Fiscal rules [versions 13.0 to 15.0]

Carl Emmerson

IFS post-Autumn Statement 2016 briefing

24 November 2016

Rules made to be broken?

12 fiscal rules since 1997

10 broken or abandoned

Conservative government's record particularly unimpressive: all three of the rules set since 2015 already missed or abandoned

The new fiscal rules

Welfare cap (version 2)

Supplementary target (version 4)

Fiscal mandate (version 4)

Welfare cap (version 2)

Forecast welfare-in-scope spending to be below a cap

- definition of spending covered by the cap unchanged
- but now applies only to 2021–22 rather than all future years
- compliance assessed once every five years, starting after next election

Set at the OBR's forecast plus 3%

- previously forecast plus 2% margin to allow only for forecast changes

Could be good reasons to want to breach a cap

If welfare spending rises undesirably then forcing an active decision could lead to better policy making

- hardly a triumph so far

Supplementary target (version 4)

Public sector net debt to fall as a share of national income in 2020–21

- whereas v3 applied to all years of the current parliament

Affected by the Bank of England’s new Term Funding Scheme

- up to £100 billion being lent to the financial sector for up to four years
- temporarily pushes up public sector net debt by this amount

The rise and fall of public sector net debt

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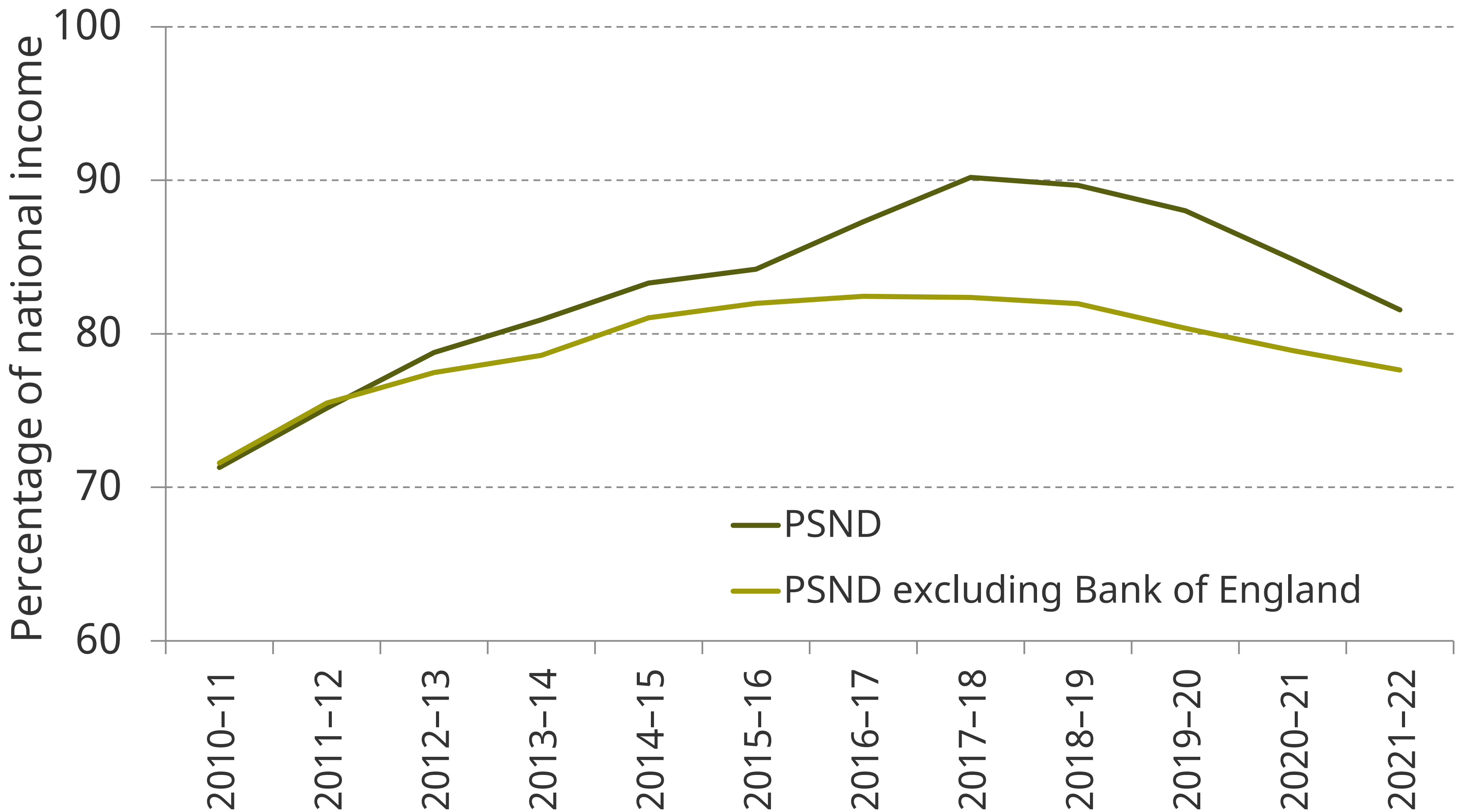

