

# PBR 2008 and the fiscal rules

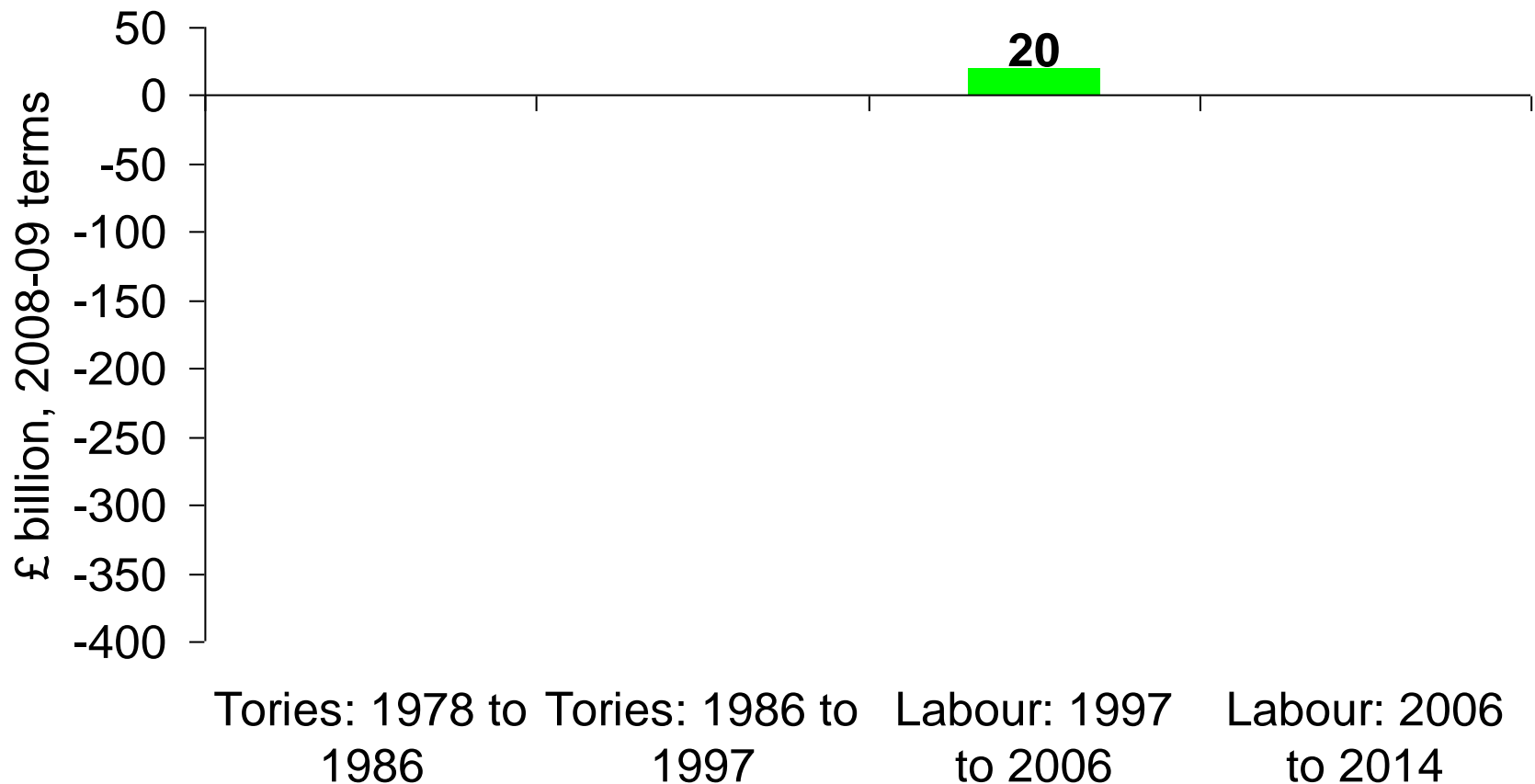
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# The previous fiscal rules over the last cycle

