

UK reflections on the golden rule

Presentation to Austrian Fiscal Advisory Council seminar

Andy King

Chief of Staff

Office for Budget Responsibility

29 September 2015

Background

The Office for Budget Responsibility

- Created in 2010 to provide independent and authoritative analysis of the public finances
- Produces the budget and autumn statement forecasts of the economy and public finances
- Assesses Government progress against fiscal targets
- Reports on the sustainability of the public finances and the health of the public sector balance sheet
- Scrutinises the Government's costing of policy measures
- Objective to make fiscal forecasts and costings unbiased and clear, but we have no role in making or commenting on Government policy

Core outputs of the OBR



Core outputs of the OBR



Core outputs of the OBR



Core outputs of the OBR



UK fiscal framework
1997 to 2008:
Golden rule &
Sustainable investment rule

Institutional context: macroeconomic policy reforms

- Bank of England given operational independence for **monetary policy**, to hit Govt inflation target
- **Financial regulation** would be brought together under a single statutory authority
- **Fiscal policy** would be guided by two new fiscal rules:
 - Golden rule – borrow only to invest over the economic cycle
 - Sustainable investment rule – keep debt at a prudent level over the economic cycle*

* The name of the rule and the 40% of GDP specification came later

Golden rule: Rationale and objectives

The 'Silver Book' argued:

- It would approximate to the principle of achieving **fairness between generations**
- It would address past fiscal failings by **removing the bias against capital spending**
- It would allow the automatic stabilisers to work, by targeting balance **over the economic cycle**
- Coupled with debt rule, it would ensure the public finances were on a **long-term sustainable path**

Sustainable investment rule: Rationale and objectives

The 'Silver Book' argued:

- It should focus on a **net measure of public debt**, for the whole public sector, as a per cent of GDP
- While public debt plays important roles, high levels of public debt reduce the buffer against shocks and may impose other costs (e.g. via interest rates)
- While current levels of public debt were not high by historical or international standards, a modest reduction to **40 per cent of GDP** was consistent with balanced and responsible fiscal management

Real-time critiques of the golden rule in the UK

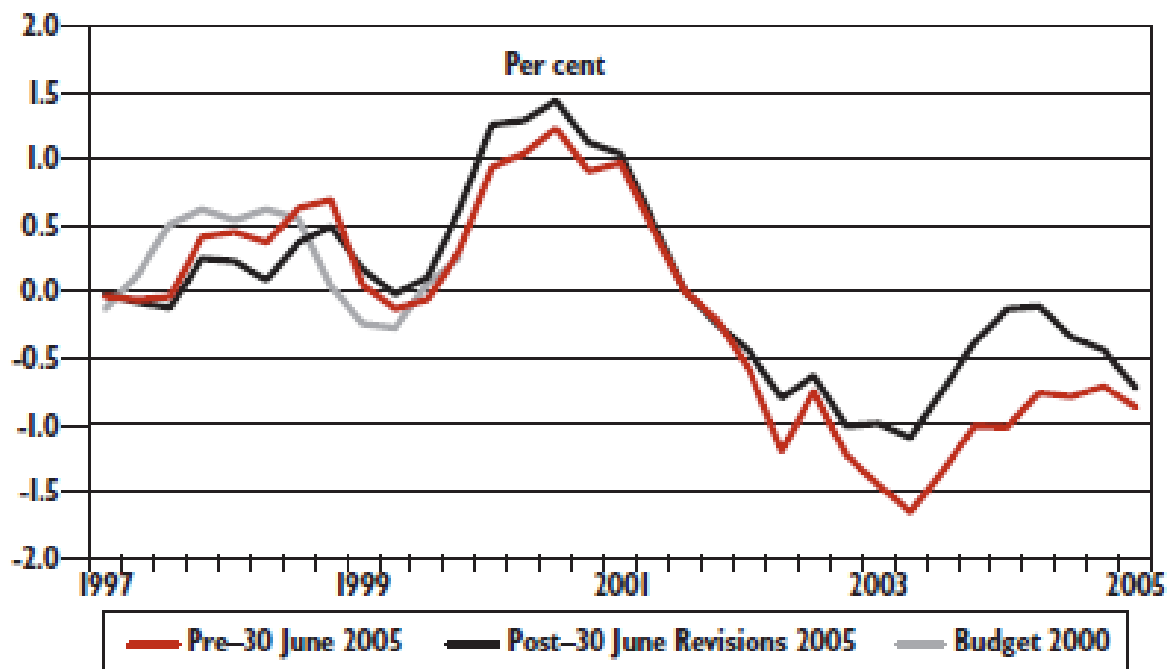
Real-time critiques: Dating the economic cycle

