis, can do much better than assume a broadly constant share. That is the note of caution, I would say. However, obviously, as I say, one of the reasons for having these regular meetings prior to the point at which the administrations are involved, prior to each forecast, is exactly for people to bring forward local information or new sources of data that they may think are appropriate.

[154] **Julie Morgan:** So, if the Welsh Government was to increase its capacity in that line, that would be useful in these pre-meetings.

[155] **Mr Chote:** Yes, we would obviously be very interested to see what it came up with. As I say, given the sorts of taxes that we are dealing with here, the nature of the data and the forecasting that would go into that, I am just hesitant about saying that you would get a very different picture if only you had some more local activity. However, we obviously look at whatever information we can.

[156] **Julie Morgan:** You would take that into account. In terms of forecasting Welsh income tax, you are heavily reliant on HM Revenue and Customs for that.

[157] **Mr Chote:** Indeed, yes, as it is administering, and will continue to administer, the tax system as a whole. We are reliant on it, as I say, in terms of the UK forecast. It is our forecast, but HMRC is cranking the handle on it. We will be asking it to make particular judgments. So, for example, when this process started with Scotland, we suddenly needed to produce a UK forecast for non-saving, non-dividend income. Previously, we did not need to do a forecast of UK-wide income tax, but now, as that is the tax base for the devolved bits of income tax, we do. So, obviously, we are in that sense reliant on HMRC to be able to come to us to say, 'Well, this is how we've tried to calculate what non-saving, non-dividend income looks like over this period', and we have obviously looked at that, given our comments and basically iterated until we are happy with the definition that you have there. As I say, the area where the income tax story will move forward is moving from a reliance on the survey of personal income to having the flagging of individual taxpayers by country. That is the biggest change. It will still be HMRC doing the process though.

[158] **Jocelyn Davies:** Mike, did you want to come in on this point?

[159] **Mike Hedges:** I have two points to make at the end of Julie's points.

[160] **Jocelyn Davies:** Julie has finished. Go on.

[161] **Mike Hedges:** I have two questions. Landfill tax, in many respects, does not matter, does it? What happens is that the Welsh Government gives money to local authorities, which are major payers of landfill tax—somewhere around the 90% mark—and then they pay the tax back to the Welsh Government. So, if it goes down or up, it is really just moving around in a circle.

[162] **Mr Chote:** That may be the case, but we would have a separate process for looking at local authority expenditure—

[163] **Jocelyn Davies:** Robert, I do not think that that was a question, so you do not need to answer it. [*Laughter.*] It was a point—

[164] **Mr Chote:** An observation.

[165] **Jocelyn Davies:** It was an observation for you to squirrel away, because you might need it at another point.

[166] **Mike Hedges:** I have a question on income tax. Income tax, especially in border regions—. I have seen the Scottish definition of a Scottish taxpayer, which is relatively complicated, but it benefits from the fact that the Scottish and English border areas are relatively unpopulated. In parts of Wales, certainly north-east Wales, the border is highly populated and you move between Wales and England quite rapidly if you are driving up there. There is a huge amount of movement across the border with some big employers,

which should not be a problem, because they will have data on where people work. However, there are a lot of small employers in the area that will probably have less good data on where people actually live. Do you see any problems with that? Also, in terms of contractors, an awful lot of people, certainly from Swansea and west Wales, contract in England in very large numbers, certainly on building sites in London, the channel tunnel, Wembley Stadium and the Olympics. However, there are quite a lot of people who really are Welsh and who have made their homes in Wales but may well spend over half the year working in England.