- Sustainable Investment Rule
  - Maintain debt below 40% of national income in each and every year
- Golden Rule
  - Borrow only to invest over the economic cycle
  - In other words, cumulative current budget must be in balance or surplus
- Both were met over the cycle now thought to have begun in 1997 and closed in second half of 2006
  - Sustainable Investment Rule:
    - Debt below 40% of national income in each year, except 1997–98
    - Debt 4% of national income below the ceiling at end of the cycle (about £59 billion in 2008–09 terms)
  - Golden rule:
    - Cumulative surplus on current budget equal to 1.4% of national income

# Meeting the Golden Rule

Cumulative surplus on the current budget over the cycle (£bn, 2008-09)



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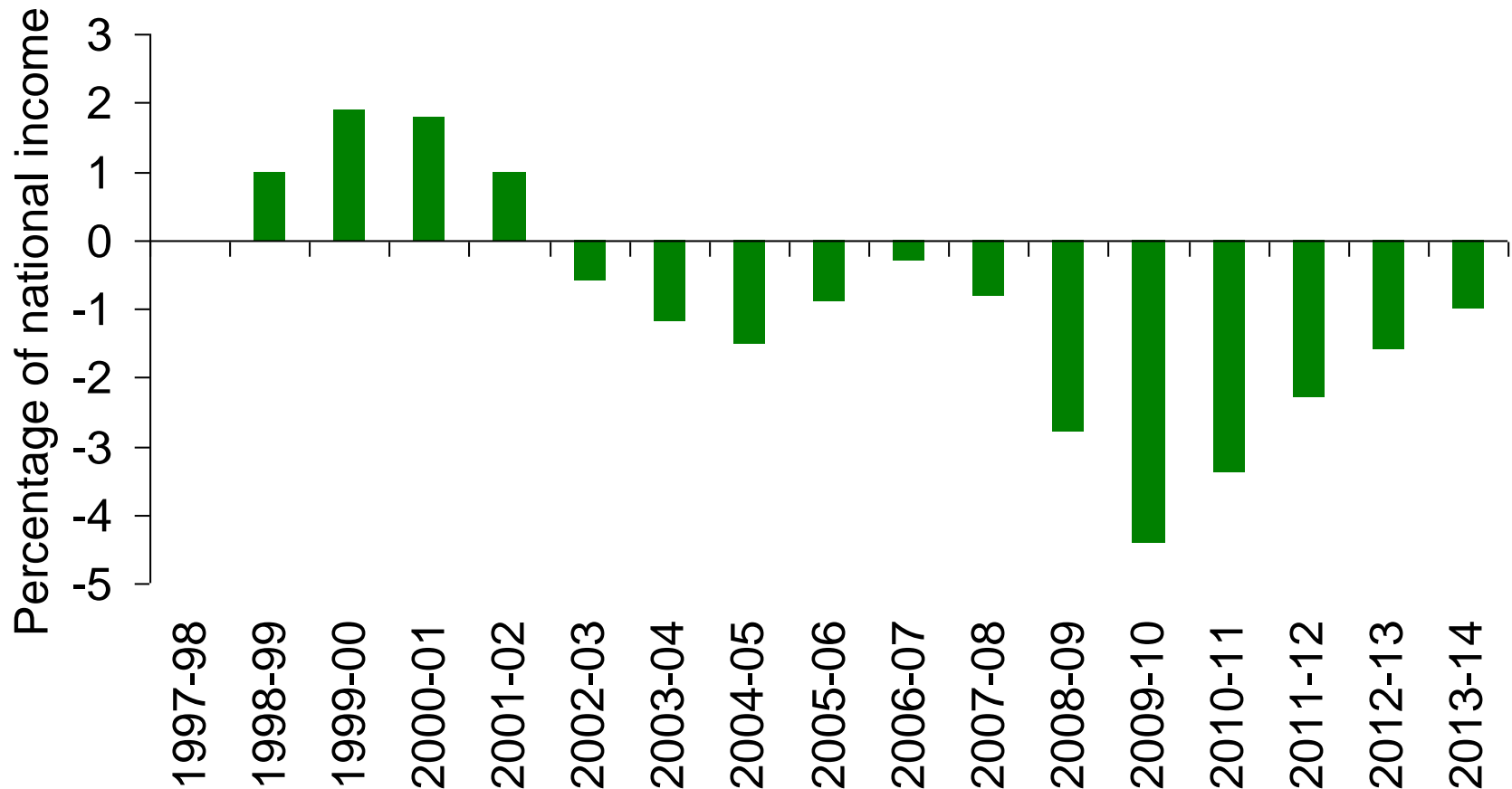


# The new fiscal framework: compliance

- Previous rules suspended
  - Justified on grounds that economic shocks could not have been anticipated and fiscal policy needs “the flexibility to respond appropriately to those shocks”
- Darling’s temporary operating rule: “...improve the cyclically-adjusted current budget each year, once the economy emerges from the downturn so it reaches balance and debt is falling as a proportion of GDP once the global shocks have worked their way through the economy in full”.