Real-time critiques: Dating the economic cycle

Evidence on the UK economic cycle

July 2005

Chart 4.1: Output gap estimates

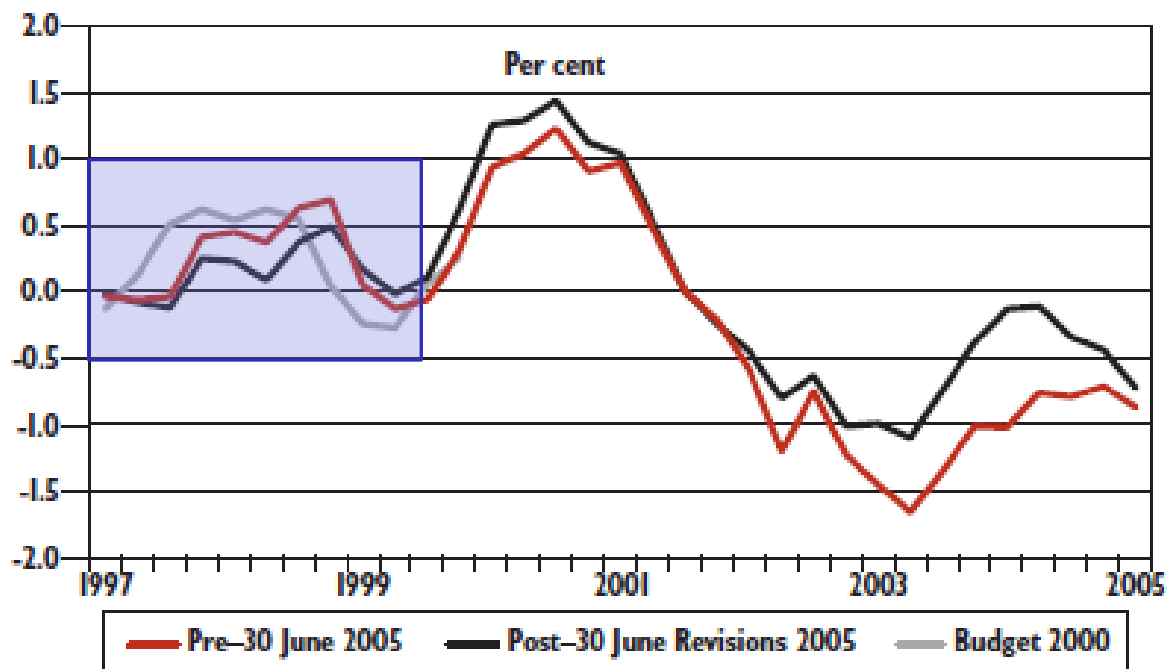


Real-time critiques: Dating the economic cycle

Evidence on the UK economic cycle

July 2005

Chart 4.1: Output gap estimates

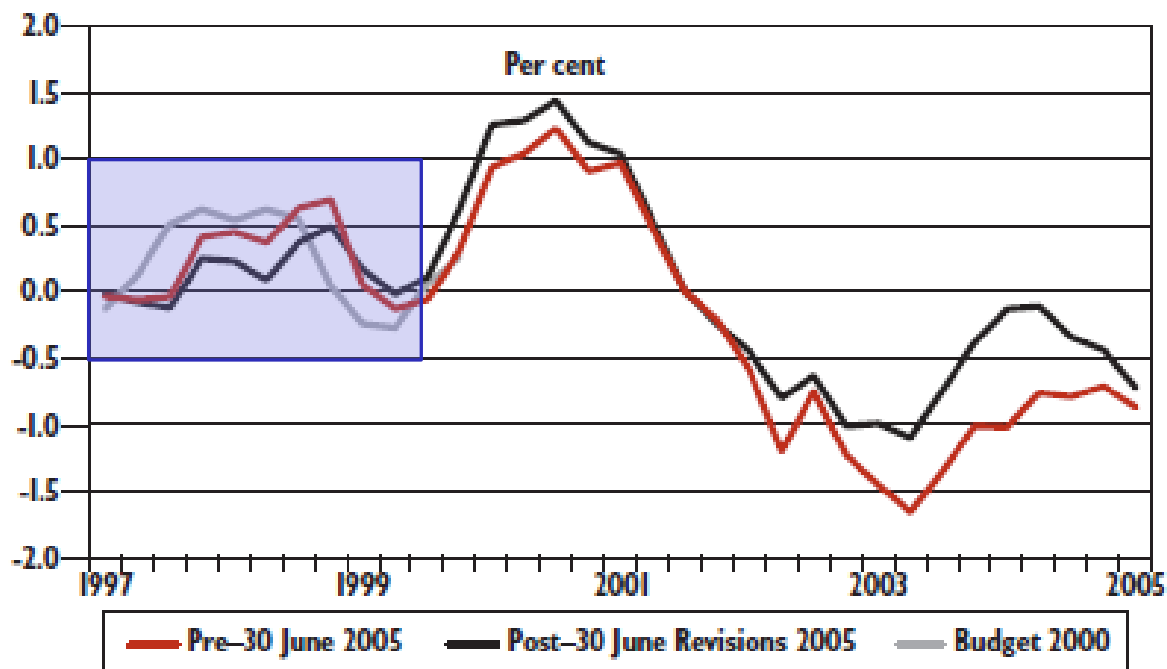


Real-time critiques: Dating the economic cycle

Evidence on the UK economic cycle

July 2005

Chart 4.1: Output gap estimates



IFS Green Budget 2006:

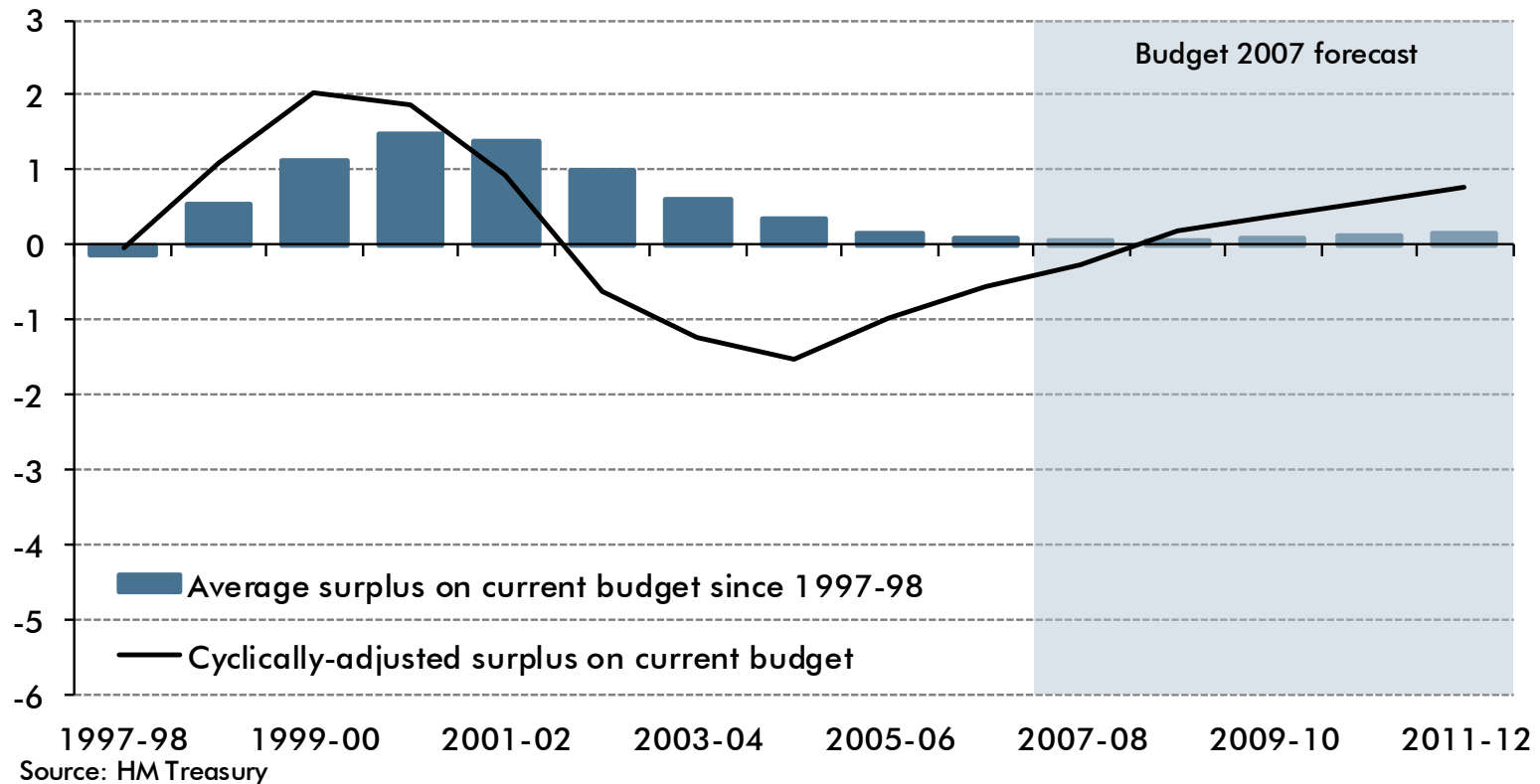
“Re-dating the cycle at such a convenient time risks undermining the credibility of the fiscal framework. The golden rule should be made more forward-looking and less reliant on a precisely dated economic cycle. If still required, the task of estimating the output gap could be handed to an independent body.”

Office for
**Budget
Responsibility**

Real-time critiques: Backward-looking approach

Real-time critiques: Backward-looking approach

Budget 2007 forecast for the golden rule from 1997-98



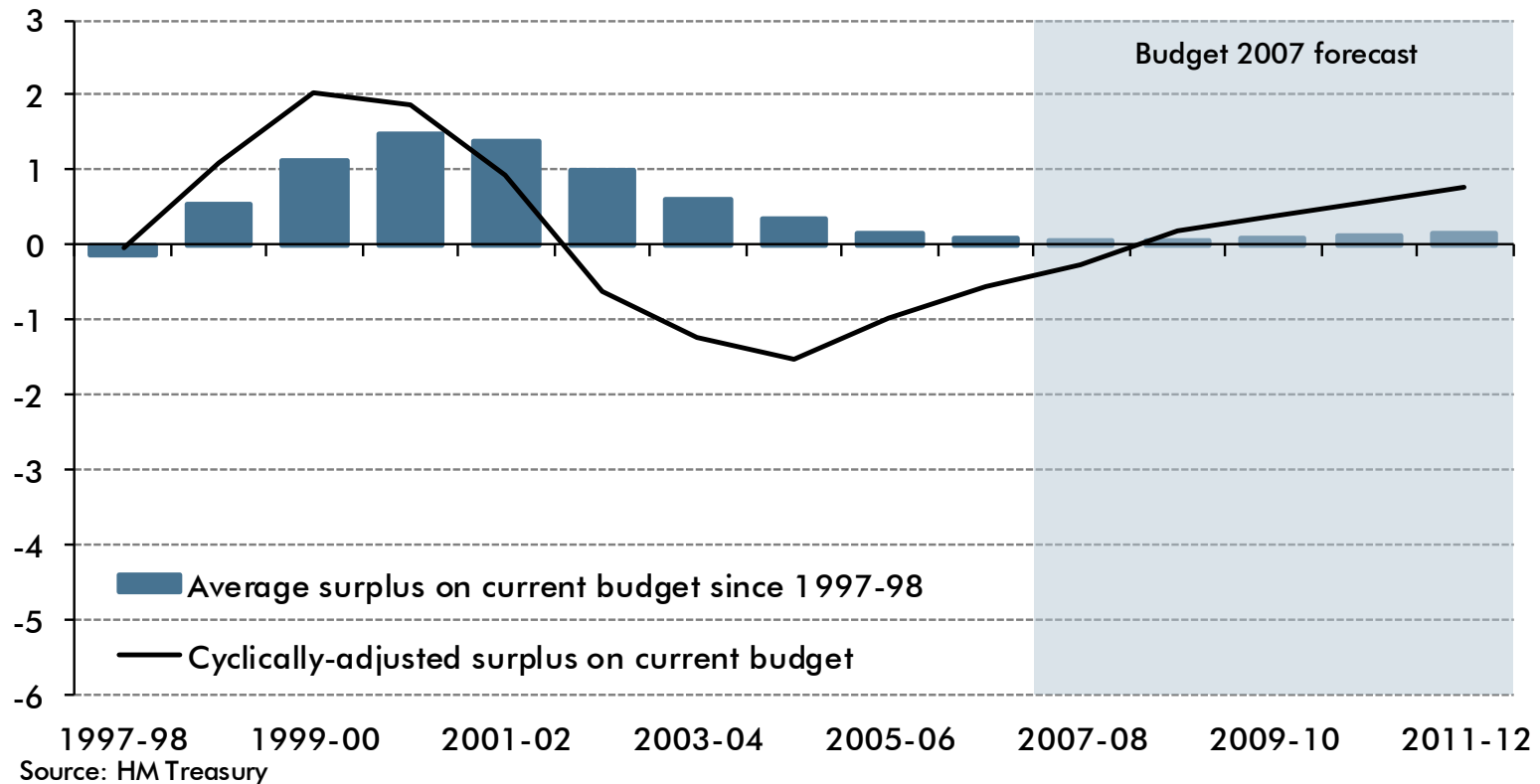
Real-time critiques: Backward-looking approach

IFS Green Budget 2006:

“...defining a particular period as ‘a cycle’ and seeking to balance the current budget over this period is not the only way to allow the automatic stabilisers to function. This approach is backward-looking in the sense that the amount you can borrow today and in the near term depends on the impact on borrowing of shocks and policy mistakes earlier in the cycle. A more forward-looking approach would set policy today consistent with meeting the rule in the future, whether or not it was consistent with meeting it in the past.”