Source: Office for Budget Responsibility.

Supplementary target (version 4)

Public sector net debt to fall as a share of national income in 2020–21

- whereas v3 applied to all years of the current parliament

Affected by the Bank of England's new Term Funding Scheme

- up to £100 billion being lent to the financial sector for up to four years
- temporarily pushes up public sector net debt by this amount
- debt will fall by this amount as the loans are repaid.....in 2020–21
- OBR estimates would need to run a deficit of around 4% of national income in 2020–21 to breach this rule

Debt still high by recent historical standards

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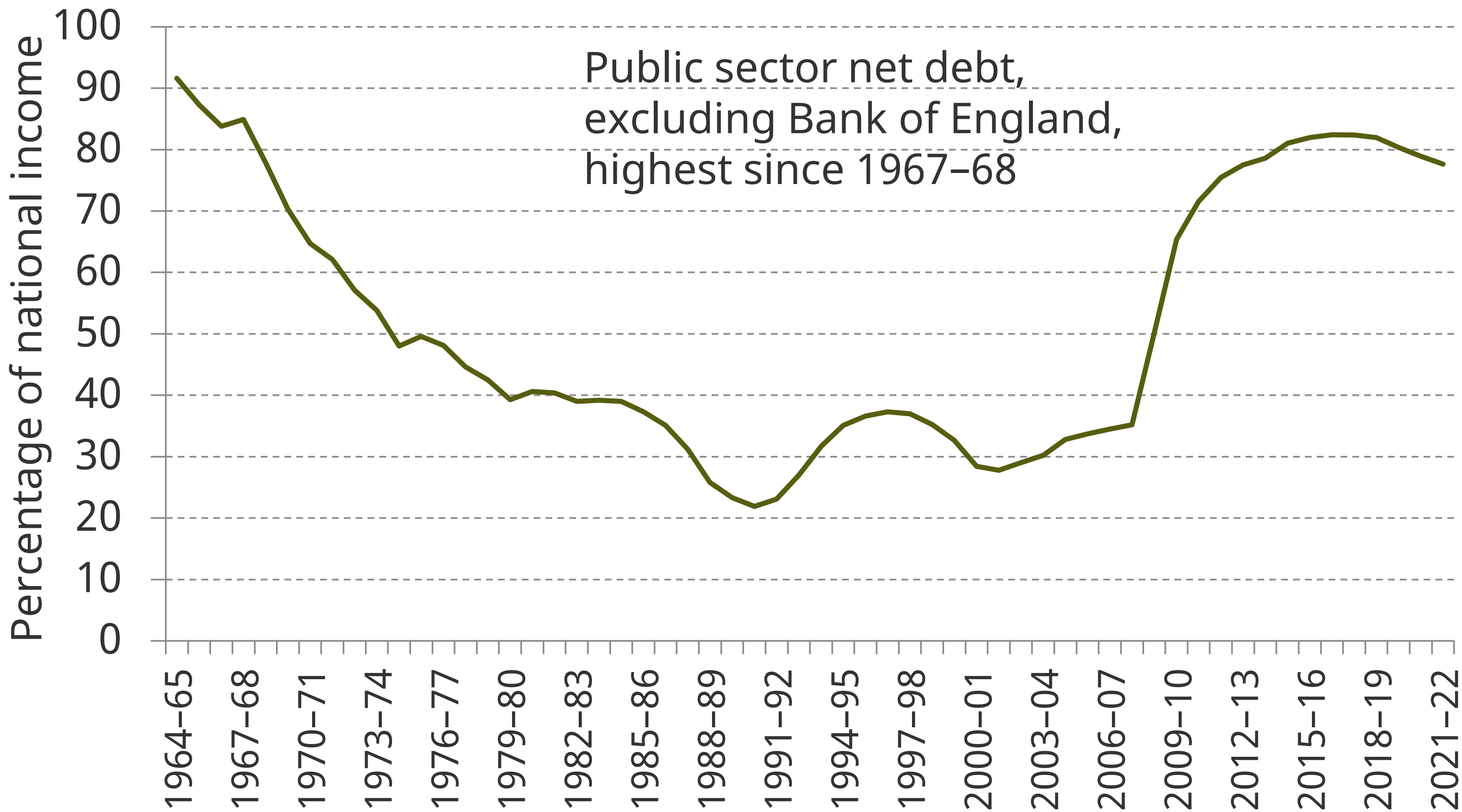