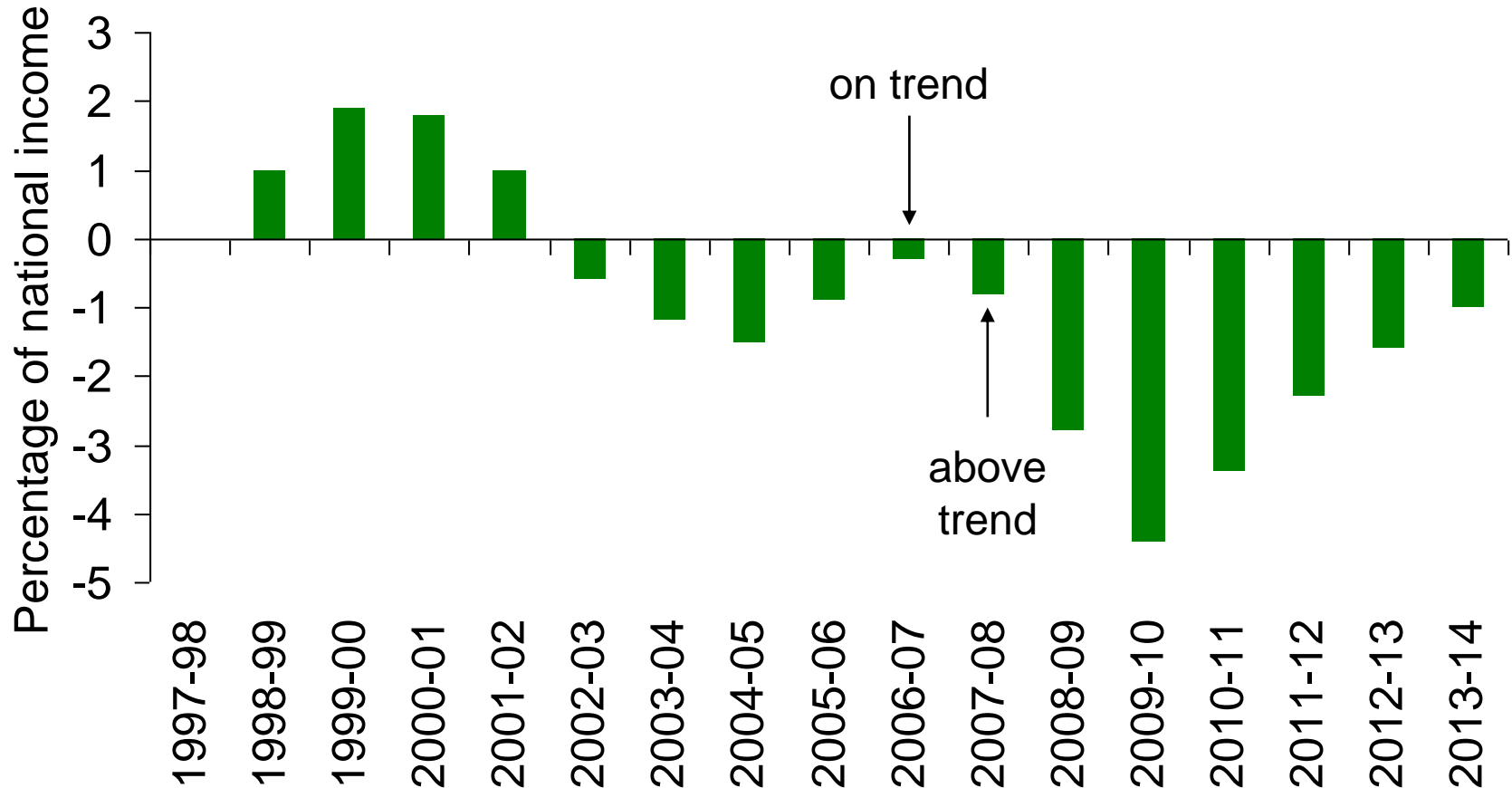
# Improving the cyclically-adjusted current budget