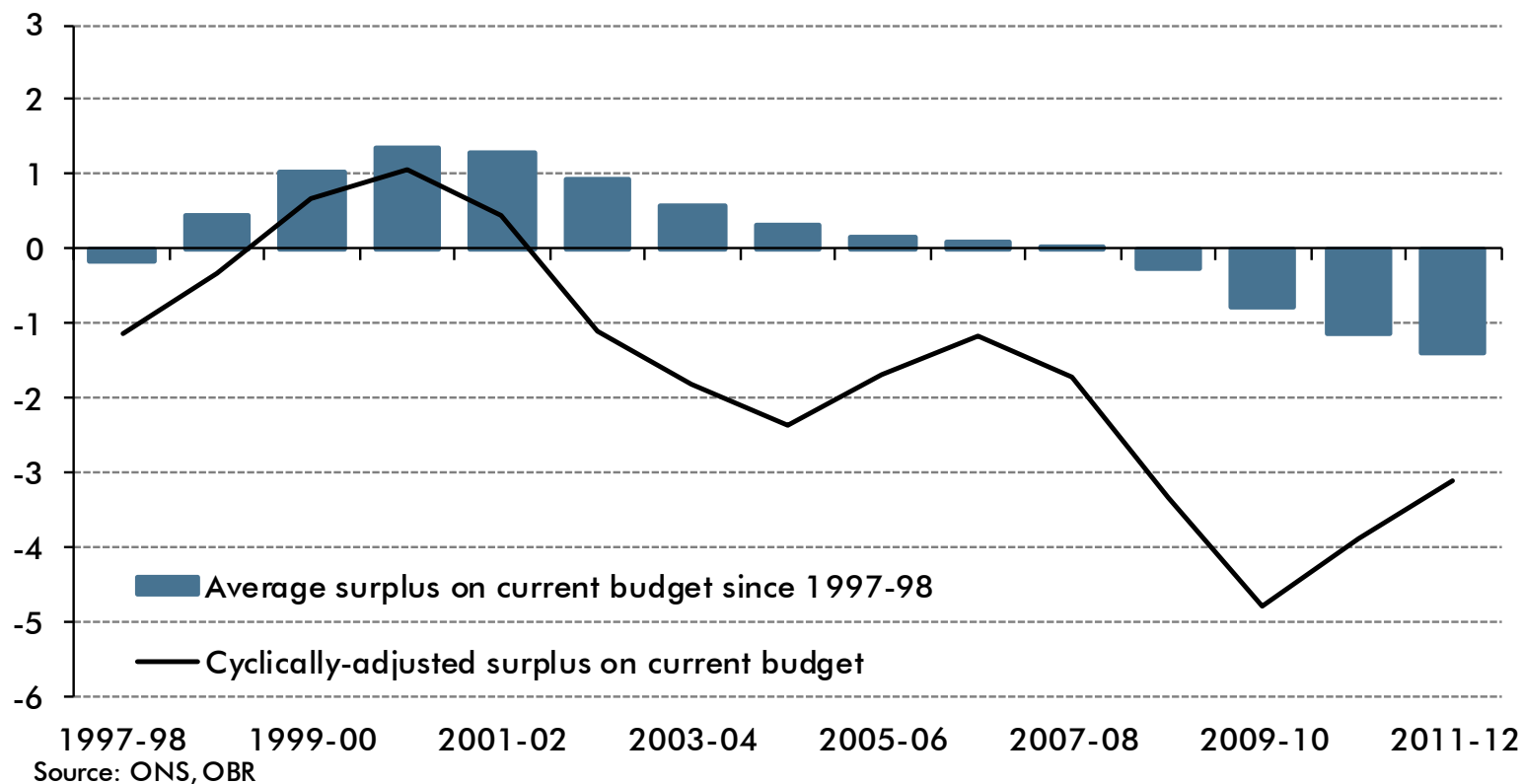
Real-time critiques: Backward-looking approach

Budget 2007 forecast for the golden rule from 1997-98



Real-time critiques: Backward-looking approach

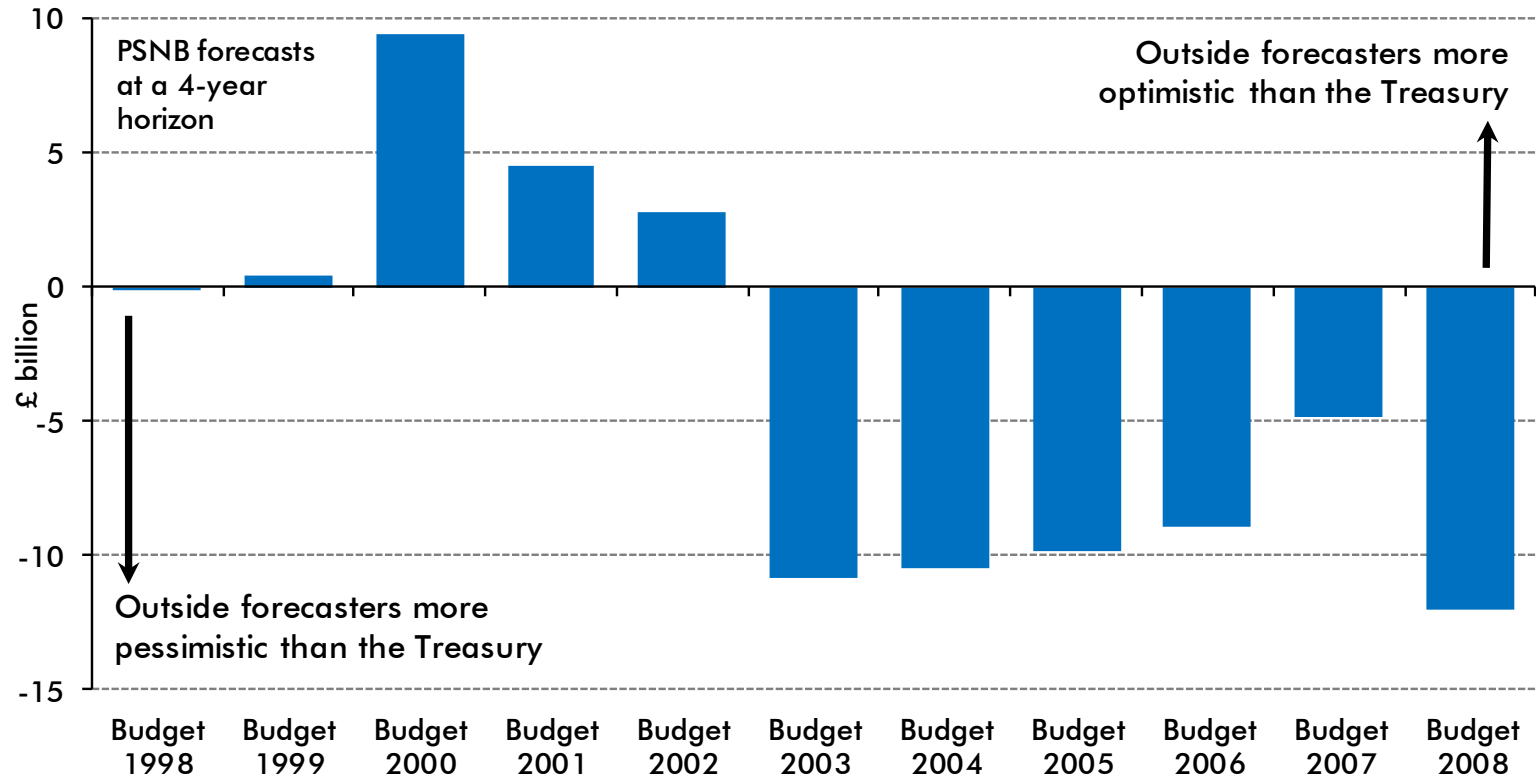
Latest data for the golden rule from 1997-98



