House of Commons Library

By Matthew Keep

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The UK's fiscal targets

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Contents

Summary

The Charter for Budget Responsibility

In the Charter for Budget Responsibility, the Government sets out how its management of the public finances operates. This 'fiscal framework' includes:

- the Government's approach and objective for manging the public finances and its targets for meeting the objective. The targets are often referred to as the fiscal targets.
- the frequency of Budget Reports, their broad contents and how parliament shall scrutinise them.
- the role and remit of the Office for Budget Responsibility (OBR).
- the Government's objective for manging government debt.
- how government debt is managed in the UK.

The current Charter was approved by the House of Commons in January 2022.

The fiscal targets

The Charter includes targets for government debt and a measure of government borrowing (the current budget). It also includes spending caps for welfare and government investment spending.

Government debt is, broadly speaking, the stock of government's past borrowing. The target for government debt is for debt to be falling, as a % of GDP, by the third year of the OBR's forecast. The Government is targeting a measure of its 'underlying' debt, which excludes the Bank of England's debt.

If the Government wants to spend more than it raises from taxes and other sources of income, it borrows. The borrowing target focuses on the 'current budget' and says that the current budget should be in balance by the third year of the OBR's forecast. The current budget excludes government investment (capital spending). If the current budget is in balance, the Government isn't borrowing to fund its day-to-day spending on areas such as public services, welfare and administration.

Government's investment spending – which is largely on fixed assets, such as roads and buildings – will be capped at 3% of GDP a year, on average, over the OBR's forecast.

The welfare cap says that spending on certain items of welfare should be within a predetermined cap and margin set by the Treasury.

1 Background

1.1 The UK's fiscal framework

The Government's decisions over tax and spending are often called its fiscal policy. The UK's fiscal framework sets out how the Government's management of fiscal policy operates.

The fiscal framework is set out in the Charter for Budget Responsibility (the Charter). The Treasury is required to publish the Charter under the Budget Responsibility and National Audit Act 2011.

The Charter was first introduced in April 2011. It has been revised on several occasions since (see Appendix 1). The current version was approved by the House of Commons in January 2022.[1]

1.2 What's in the Charter for Budget Responsibility?

Amongst other things, the Charter sets out:

- the Government's approach and objective for fiscal policy and its targets for meeting the objective. The targets are often referred to as the fiscal targets.
- the frequency of Budget Reports, their broad contents and how parliament shall scrutinise them.
- the Office for Budget Responsibility's role of providing official economic and fiscal forecasts for the Budget Report.
- the Government's objective for manging government debt.
- how government debt is managed in the UK.

The Office for Budget Responsibility (OBR) is the UK's public finances watchdog. The Charter sets out the OBR's remit, how it is to perform its duties, the required content of its key publications and the arrangements for determining the timing of its forecasts and other key publications. The Library

1 HC Deb 10 January 2022 [Charter for Budget Responsibility and Welfare Cap].

briefing The Office for Budget Responsibility has more on the UK's public finances watchdog.

1.3 Fiscal targets

Since the 1990s UK governments have adopted fiscal targets to guide and constrain fiscal policy. The targets have been included in the Charter for Budget Responsibility (the Charter) since it was introduced in 2011. The targets have changed regularly (see section 5 and Appendix 1). We discuss the current targets in section 2.

The UK fiscal targets have traditionally focused on:

- some measure of the Government's borrowing (often referred to as the budget deficit), which is the difference between what the Government spends and what it raises from taxes and other income sources
- Government debt, which is the overall level of government indebtedness, built up over many years. Broadly speaking, it is the total amount of money currently loaned to the Government to fund previous government budget deficits.

The OBR uses its forecasts to report on whether, in its judgement, the Government's policies have a better than 50:50 chance of meeting the fiscal targets.