10:45

[167] **Mr Chote:** ‘Problem’ is probably not the word I would use. I think that there are two issues here. At the end of the day, we will have to produce forecasts for whatever definition of a Welsh taxpayer is adopted and applied by HMRC. It is not going to be for us to say, ‘Actually, the real Welsh tax receipts are different because we think HMRC is defining some people as Welsh who are not’. That is not an area we will get into. You do, however, raise a subsidiary and important point, which is that the forecasting task will get more difficult—and exactly the same is true of Scotland—if, as a result of policy decisions, you end up with a significant differential in the tax rates, which will then require us to have to make some sort of judgment about what the behavioural response is to those differentials. Are they big enough and, for the sorts of people concerned, does that suggest that there will be shifting within the UK as a consequence? Scotland has had the ability to change its income tax rate already but has never used it, so that issue has not arisen. However, obviously, if you did end up in a world in which there was a significant difference, if what you say is right—well, I know what you say about the proximity is right, but if there were reasons to believe that cross-border movements were more likely in Wales than they were in Scotland for a given differential in the tax rate—that is the sort of issue we would have to grapple with. I suspect that I would be coming before you and saying, ‘We’ve had to make a judgment on this and it is extremely uncertain’.

[168] **Jocelyn Davies:** Nick, shall we come to your questions?

[169] **Nick Ramsay:** Yes. I am quite interested in this issue of the definition of a Welsh taxpayer as well. I think that we should ask HMRC about that at some point.

[170] **Jocelyn Davies:** I think that it is in legislation, is it not? So, it is a parliamentary issue, really.

[171] **Mike Hedges:** It is in the command paper.

[172] **Mr Chote:** I think the overarching phrase is ‘closest relationship with’, and then there are issues about principal residence et cetera. I am not an expert on it.

[173] **Jocelyn Davies:** We are told by the lawyer that it is in the Bill, so it is a parliamentary—

[174] **Nick Ramsay:** Is it defined in the Bill though?

[175] **Mike Hedges:** It is defined in the command paper, is it not?

[176] **Ms Jackson:** It is defined in the Bill as well.

[177] **Jocelyn Davies:** So, it is law.

[178] **Nick Ramsay:** Okay. Well, I will move on to my next question then. That is quite definitive. You mentioned earlier the merits of having a joint Scottish/Welsh forecast—

[179] **Mr Chote:** Publication.

[180] **Nick Ramsay:** Publication, sorry, looking at the forecast with a similar methodology. What about the broader relationship between the OBR and the Scottish Parliament? Do you think that that could be mirrored entirely with the National Assembly and the Welsh Government as well, or do you think that there should be certain differences in our relationship with you?

[181] **Mr Chote:** Well, it depends in part on what you—. Let me explain the situation with the Scots as it has run so far and is evolving as we speak. There is not a formal relationship in the sense of the governance relationship that we have with the Treasury Committee at Westminster. However, we give evidence on a regular basis to your Scottish counterparts, the Scottish Parliament's Finance Committee. Obviously, if you would like that, then it would be great to do that here too. Where there is a slight difference now is that Scotland has decided, first of all, to create a different system of property transactions tax. So, it is getting rid of stamp duty as it exists in the rest of the UK and replacing it with a land and buildings transactions tax, the details of which I think we will hear about when it does its draft budget, which I think is roughly when you do your draft budget, which is fairly soon. That tax is being designed and administered by the Scottish Government and Revenue Scotland, and we will have to have a relationship with them because we will still have to include within our UK forecast an estimate of the new Scottish land and buildings transaction—

[182] **Nick Ramsay:** Is that going to be a significantly different stamp duty?

[183] **Mr Chote:** The main difference will be that, at the moment, the stamp duty in the UK has something called a 'slab' structure. So, if your house price moves from the 1% rate to the 2% rate, you pay 2% on the whole of the property price and not just the bit above the 1% threshold. In income tax, you pay 20% on this chunk of income, 40% on the next chunk of income, and 45% on the following chunk of income. The equivalent would be, if you operated income tax in the same way, that if you went over the higher rate threshold, you would be paying 40% on all of your income suddenly, having paid 20% just below that point, which, needless to say, gives you a huge spike in the increase in the tax bill at that point. One consequence of this, if you look at the way that it affects the property market, is that you get an awful lot of properties being sold for £249,999 and possibly some quite expensive fridges being thrown into the deal as well, rather than a smooth progression—

[184] **Nick Ramsay:** You are not proposing a fridge tax, are you?