Real-time critiques: Optimistic revenue forecasts

Real-time critiques: Optimistic revenue forecasts

Difference between official and external PSNB forecasts



Source: HM Treasury

Looking back at pre- and post-crisis fiscal performance

Office for
**Budget
Responsibility**

Working paper No.7

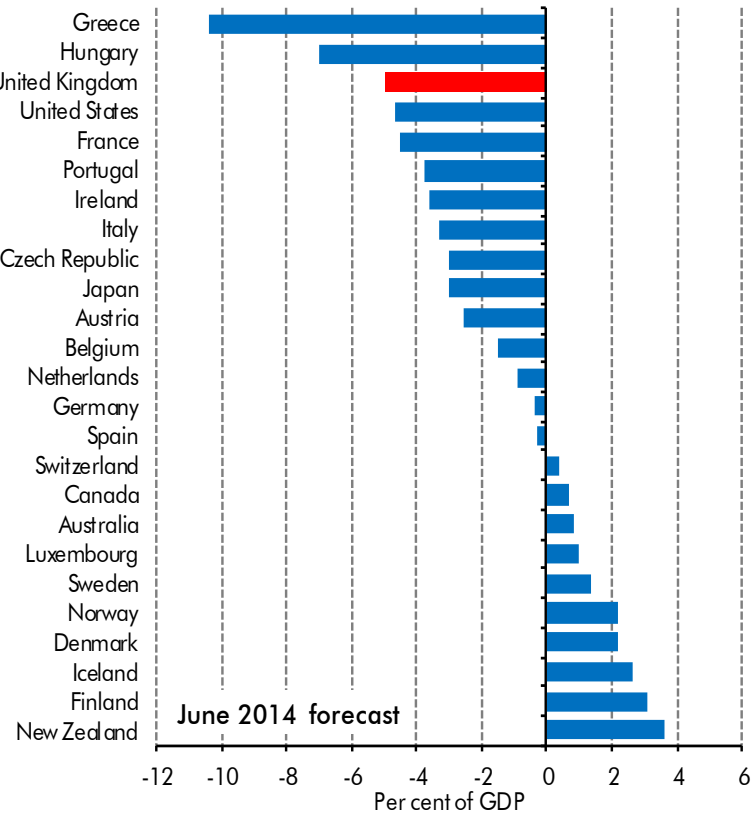
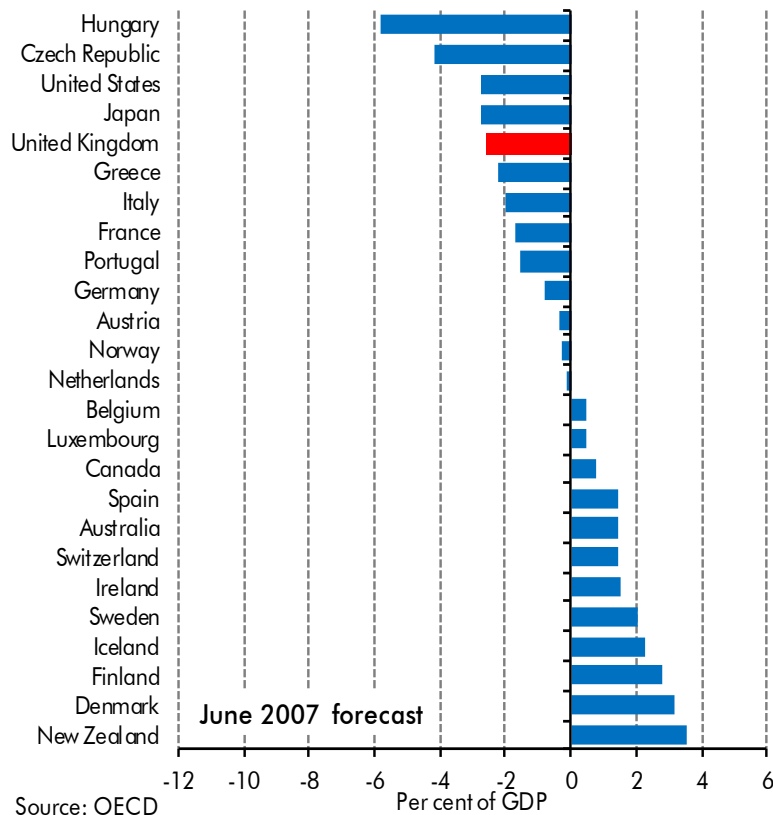
Crisis and consolidation in the public finances

Jon Riley & Robert Chote

September 2014

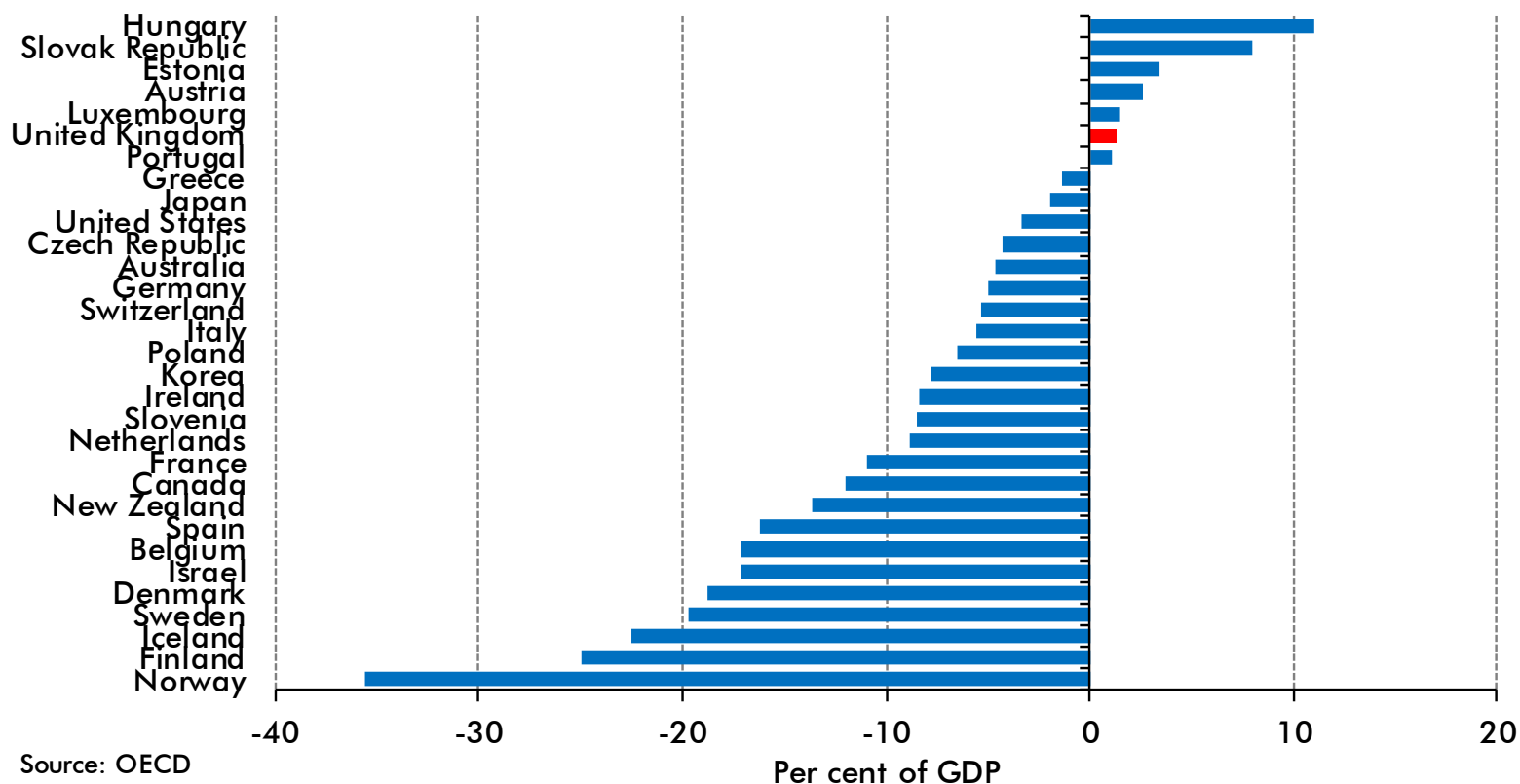
UK running structural deficit when the crisis struck