Source: Office for Budget Responsibility.

But we have managed more

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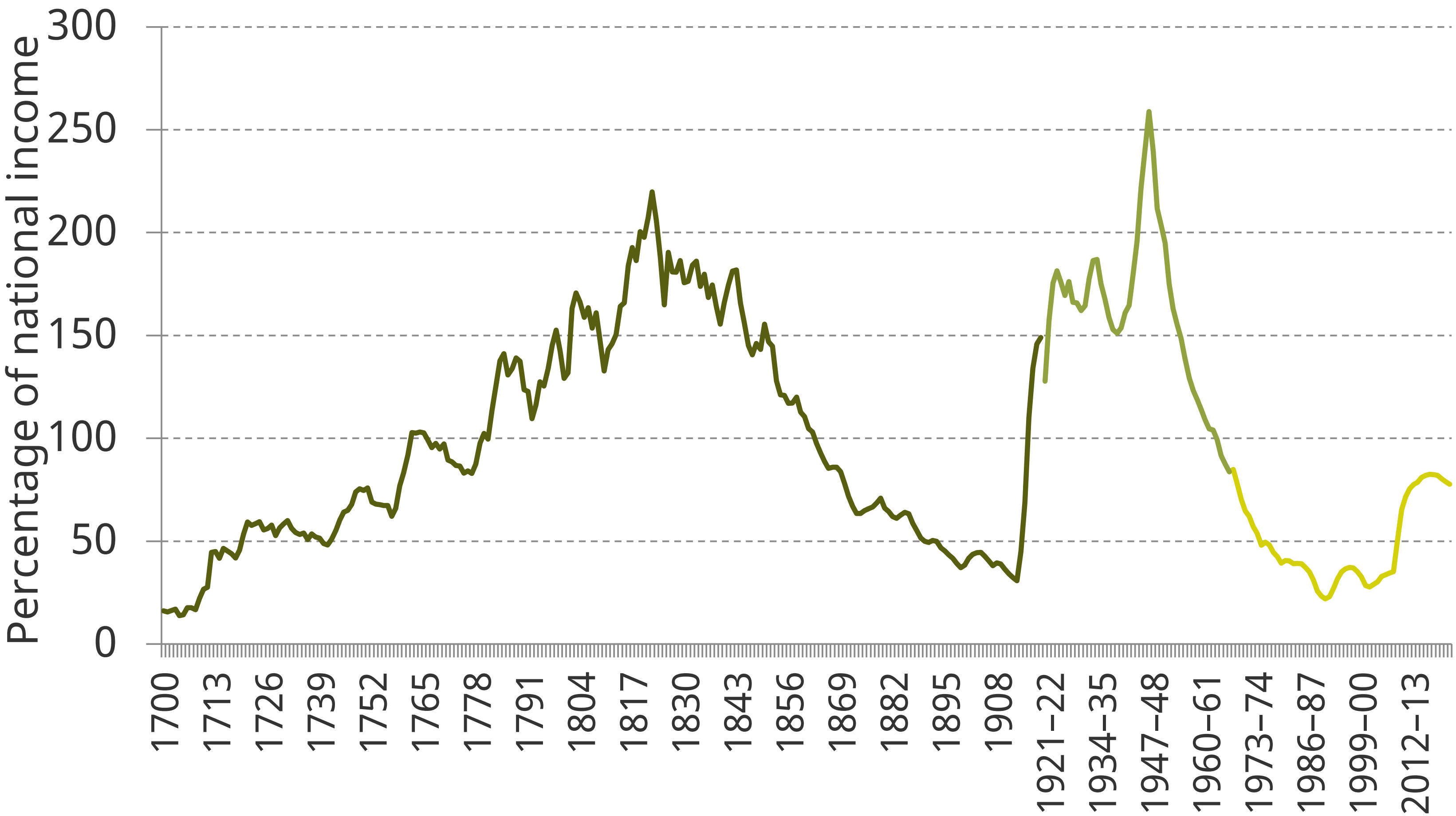