[185] **Mr Chote:** HMRC will keep a very close look out for this, but, obviously, it creates an incentive to keep—

[186] **Jocelyn Davies:** This new legislation in Scotland is trying to do away with that, and to create what they would consider to be a fairer system.

[187] **Mr Chote:** Exactly, more like the way we have with income tax. So, that will have some interesting implications. It is obviously interesting for Scotland in the sense that it should get rid of the bumps in the threshold, but it creates some additional uncertainties, because we do not know how the public is going to react to a new and rather unfamiliar-looking schedule of stamp duty rates.

[188] Another feature of our legislation is that I am not permitted to talk about the relative merits of particular individual taxes' designs, but if you were to read what I had said about stamp duty when I did my previous job at the Institute for Fiscal Studies, you would see that I said that it is probably the worst designed tax of pretty much any, and one big difficulty is the

slab system. However, I cannot say whether I still think that.

[189] **Jocelyn Davies:** So, you used to think that, and nothing has changed.

[190] **Nick Ramsay:** Can we get that paper, Chair?

[191] **Jocelyn Davies:** Yes.

[192] **Mr Chote:** I cannot—

[193] **Jocelyn Davies:** Anyway, we had better move on. [*Laughter.*]

[194] **Mr Chote:** I think that there will be an interest in that because of its potentially wider implications. The further wrinkle with Scotland is that in addition to now having a tax that they will design, implement, run themselves and, presumably, produce their own forecast for, we now have a Scottish counterpart in something called the Scottish Fiscal Commission. That has a responsibility to the Scottish Government to scrutinise the forecasts that the Scottish Government makes of its devolved taxes. We are now in contact. Lady Susan Rice chairs that with two economists as her deputies. I have already met with them in Edinburgh, and we look to have a good working relationship with them as well. So, whether one ends up having the same relationship with Wales will depend partly on whether you decide to create some new taxes or to change some of the taxes to things that are different from those in the rest of the UK, and to administer, design and forecast them within Wales—that is, they are not being run by HMRC, with which we have a memorandum of understanding anyway. However, if there were a ‘Revenue Wales’ that we needed to have some arrangements to talk to, and you—

[195] **Nick Ramsay:** I was just about to ask you about that and your relationship with Revenue Scotland, because a White Paper came through this week, yesterday, on the new Welsh revenue authority. So, how do you work with Revenue Scotland and would you see your relationship with a ‘Revenue Wales’ or equivalent body working in a similar way?

[196] **Mr Chote:** At this stage, it is too early to know exactly how that will work. As you will appreciate, given the referendum that was going on in Scotland, we will need to see the new system settle down for a bit in terms of what sort of exchange of information we have, when we do it and whether that has to happen primarily with the Scottish Government, or with Revenue Scotland, or with the Scottish Fiscal Commission or with some combination of those three. They have had other things on their minds, entirely understandably, and we will want to see how that settles down.

[197] **Nick Ramsay:** Very briefly, you said earlier, I think, that you do not have a formal relationship with the Scottish Parliament as an organisation. Do you have a written agreement with it in any way, or is it purely ad hoc?

[198] **Mr Chote:** No. Since the changes that I have just been describing, I think, in the longer term, it would probably be a good idea to have a memorandum of understanding. That might not be necessary if you did not have this additional set of changes. If, basically, all your devolved taxes are going to be administered and run by HMRC, that might be sufficient. We already have a memorandum of understanding on relationships with it, and I am obviously happy, as are colleagues, to come here or do video-conferencing or to just respond to questions anyway. If there was a feeling that it was necessary to do that, then obviously we can do that, but I am not a great believer in over-engineering these things unless it is necessary to do so.