Contemporaneous and recent OECD estimates



UK public sector debt rising before the crisis struck

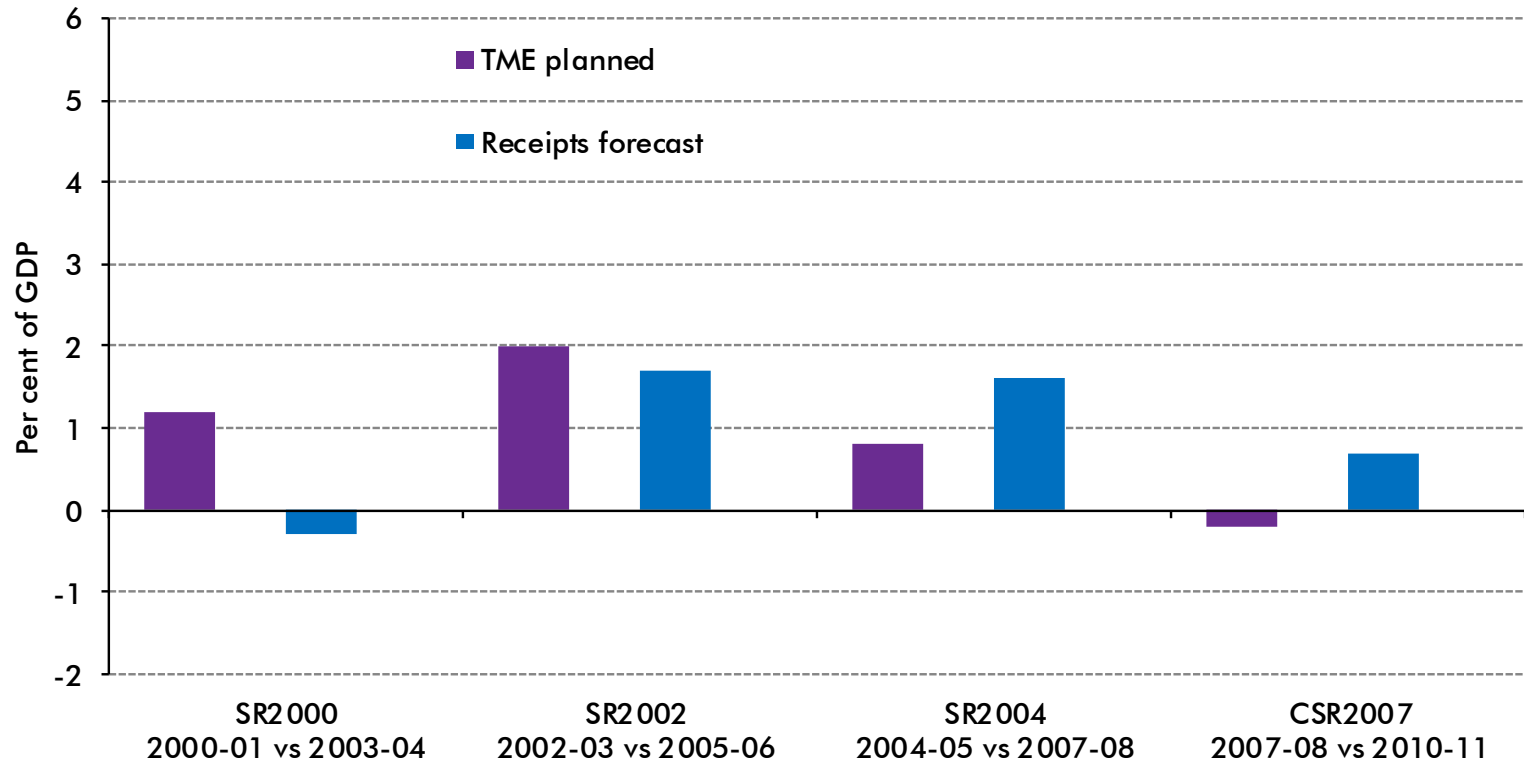
Change in general govt net liabilities: 2004 to 2007