Source: Office for Budget Responsibility; Bank of England.

Fiscal mandate (version 4)

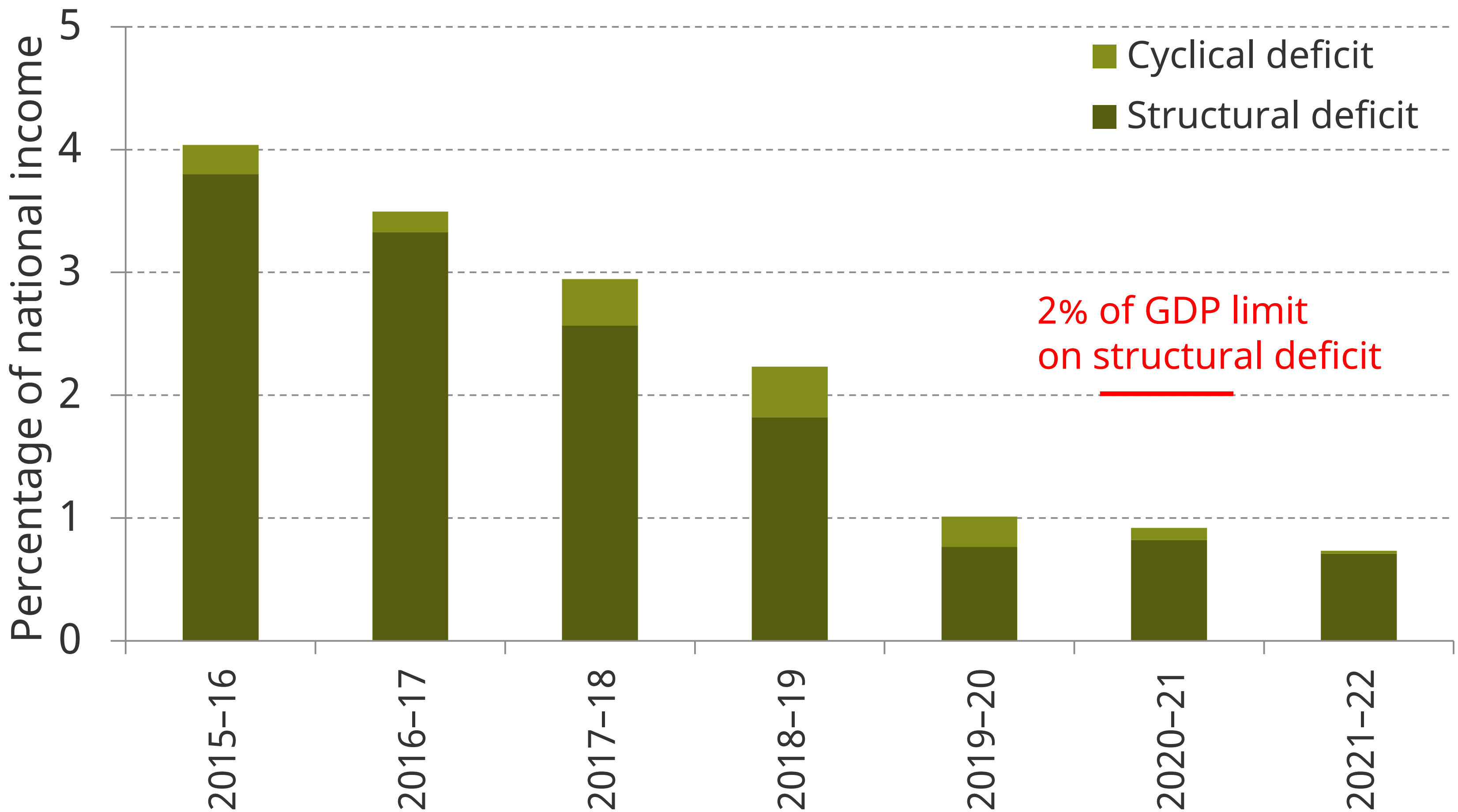
Structural borrowing to be below 2% of national income by 2020–21

Headline surplus as soon as possible in the next Parliament

Rule jettisoned if there is a ‘significant negative shock’

- this to be assessed by the Treasury, unlike previous escape clause

Reducing the deficit



Source: Office for Budget Responsibility.

Structural borrowing to be below 2% of national income by 2020–21

Forecast to be 0.8% of national income, or £18.5 billion

- previous forecast errors suggest a two-in-three chance of success on unchanged policies
- heightened uncertainty means true chance likely less than this
- 2.4% hit to trend output would do this, yesterday we lost roughly 1½%
- (one-in-three chance of still eliminating the entire deficit by 2019–20)

Won't know it has been met until after the next general election

Headline surplus as soon as possible in the next Parliament

Deficit forecast to be 0.7% of national income in 2021–22

- population ageing projected to add 0.8% of national income to spending between 2019–20 and 2024–25