1.4 How is the Charter changed?

When the Treasury wishes to modify the Charter, it lays a revised Charter before Parliament. The Charter comes into force once it has been approved a vote of the House of Commons.[2]

If the Treasury wants to modify the Charter's guidance for the OBR, a draft of the revised guidance must be published at least 28 days before being laid before Parliament.[3]

2 Budget Responsibility and National Audit Act 2011, section 1

3 Budget Responsibility and National Audit Act 2011, section 6

2 The Charter and fiscal targets

The current fiscal objective and targets were proposed by the Chancellor alongside Autumn Budget 2021.[4] They came into force in January 2022, once a revised Charter for Budget Responsibility was approved by the House of Commons.[5] The previous Charter and targets had been in place since January 2017 (see section 5 and Appendix 1).

Following the 2019 General Election, the Government didn't follow the previous targets, but they weren't officially replaced until January 2022, largely because of the economic uncertainty caused by the coronavirus pandemic.

2.1 Fiscal objective

The Treasury's objective for fiscal policy is:

> to ensure sustainable public finances, economic growth and stability, value for money for the taxpayer, a strong balance sheet, and intergenerational fairness.

The previous fiscal objective was for the 'public finances to balance at the earliest date in the next Parliament'.[6] Even before the Johnson Government took office, the objective of reaching a budget balance was being downplayed by the then Chancellor, Philip Hammond.[7]

2.2 Fiscal targets

For most of the past quarter of a century, UK fiscal targets have focused on debt and the current budget.[8] The current targets do likewise, and they are

4 HM Treasury. Charter for Budget Responsibility: autumn 2021 update, 27 October 2021

5 HC Deb 10 January 2022 [Charter for Budget Responsibility and Welfare Cap].

6 HM Treasury. Charter for Budget Responsibility: autumn 2016 update, January 2017, para 3.1

7 Treasury Committee, Autumn Budget 2018, 12 February 2019, HC1601 2017-19, para 57

8 Both Gordon Brown (in place from 1997 to 2008) and George Osborne (in place from 2010 to 2015) had targets which focused on debt and the current budget See para 4.9 of the OBR's economic and fiscal outlook – October 2021.

supplemented by two caps on spending – one on investment (capital) and one on welfare.

The fiscal targets, explained in more detail in the sections below, are:

- for public sector net debt (excluding the Bank of England) as a % of GDP to be falling by the third year of the OBR's forecast
- to balance the current budget by the third year of the OBR's forecast
- to ensure that public sector net investment doesn't exceed 3% of GDP per year on average across the forecast period
- to ensure that spending on welfare is contained within a predetermined cap set by the Treasury

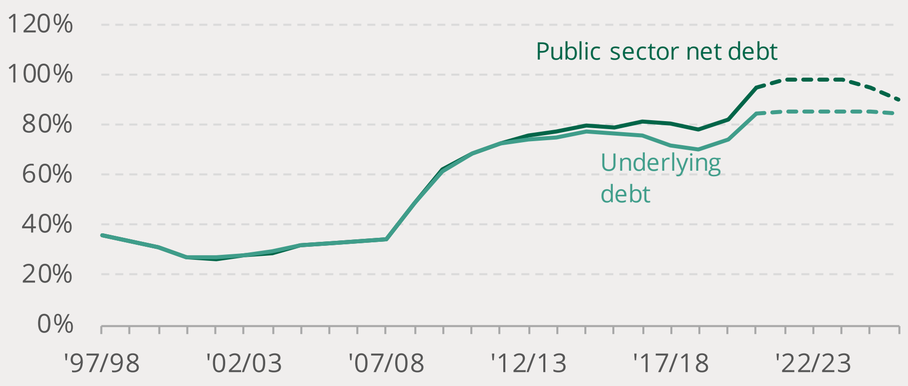
Government debt (public sector net debt)

Public sector net debt is the overall level of government indebtedness, built up over many years. Broadly speaking, it is the total amount of money currently loaned to the Government to fund previous government budget deficits.[9]

The debt target focuses on a particular measure of public sector net debt, which excludes the Bank of England.[10] Excluding the Bank of England means that this measure of the Government's debt is more closely associated with the Government's choices around spending and tax.[11] It is also thought to be a better measure of the Government's underlying debt.[12]

Public sector net debt, % GDP

OBR October 2021 forecasts from 2021/22



Source: OBR. Public finances databank – October 2021 [accessed on 11 November 2021]

[9] The Government has a budget deficit if it spends more than it receives from taxes and other revenues.