Source: OECD

Revenue forecasts and spending plans

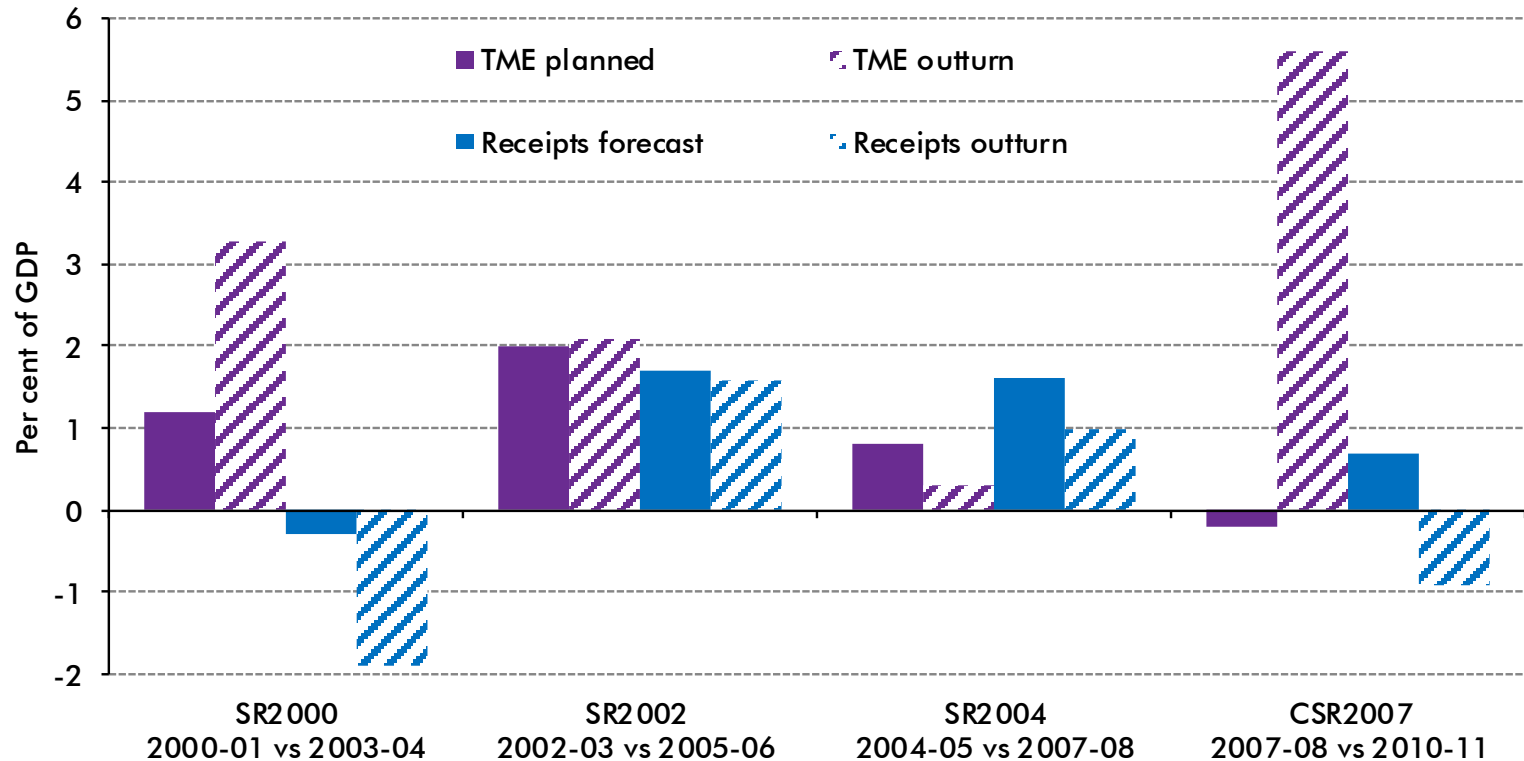
Successive pre-crisis Spending Reviews



Source: HM Treasury

Revenue forecasts and spending plans

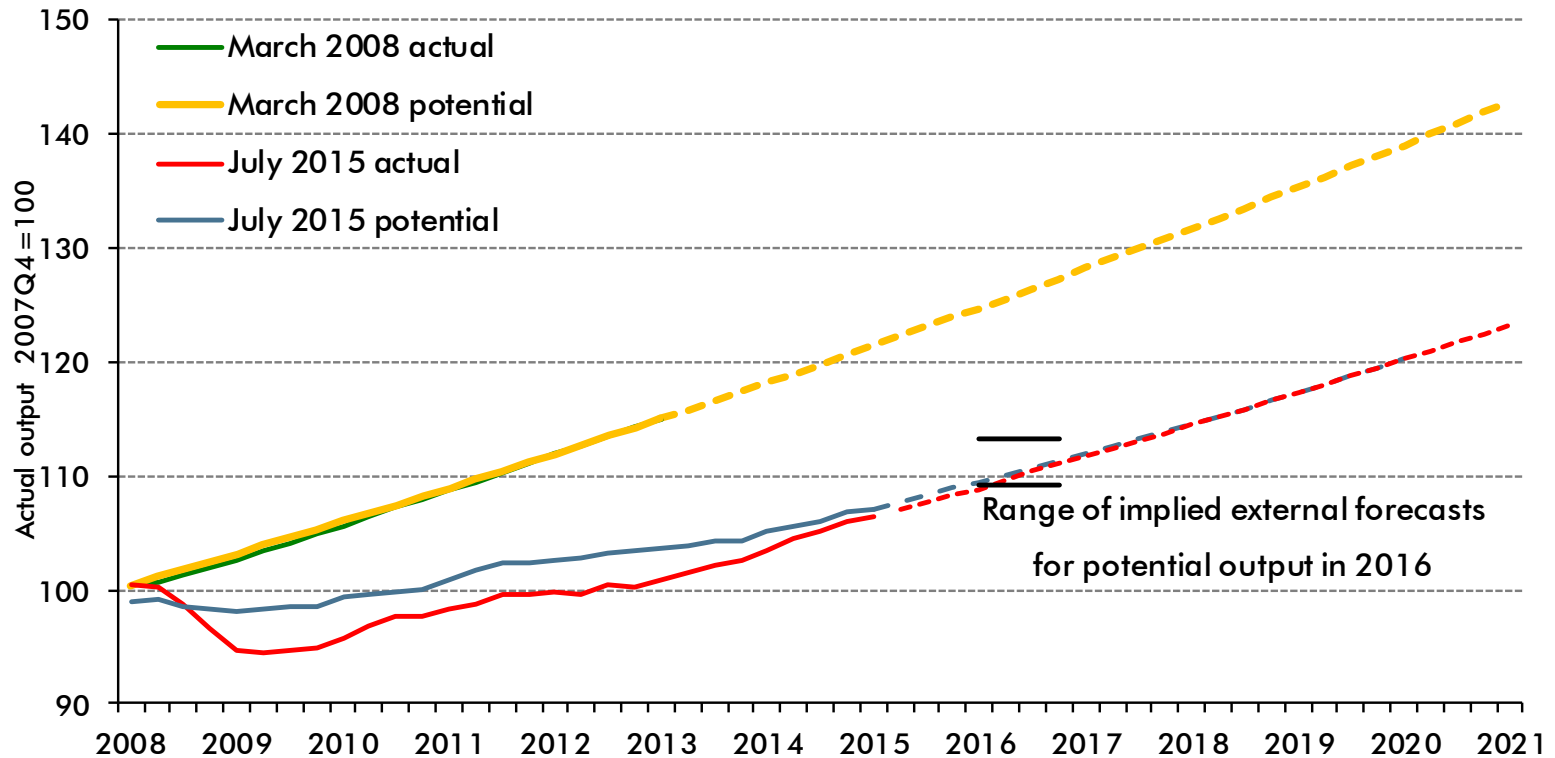
Successive pre-crisis Spending Reviews



Source: HM Treasury

Crisis-related structural hit to the public finances

Pre-crisis and latest estimates of potential output



Source: HM Treasury, ONS, OBR

Temporary fiscal rules

2008 to 2010

Temporary fiscal rules

November 2008: **Temporary operating rule:**

“to set policies to 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”

Temporary fiscal rules

November 2008: **Temporary operating rule:**

“to set policies to 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”

February 2010: **Fiscal Responsibility Act:**

Legislative duties:

- Borrowing to be more than halved to 5.5% of GDP or less in 2013-14
- Borrowing to be reduced as a share of GDP in each and every year from 2009-10 to 2015-16; and
- Public sector net debt to be falling as a share of GDP in 2015-16

UK fiscal framework
2010 to 2015:
Fiscal mandate &
Supplementary target

The 2010 fiscal framework

Fiscal mandate:

- to achieve cyclically-adjusted current balance by the end of the rolling, five-year forecast period

Supplementary debt target:

- for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16

Office for Budget Responsibility:

- an independent fiscal institution

Fiscal mandate: Rationale and objectives

June 2010 Budget argued:

- The fiscal mandate is based on:
 - the **current balance**, to protect the most productive public investment expenditure
 - a **cyclically adjusted aggregate**, to allow some fiscal flexibility at a time of economic uncertainty
- Unlike the golden rule, the fiscal mandate is:
 - forward-looking, not backward-looking
 - based on an independent OBR assessment of the structural fiscal position

Supplementary target: Rationale and objectives

June 2010 Budget argued:

- “At this time of rapidly rising debt, the fiscal mandate will be supplemented by a target for public sector net debt... ensuring that the public finances are restored to a sustainable path.”
- “once the exceptional rise in debt has been addressed, a new target for debt as a percentage of GDP will be set, taking account of the OBR’s assessment of the long-term sustainability of the public finances.”

Office for Budget Responsibility: Rationale and objectives

June 2010 Budget argued:

- In order to promote international and domestic confidence in the sustainability of the public finances, the Government had:

“created the new Office for Budget Responsibility (OBR), which introduces independence, greater transparency and credibility to the economic and fiscal forecasts on which fiscal policy is based.”

**UK fiscal framework
from 2015:
Proposed new fiscal targets**

Proposed fiscal rules

Draft Charter for Budget Responsibility sets out:

- In normal times: a target for a surplus on public sector net borrowing in each subsequent year
- For the period outside normal times from 2015-16: a surplus on public sector net borrowing by 2019-20
- Until 2019-20, the mandate is supplemented by a target for public sector net debt as a percentage of GDP to be falling in each year

Proposed fiscal rules

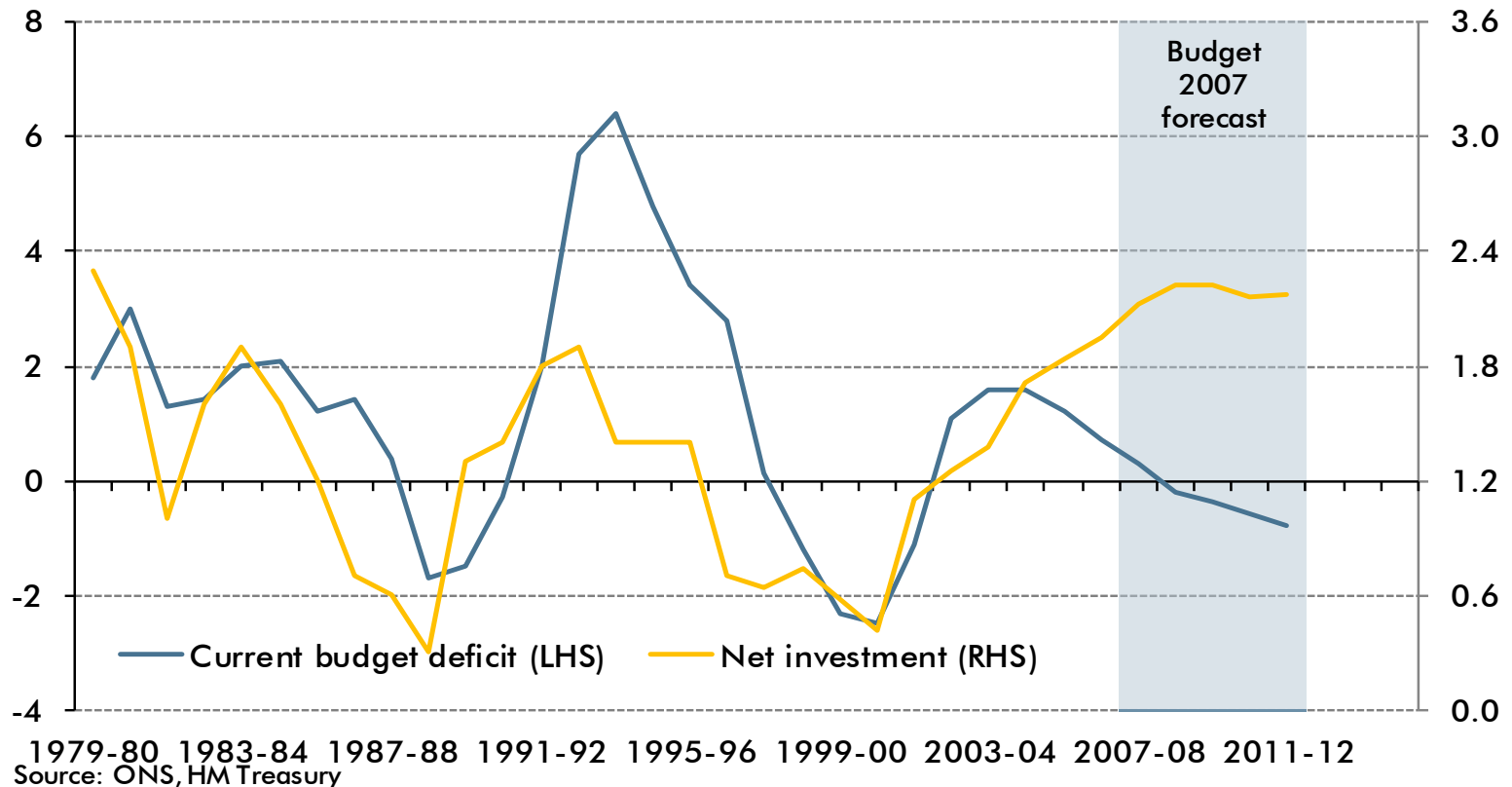
Draft Charter for Budget Responsibility sets out:

- These targets apply unless and until the Office for Budget Responsibility assess, as part of their economic and fiscal forecast, that there is a significant negative shock to the UK. A significant negative shock is defined as real GDP growth of less than 1% on a rolling 4 quarter-on-4 quarter basis.