[199] **Jocelyn Davies:** Chris, shall we come to your question?

[200] **Christine Chapman:** Okay, thanks. When you will be preparing the tax forecast, can you tell me what sort of information you will need from Welsh Government, and could you also say something about the timescales on this. What type of information do you want and when must this information be available each year?

[201] **Mr Chote:** The principal bits of information that we need are obviously going to be whatever rates the Welsh Government chooses to set for the particular taxes in question. Now, as I dimly recall from reading the command paper, I think that there is a time by which the UK authorities need to know. For example, on income tax, it is by late November. HMRC needs to know what the Welsh Government would want to set as an income tax rate, if that goes through on a referendum, for the following year. From our point of view, we produce our forecasts for the autumn statement and the budget, the dates of which move from year to year but are roughly speaking the last week in November or first week in December for the autumn statement, and mid-March for the budget. So, HMRC would need to know earlier because of the practical difficulties that it would have of implementing it, the same as we would do, in sticking it into a spreadsheet and making some judgments about the forecast. So, I do not think that our needs for information on the policy choices are going to be more constraining than the ones that HMRC would have anyway in order to implement the tax in the first place.

[202] Then, as I say, in terms of other information that one needs, when we have our meetings in the process of producing the pre-measures forecast, any additional information that the Welsh Government feels might be helpful to us in reaching those judgments would of course be welcome. However, there is not a requirement unless you go into a world in which the Welsh Government is administering and running its own tax, as Scotland is going to be doing for the land and buildings transactions tax, and then an additional set of information may be required.

[203] **Mike Hedges:** Does the command paper also say that if the information on income tax is late, HMRC can make a charge for it?

[204] **Mr Chote:** I cannot remember, but it sounds plausible. That sounds like the sort of thing that you would stick in a command paper. [*Laughter.*]

[205] **Jocelyn Davies:** Right. Mike, shall we come to your question, the last one?

[206] **Mike Hedges:** What systems and organisation do you feel would need to be in place in Wales to inform and scrutinise the future use of taxation and borrowing powers?

[207] **Jocelyn Davies:** Is it within your remit to tell us that?

[208] **Mr Chote:** Obviously, a choice that you would have to make is whether you want to have an equivalent of the Scottish Fiscal Commission to be providing a level of independent scrutiny at a national level of the particular tax forecasts. As I say, I suspect that that would depend, in part, on whether you did end up taking up the income tax option and whether you did have a property transactions tax that looked materially different from the one at the moment. You may or may not feel that that is necessary, depending on how far you go down that road. Doubtless, other people you have taken evidence from in your inquiry would say whether the structure of broader budget scrutiny would need to be better or different, but that is beyond our remit. Our role is very much on the forecast side.

11:00

[209] **Jocelyn Davies:** Okay. Is everybody happy? I see that you are. Thank you very much for your evidence to the committee. Obviously, it is new ground for us, but we are grateful for

your input and we look forward to seeing you again, because I am sure that there will be opportunities in the future as things are going. We will send you a transcript and, if you could check that for factual accuracy, we would be grateful. It will then be published.

[210] **Mr Chote:** Thank you very much indeed. It has been a pleasure to visit.

**Cynnig o dan Reol Sefydlog 17.42 i Benderfynu Gwahardd y Cyhoedd o'r
Cyfarfod
Motion under Standing Order 17.42 to Resolve to Exclude the Public from the
Meeting**

[211] **Jocelyn Davies:** I move that

the committee resolves to exclude the public from the remainder of the meeting and item 1 of the meeting to be held on 2 October in accordance with Standing Order No. 17.42(vi).

[212] Does everybody agree? I see that you do.

*Derbyniwyd y cynnig.
Motion agreed.*

*Daeth rhan gyhoeddus y cyfarfod i ben am 11:00.
The public part of the meeting ended at 11:00.*