Cyclically-adjusted surplus on the current budget (% national income)



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Cyclically-adjusted surplus on the current budget (% national income)



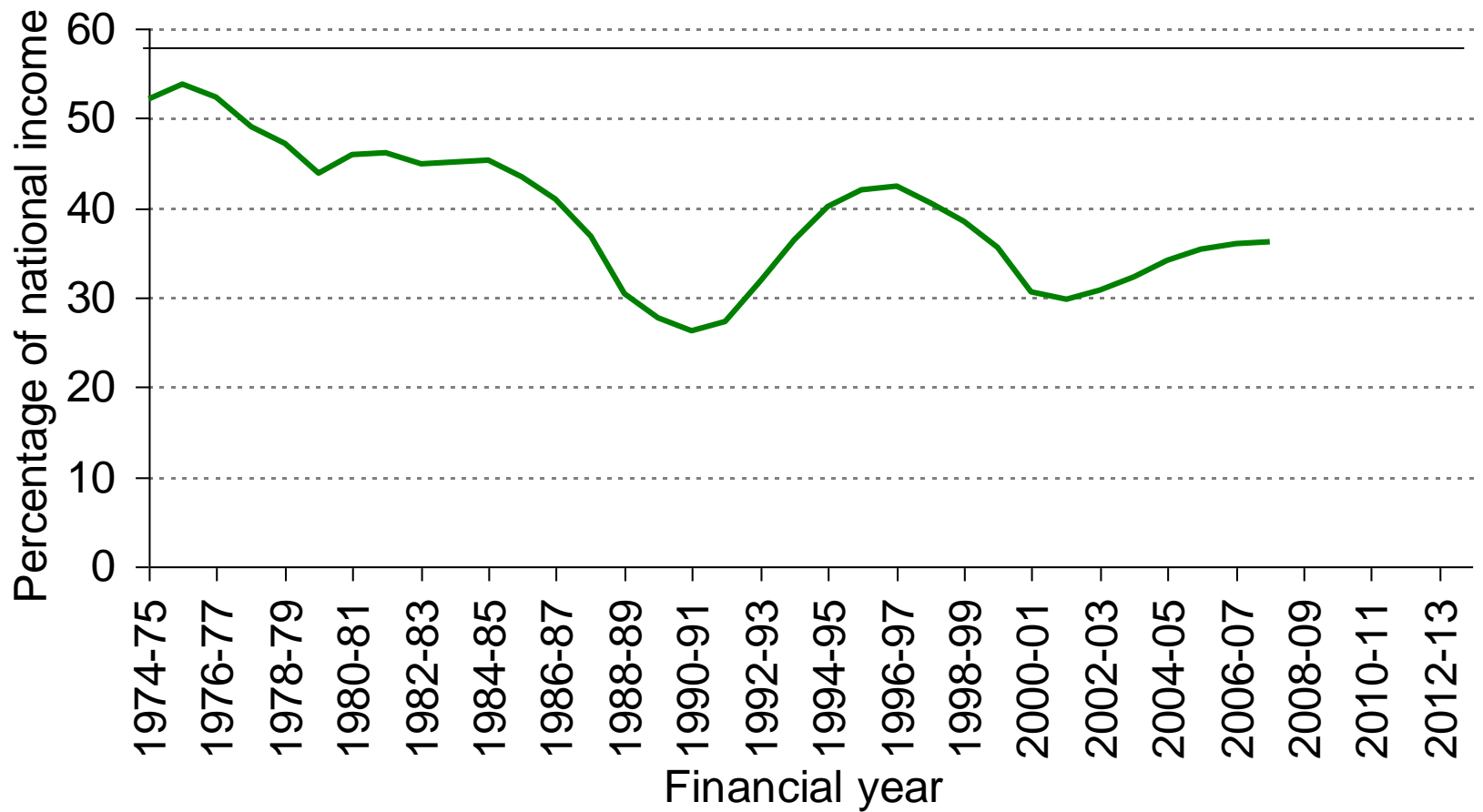
Source: HM Treasury, Authors' calculations