Public investment in the UK

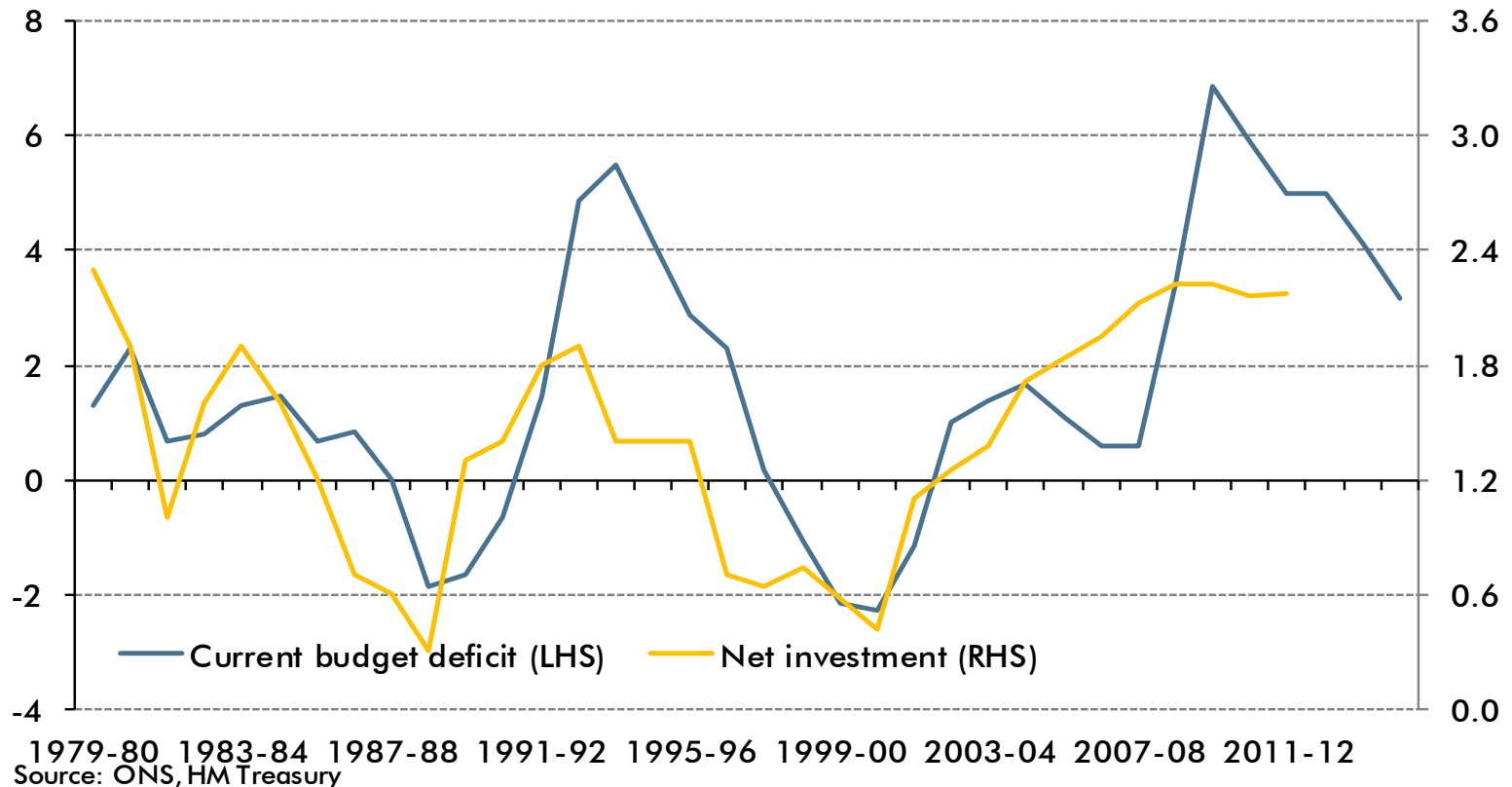
Current budget deficit and net investment

Budget 2007 outturns and forecast



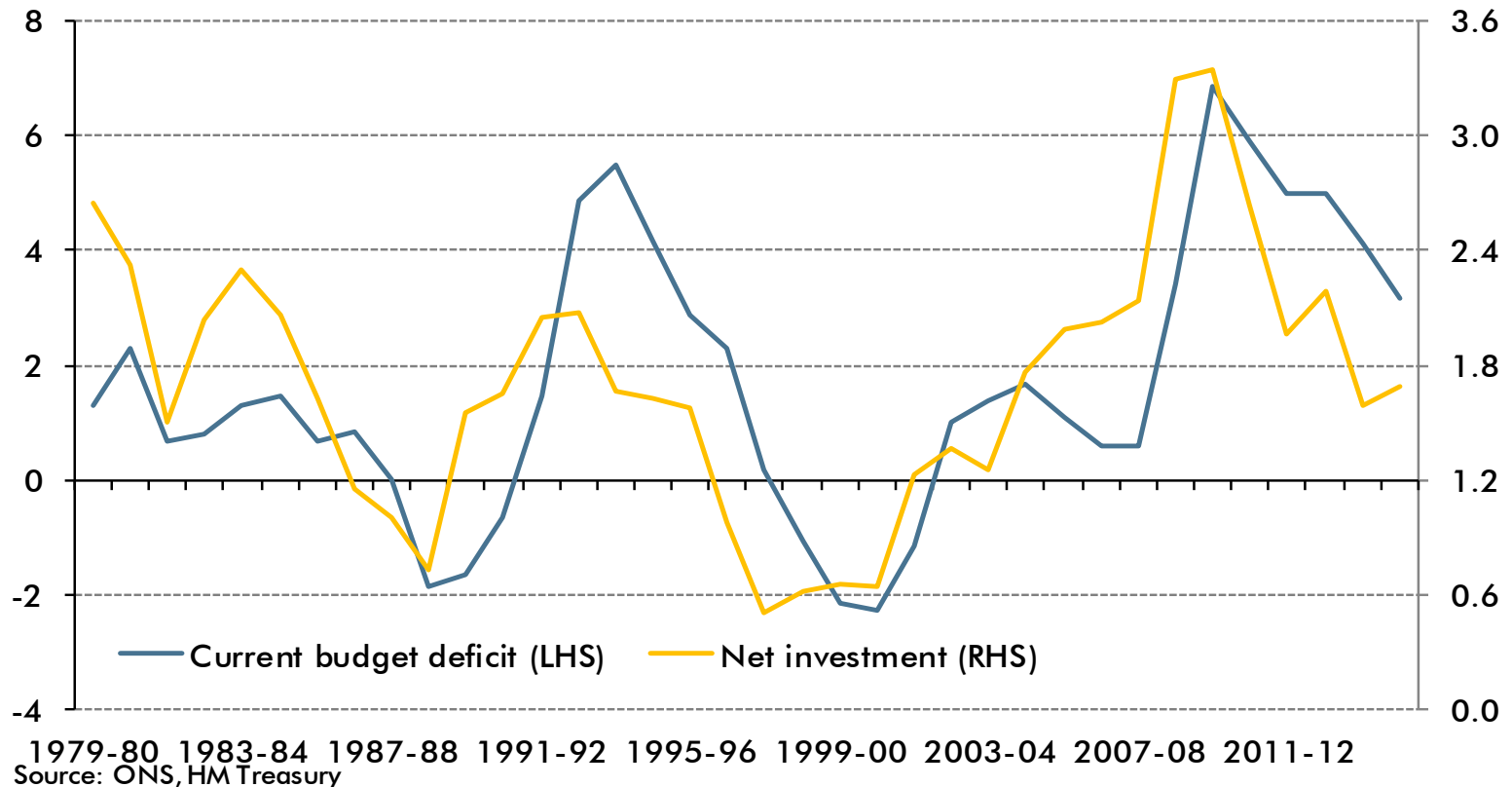
Current budget deficit and net investment

