The new fiscal framework: an assessment

Rowena Crawford, Carl Emmerson and Gemma Tetlow
The story so far

Notes and sources: see Figure 2.1 of The IFS Green Budget: February 2011.
The story so far

Percentage of national income

- Total spending – no policy change
- Revenues – no policy change
- Total spending – latest forecast
- Revenues – latest forecast

Notes and sources: see Figure 2.1 of The IFS Green Budget: February 2011.
The new fiscal framework

- Two new fiscal targets:
  - The fiscal mandate
  - The supplementary target

- Set up independent Office for Budget Responsibility (OBR)
  - Prepare economic and fiscal forecasts
  - Assess the extent to which the fiscal mandate has been, or is likely to be achieved
  - Analyse the sustainability of the public finances
  - Assess the accuracy of its previous fiscal and economic forecasts
The fiscal mandate (1/2)

• “To achieve cyclically-adjusted current budget balance by the end of the rolling, five-year forecast horizon”

• Essentially a new ‘golden rule’
  – Appropriate for governments to borrow to finance investment spending but not day-to-day spending
  – Allows borrowing to be higher when the economy is thought to be temporarily weak
  – (Both desirable features)
The fiscal mandate (2/2)

- “To achieve cyclically-adjusted current budget balance by the end of the rolling, five-year forecast horizon”

- Difference in how the new fiscal mandate is operationalised
  - Forward-looking
  - Potential problems of interpretation

- A greater than 50% chance of meeting the mandate is equivalent to a forecast cyclically-adjusted current budget surplus
Will the fiscal mandate be ‘met’?

Forecast cyclically-adjusted current budget under...

Notes and sources: see Figure 2.2 of *The IFS Green Budget: February 2011*.
The supplementary target

• “public sector net debt as a percentage of national income to be falling at a fixed date of 2015-16”
Will the supplementary target be met?

Forecast public sector net debt under...

- Current policy
- Inherited policy

Notes and sources: see Figure 2.6 of *The IFS Green Budget: February 2011*.
Will these targets ensure fiscal sustainability?

- No

- Fiscal mandate
  - Constrains forecasts not outturns
  - Needs careful monitoring to ensure forward looking nature not manipulated (existence of the OBR should help)

- Supplementary target
  - Is only binding in one year
  - Will become obsolete after 2015-16
Replacing the supplementary target

• The government intends to introduce a new target for debt as a share of national income
  – Based on an assessment by the OBR of the long-term sustainability of the public finances

• Issues to consider:
  – Long term pressures on the public finances: e.g. demographics
  – Consider a broader measure of indebtedness than public sector net debt: include other long term liabilities such as pension promises?
  – Perhaps target level of pre-committed annual payments rather than total level of indebtedness?
The Office for Budget Responsibility (1/2)

• Improved the presentation, transparency and credibility of official forecasts

• Welcome increases in transparency:
  – Explanation of the fiscal forecasting process
  – Publication of key economic assumptions underlying fiscal forecasts
  – Central forecasts (no unquantified degree of ‘caution’ built in)

• Further improvements in transparency possible
  – Particularly regarding their macroeconomic forecasts
  – How and why do forecasts differ from those of the Bank of England?
The Office for Budget Responsibility (2/2)

• Degree of interaction between the OBR and government
  – Interaction could damage the perception of the OBR as independent
  + Interaction aids policy making
  ⇨ Interaction should continue but need to be open about it

• Not allowed to consider alternative policy scenarios
  + Avoids danger of being drawn into political discussion
  – Would inform public debate (especially prior to elections)
  ⇨ Certainly want ‘no policy change’ forecasts published
Summary

• New fiscal mandate
  – Desirable in its forward looking nature
  – Will require careful monitoring to ensure not abused
  – OBR forecasts it will be met under current policies

• Supplementary target
  – OBR forecasts it will be met under current policies
  – Will need replacing

• Office for Budget Responsibility
  – Has improved the presentation, transparency and credibility of official forecasts
  – Should help ensure fiscal sustainability in future
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