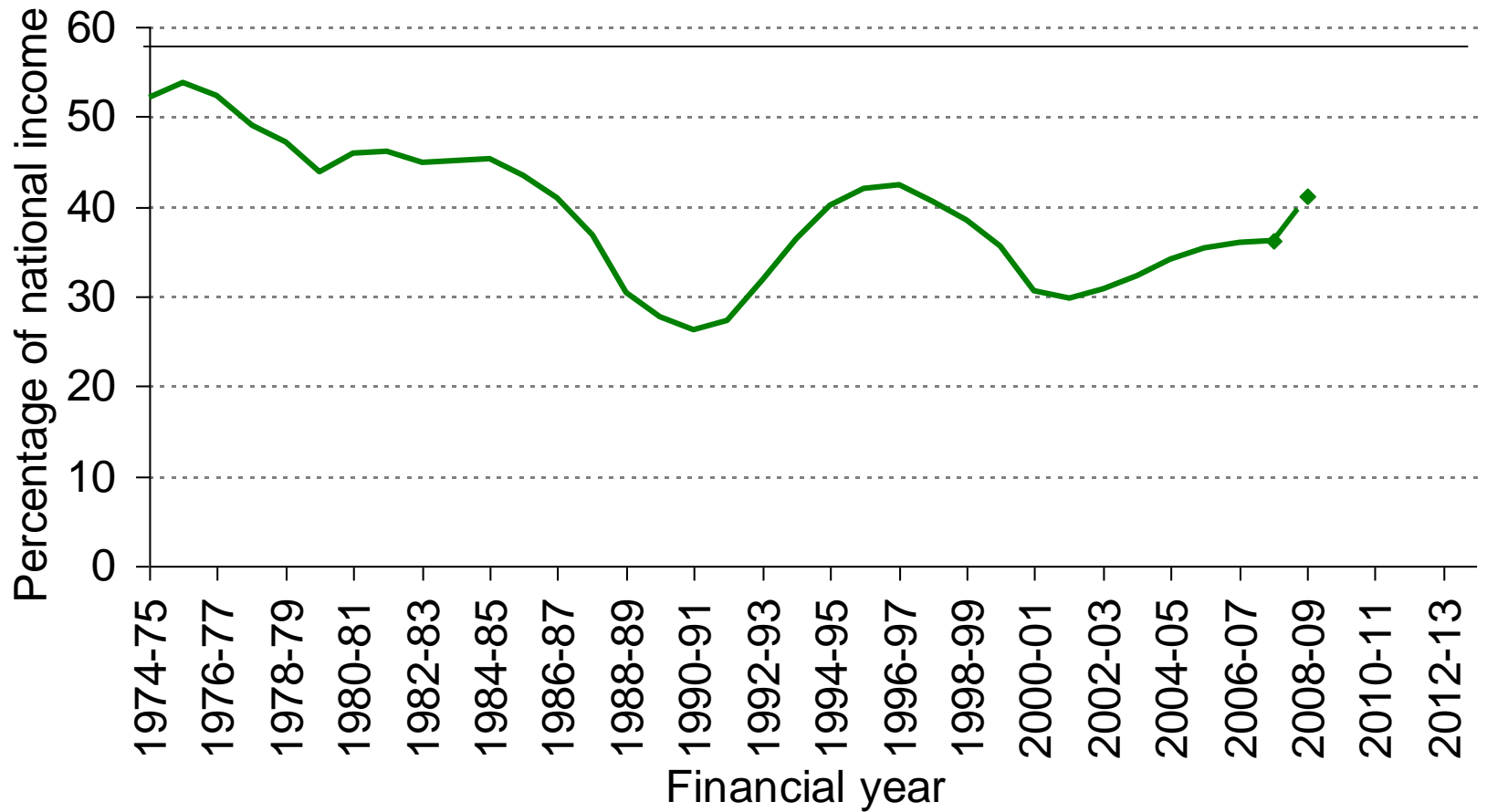
# The new fiscal framework: critique

- Darling's temporary operating rule: "...improve the cyclically-adjusted current budget each year, once the economy emerges from the downturn so it reaches balance and debt is falling as a proportion of GDP once the global shocks have worked their way through the economy in full".
- Tory proposal, September 2008: "At the end of a forecast horizon: falling debt as a percentage of GDP and a balanced current budget, adjusted for the cycle"
- Falling debt at the end of the forecasting period is not a sufficiently constraining fiscal target