[10] Including the Bank's gilt purchases under QE and the loans it extends under the Term Funding Scheme. For more see ONS. Autumn statement: Supplementary fiscal aggregates: 2016, 23/11/2016

[11] IFS. Green Budget 2021, October 2021, Box 3.1; HM Treasury. Autumn Budget and Spending Review 2021, para A.21

[12] HM Treasury. Autumn Budget and Spending Review 2021, para A.21

In its **latest assessment of progress towards the debt target** (October 2021), the OBR say that the debt target is more likely to be met than missed. The OBR's October 2021 forecast has the debt-to-GDP ratio (excluding the Bank of England) falling in the third year of the forecast (2024/25). Debt is forecast to fall by 0.6% of GDP in 2024/25.[13]

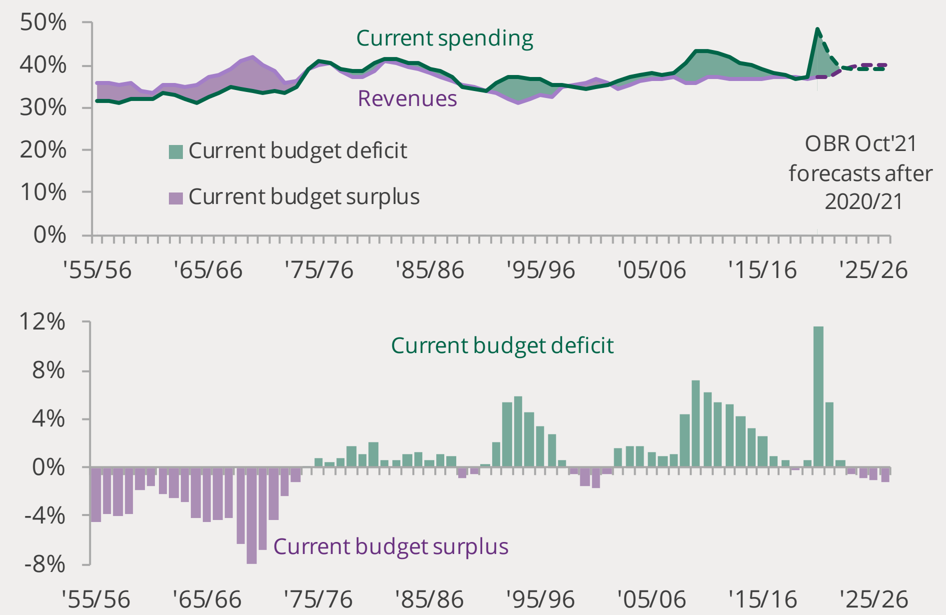
Current budget balance/surplus

For the current budget to be in balance, government revenues, from taxes and other sources, must cover day-to-day government spending on areas such as public services and welfare. If the current budget is in balance (or in surplus), the Government isn't borrowing to fund day-to-day spending. It can, however, be borrowing for investment spending, as current spending doesn't include such capital spending.

The current budget deficit was £250 billion in 2020/21. In the OBR's October 2021 forecast, the current budget reaches a surplus in 2023/24 and remains in surplus for the rest of the forecast, which ends in 2026/27.[14]

When current spending is higher than revenues, the government has a current budget deficit