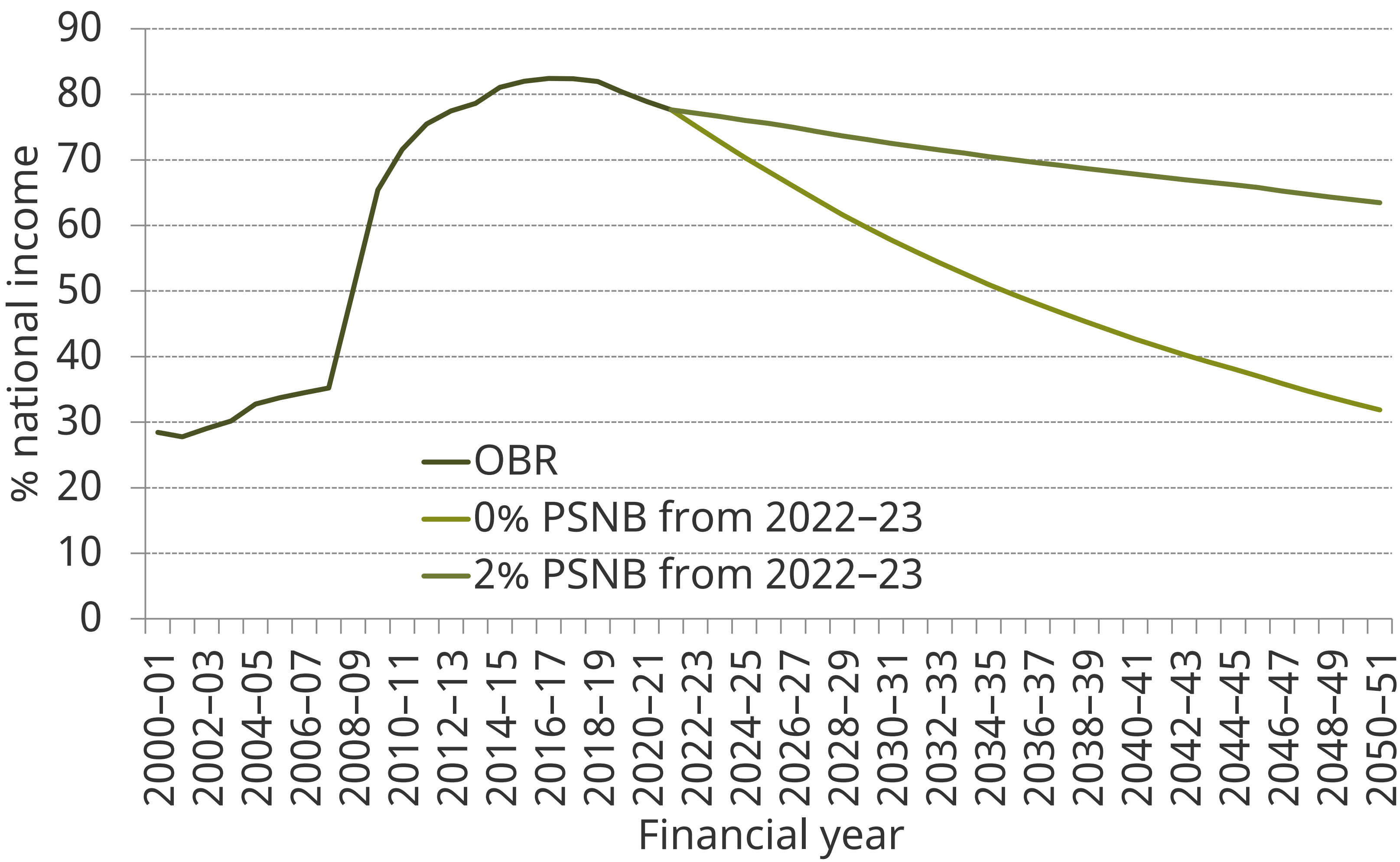
Further austerity likely needed to deliver an overall budget surplus

- 1.5% of national income equivalent to £30 billion in today’s terms
- could be achieved by a two year real freeze to total public spending

An early election could make this particularly challenging to meet

- 2017 election followed by a four year parliament would require a surplus by 2020–21 at the latest

Debt projections under different fiscal rules



Source: Office for Budget Responsibility; Author’s calculations.

Conclusions

Most fiscal rules since 1997 have been broken or abandoned

- Conservative Government's record particularly unimpressive

For now we are on course to meet the new fiscal rules

- timing of new supplementary target looks rigged to take advantage of oddity in the measure of public sector net debt
- conveniently compliance with all of the rules cannot be formally assessed until after the next general election
- far from certain that a structural deficit below 2% of GDP in 2020–21 will be achieved without further policy action
- additional austerity in the next parliament likely required if the deficit is to be entirely eliminated

Debt will remain high by recent historical standards for some time

- running budget balances from 2022 would take two decades to return debt to pre-crisis levels

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