# Net debt – a 40-year high

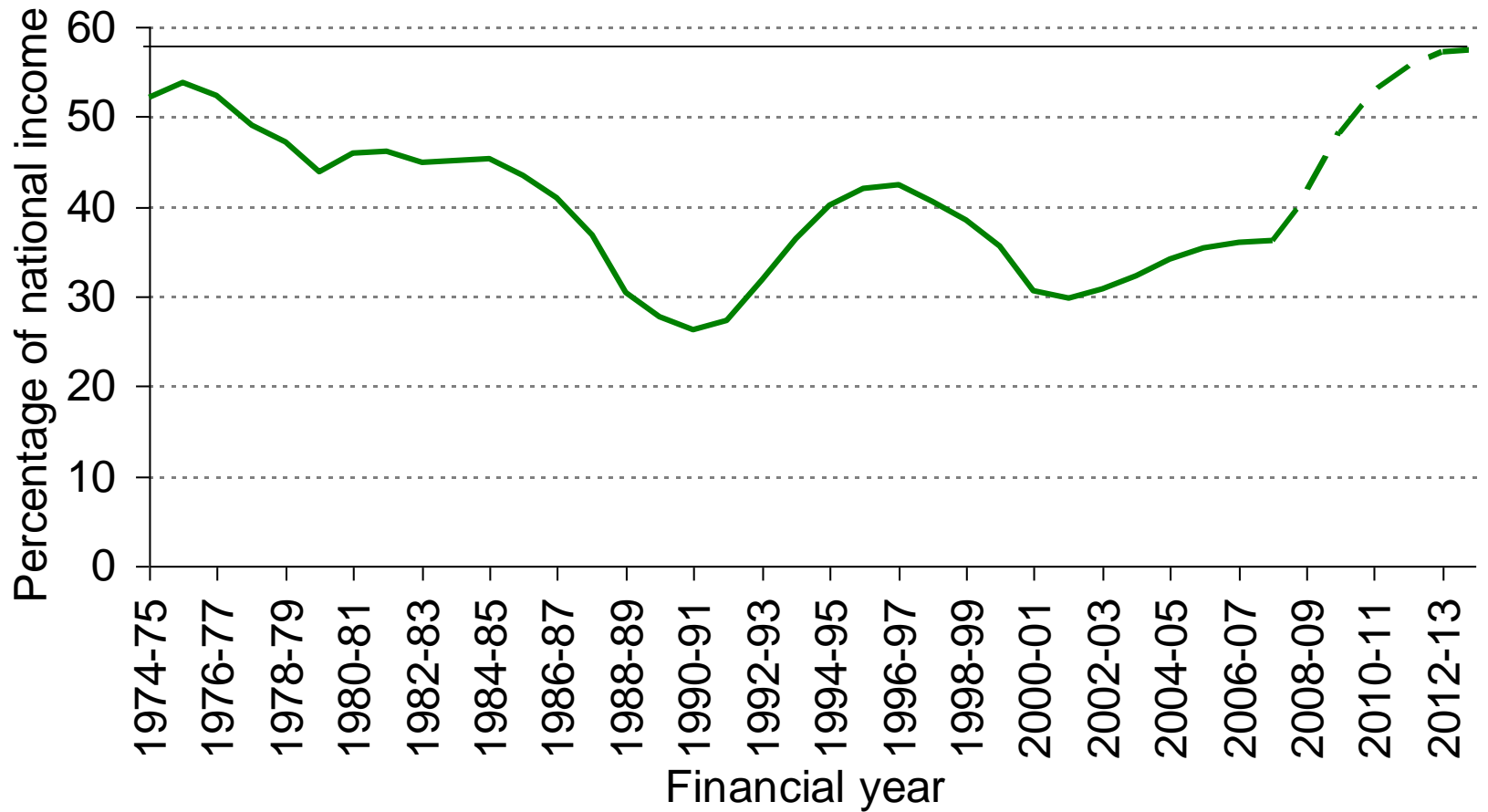


# Net debt – a 40-year high

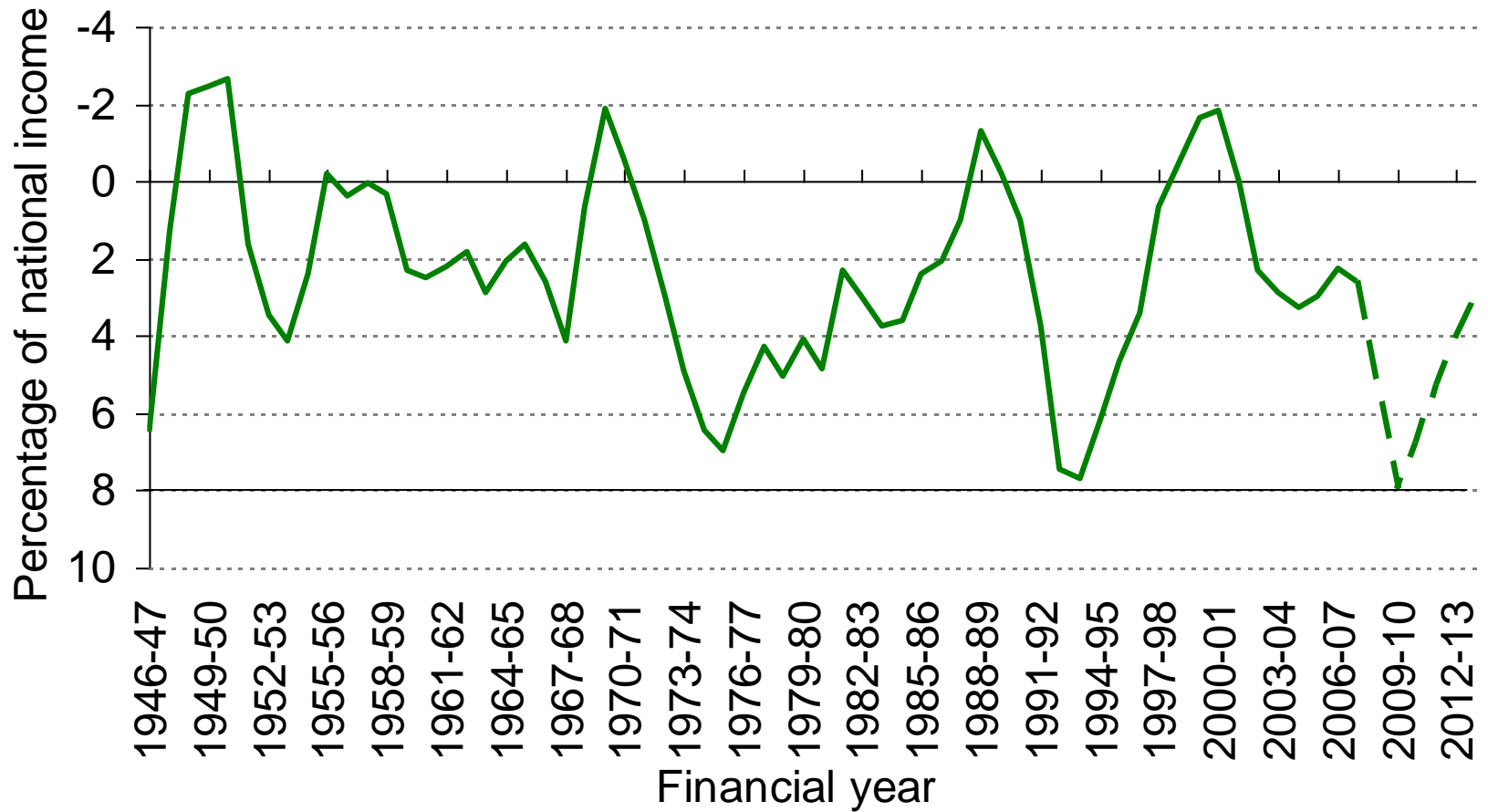


Source: HM Treasury

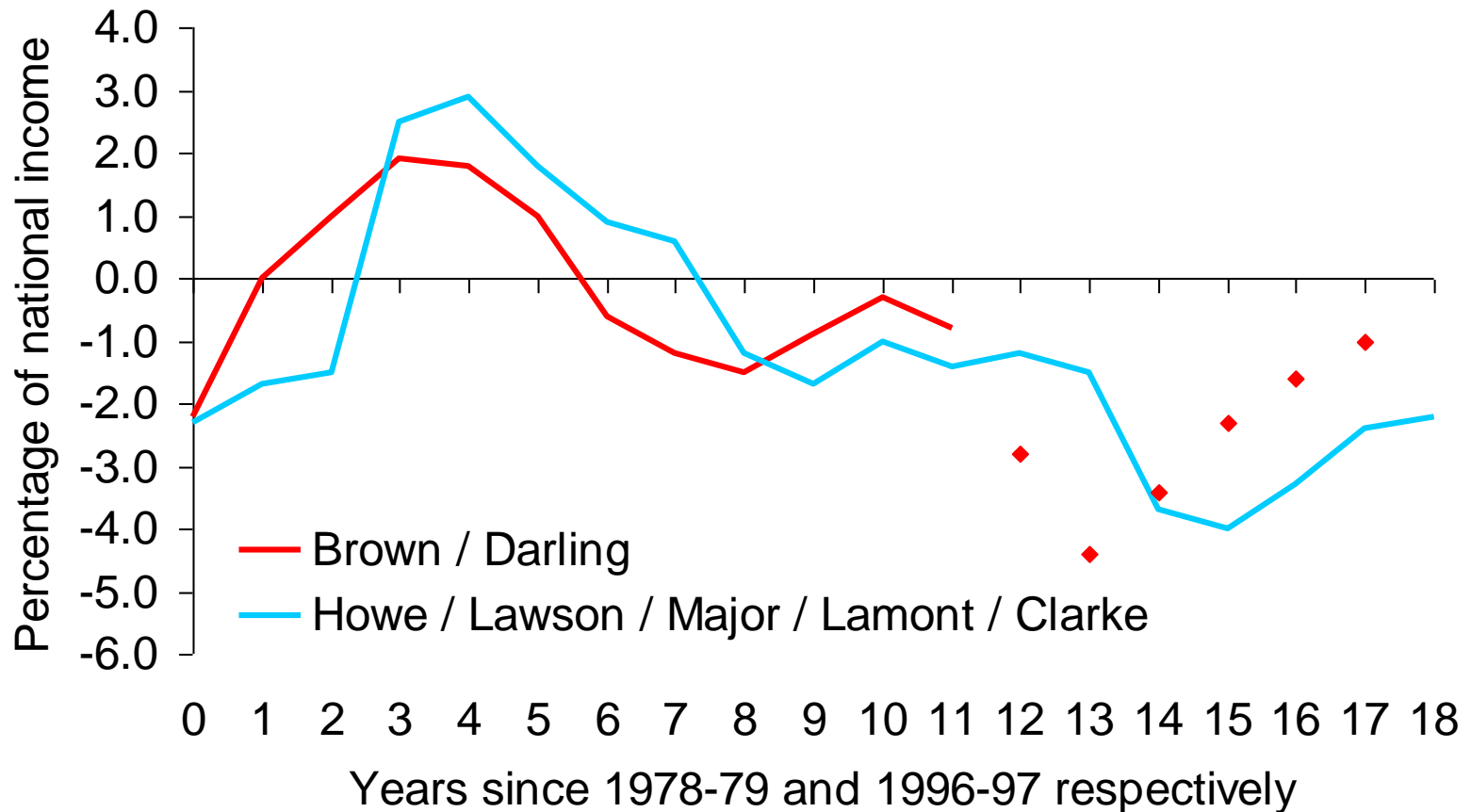
# Net debt – a 40-year high



# Borrowing – a 63-year high



## Structural current budget balance: Labour vs Conservatives



# Conclusions

- Sharp deterioration in forecast for GDP and borrowing
  - Including 4% permanent loss of trend GDP
- Both fiscal rules set to be missed and no adequate replacement
- Debt and borrowing both set to rise to historically high levels
- Medium-term tightening
  - Largely through cutbacks to spending plans
  - Planned real cuts in capital spending