Current spending, revenues, current budget deficit, % of GDP



Notes: Current spending includes deprecation

Source: OBR. Public finances databank – January 2022

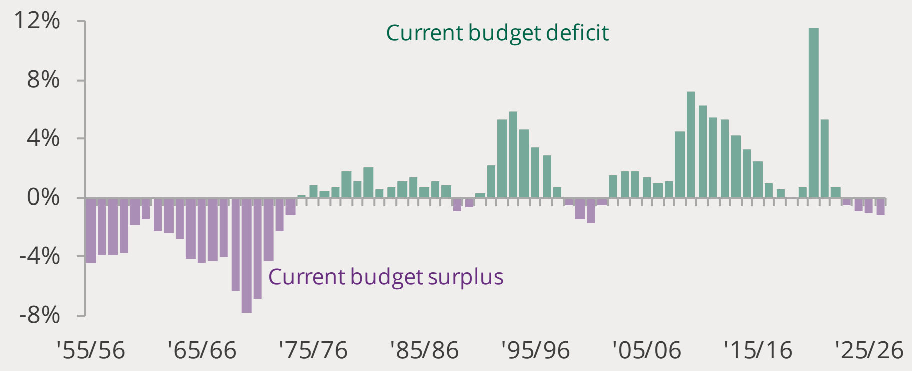
[13] OBR. Economic and fiscal outlook – October 2021, para 4.11

[14] OBR. Economic and fiscal outlook – October 2021, para 4.11

The UK had a current budget surplus in 7 of the 47 years since the mid 1970s. The current budget was in surplus in each year between 1947/48 and 1973/74.

Since the mid-1970s, current budget surpluses have been uncommon in the UK

Current budget deficit, % of GDP



Notes: Current spending includes deprecation.

Source: OBR. Public finances databank – October 2021

In its **latest assessment of progress towards the current budget target**, the OBR say that the current budget balance target is being met by a margin of £25.1 billion (0.9% of GDP). A current budget surplus of £25.1 billion is forecast for the current target year of 2024/25.

1: Rolling targets

Both the debt and current budget targets are rolling targets to be achieved in the third year of the forecast. The OBR's latest forecast was produced in 2021/22, so the target year is 2024/25. Once we move into 2022/23 the target year will roll onto 2025/26. The Treasury could have alternatively chosen to use fixed date targets, which would have focused on a specific year or period of time.

Rolling targets and fixed year targets each have their pros and cons. The OBR say that having rolling targets gives a horizon over which policy can be adjusted in light of 'normal' future surprises. With fixed date targets, as the target year gets closer "the shorter the period over which any fiscal surprises must be offset by policy or (as history has shown) the greater risk that the targets will be missed or abandoned in the face of a shock."[15]

However, the actual date for meeting rolling targets never arrives. The OBR say that this means that the public finances can progressively deteriorate.

[15] OBR. Economic and fiscal outlook – October 2021, paras 4.29-4.32

This is because Chancellors can loosen fiscal policy in the near years but present tighten plans in the future target year to meet the target.[16]

Investment spending

Public sector net investment is largely capital spending. It includes public sector spending on fixed assets, such as roads and buildings, as well as a significant amount of research and development spending. The depreciation of assets, which lowers investment, is also included. Capital grants to the private sector – such as grants for social housing – are also part of public sector net investment.[17]

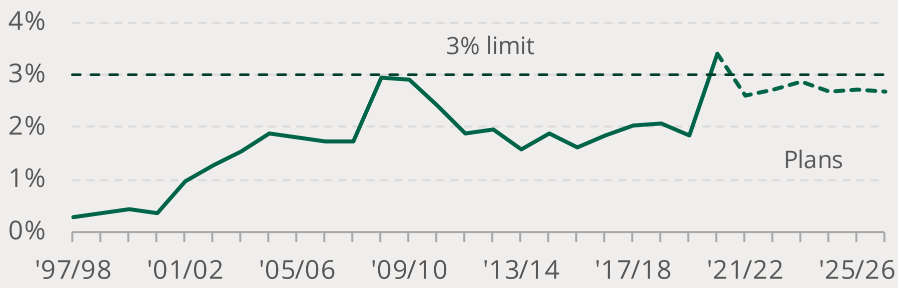
Investment spending isn't part of the Government's current (day-to-day) spending. This means that even if the current budget is balanced, the Government can still borrow for investment spending. The Charter puts a limit on investment spending of 3% of GDP per year, across the OBR's 5-year forecast period. The Government plans to spend a little below the 3% of GDP limit.

