How could the UK’s fiscal framework be improved?

The Treasury today announced that the Pre-Budget Report would take place in 3 weeks’ time on Thursday 2nd December. To contribute to the government’s thinking in the run-up to the Budget the IFS today publishes new research1, funded by the Economic and Social Research Council, assessing the operation of the Government’s Code for Fiscal Stability2 since its introduction in 1998. This code sets out the five key principles that the government should adhere to in formulating fiscal policy as responsibility, stability, transparency, fairness and efficiency.

While the code has generally worked well, the authors believe it could be improved in a number of ways:

- **Responsibility**: Less emphasis should be placed on precise fiscal forecasts and more attention paid to the uncertainties inherent in those forecasts. For example, the Treasury’s past forecasting performance suggests that on its own figures the probability of meeting the Chancellor’s “golden rule” without further tax increases or spending cuts fell further between Budget 2003 and Budget 2004 than between Budget 2002 and Budget 2003, even though the downwards revision to the borrowing forecast was larger over the earlier period. (see figure 1). The uncertainty surrounding projections for fiscal aggregates also has implications for the way in which progress towards any fiscal rules should be interpreted.

- **Stability**: At present the Code does not require the government to set out in advance precisely how it will assess compliance with the fiscal rules and what corrective action it intends to undertake if the rules are missed. Including a requirement for this information would further promote stability.

- **Transparency**: While there may be certain circumstances under which information should be withheld, it does not seem appropriate that the Code allows the withholding of information on the basis that it would “harm the integrity of the decision-making process and policy advice process in Government”. In addition it would be useful to have more notice of the timing of important fiscal events, such as the Pre-Budget Report.

- **Fairness**: In many areas the government has exceeded the requirements of the Code. For example, it often publishes analysis of the distributional impact of new policies. Extending the Code to require such analysis would be welcome, as would a requirement to publish assessments of the inter-generational or long-term impact of policies whose effects vary over time and/or generations.

- **Efficiency**: A requirement to evaluate regularly the impact of policies – where not prohibitively costly – would strengthen the efficiency principle in the Code.

One of the authors, IFS deputy director Carl Emmerson said, “It is now 6 years since the introduction of the Code for Fiscal Stability and it is therefore a good time to consider what improvements could be made after seeing it operate in practice. To give one example, the current framework puts too much emphasis on whether a particular target for borrowing will be hit or missed and not enough on the uncertainties inherent in any fiscal projection. Providing more information on the likelihood that the fiscal objectives will be achieved and then stating what should happen in the event of adverse shocks would aid both the transparency and the stability of fiscal policy setting.”
Figure 1. Comparison of recent Budget publications in terms of estimated uncertainty inherent in future forecasts of complying with the “golden rule” without further tax increases or spending cuts.

<table>
<thead>
<tr>
<th>Budget Year</th>
<th>Likelihood of Meeting the Golden Rule</th>
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<tr>
<td>Budget 2002</td>
<td>81.9%</td>
</tr>
<tr>
<td>Budget 2003</td>
<td>74.2%</td>
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<tr>
<td>Budget 2004</td>
<td>59.1%</td>
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ENDS

Notes to editors


2. There will be a post-PBR press conference at the IFS on Friday 3rd December starting at 1pm. If you wish to attend contact Bonnie Brimstone (Bonnie.Brimstone@ifs.org.uk).


4. Financial support from the ESRC-funded Centre for the Microeconomic Analysis of Public Policy at IFS (grant number M535255111) is gratefully acknowledged.

5. For press enquiries contact Emma Hyman (020 7291 4850).