Latest current budget and Budget 2007 investment



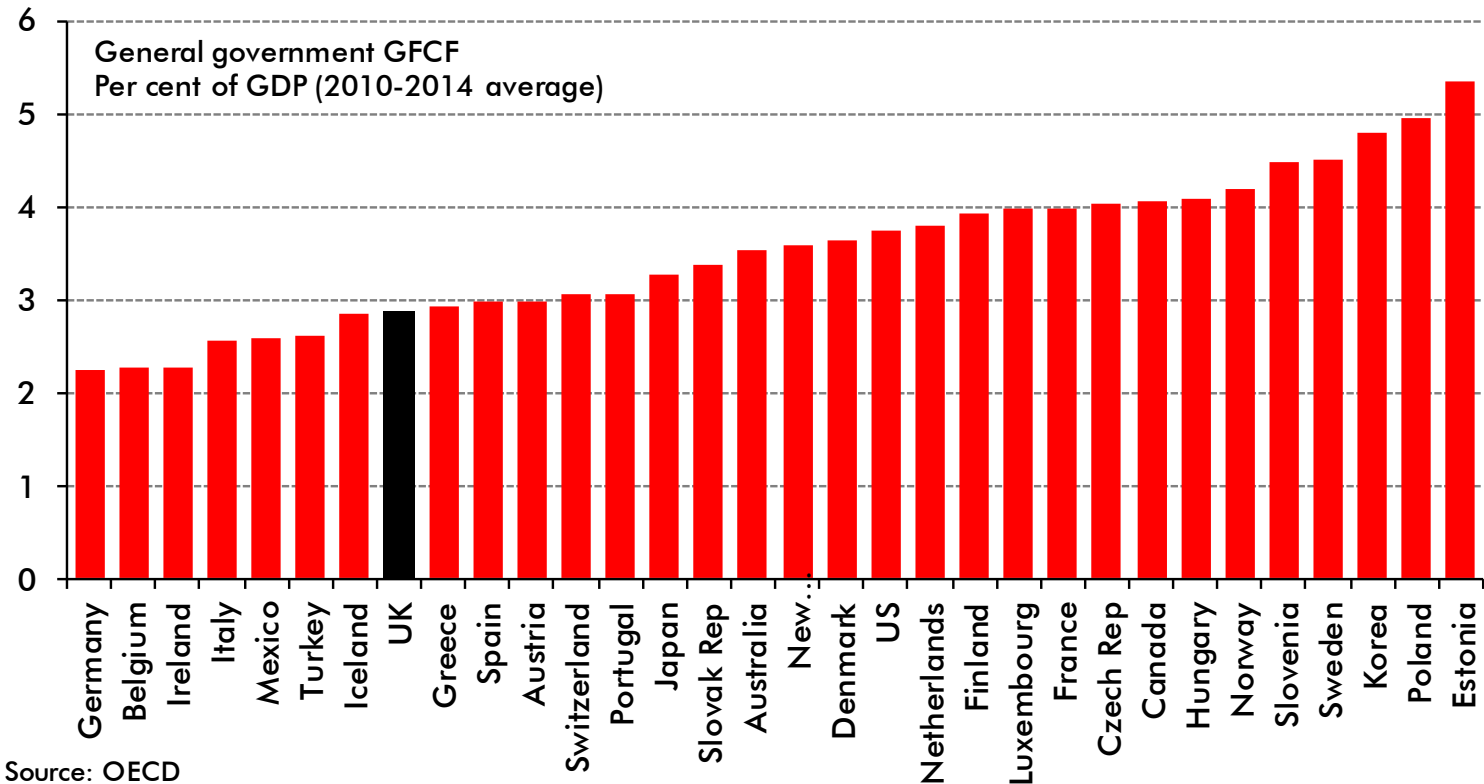
Current budget deficit and net investment

Latest outturns



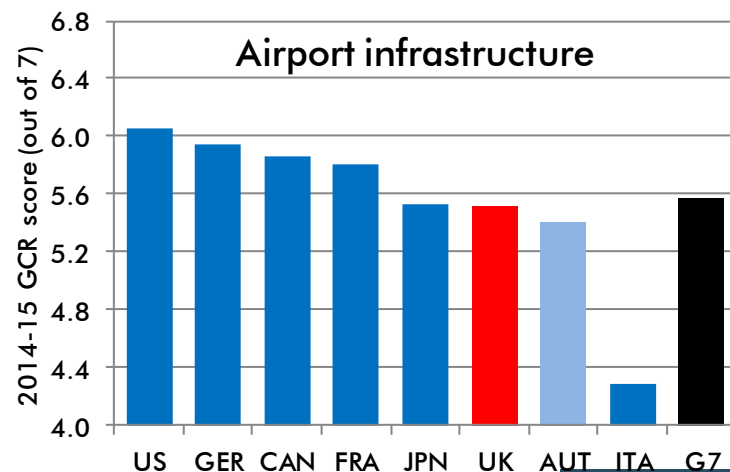
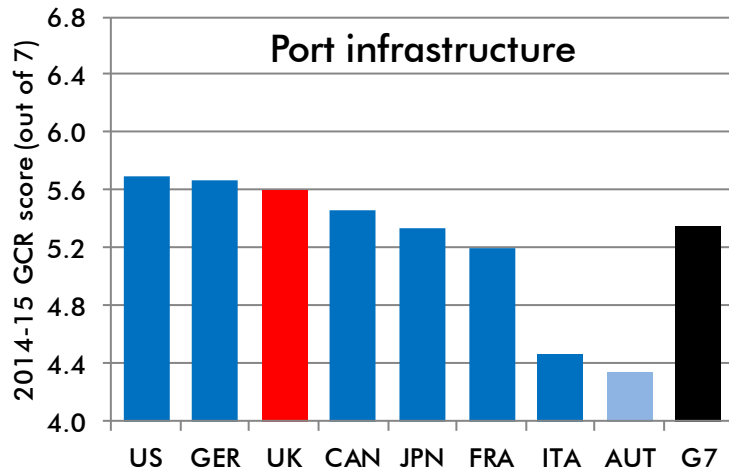
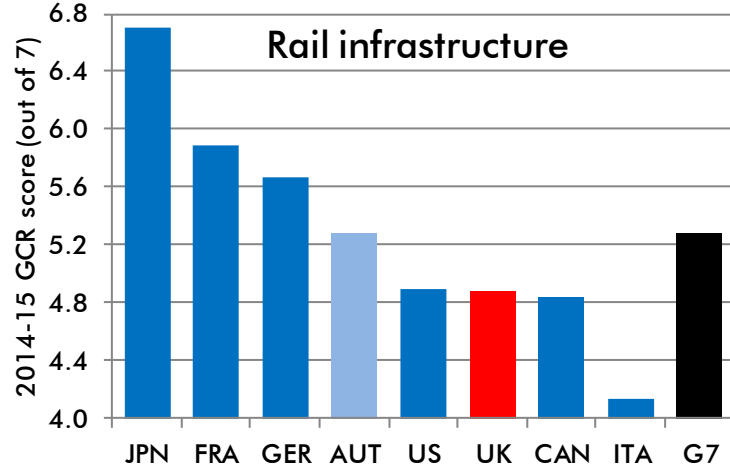
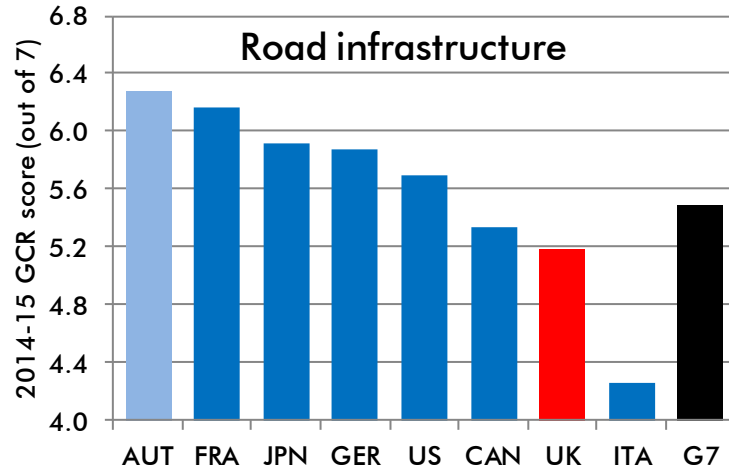
International comparison

Government investment in the OECD



Source: OECD

Infrastructure: Survey indicators



Source: 2014-15 Global Competitiveness Report

Conclusions