Investment of around 3% of GDP per year will be higher than in recent years. Investment reached 3% of GDP during the 2007-2009 financial crisis, due to Government intervention to support the economy. Prior to this, investment last regularly averaged over 3% of GDP during the late 1970s, when there were more publicly owned industries than now. Such industries required public capital investment.

The Government has promised an "infrastructure revolution" and is willing to borrow to do so, particularly while interest rates on such borrowing are low.[18]

Government plans public investment of around 3% of GDP

Public sector net investment, % GDP, outturns and plans (from 2021/22)



Source: OBR. Public finances databank – November 2021

[16] ibid

[17] OBR. Public sector net investment, March 2020

[18] Spending Round 2019: Chancellor Sajid Javid's speech; HM Government. Queen's Speech December 2019: background briefing notes, page 132; HC Deb 27 October 2021 [Financial Statement].

Welfare cap

The welfare cap was introduced, in its original form, in Budget 2014 and sets limits on the amount that can be spent on certain benefits.[19] The cap covers around 50% of welfare spending, excluding pensions and Jobseekers Allowance payments, but including tax credits, child benefit and disability benefit.[20]

How does the cap work?

The Treasury sets the level of the cap and the year in which it will apply, at or before the first fiscal event of each new Parliament.[21] At the same time the Treasury sets a pathway for relevant welfare spending in each year running up to year of the welfare cap. The Treasury also sets the percentage margin for the cap and pathway in each year. The margin is set as a percentage of either the pathway or the cap.

The cap is only formally assessed at the first fiscal event of a new Parliament, coinciding with the incoming government's setting of a new cap. The OBR's forecasts do, however, monitor the Government's progress against the cap.

If the Treasury wishes to reset the level of the cap, the year in which it applies, the margin or the items of spending in the cap it needs to get the approval of the House of Commons. In Autumn Budget 2021, the Treasury proposed changes to the level of the cap, which Parliament approved in January 2022.[22] The cap has been reset in line with the OBR's latest forecast. The OBR report that "The new cap is £11.6 billion higher than the one it replaces. But it provides a smaller margin of 2 per cent rather than 3 per cent, so the effective cap (i.e. the cap plus margin), is £10.5 billion higher than the one it replaces."[23]

The Library briefing The welfare cap has further information on how the cap operates.

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19 It entered into the Charter in the March 2014 update.

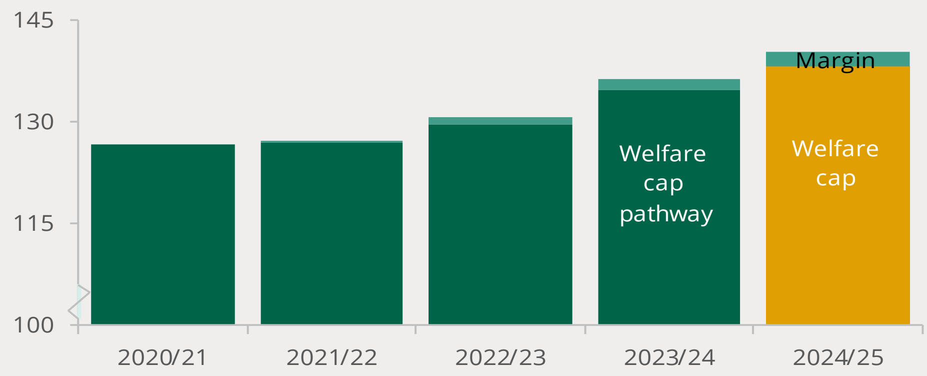
20 OBR. Economic and fiscal outlook – October 2021, Table 3.20

21 Fiscal events are understood to mean budgets, autumn statements or spring statements.

22 HC Deb 10 January 2022 [Charter for Budget Responsibility and Welfare Cap].

23 OBR. Economic and fiscal outlook – October 2021, para 4.16

Welfare cap, pathway and margin, proposed at Autumn Budget 2021
£ billion



Source: OBR. Economic and fiscal outlook – October 2021, Table 4.4

The Library briefing The welfare cap has further information on how the cap operates.

The targets can be suspended

If there is a "significant negative shock to the UK economy" the Treasury may temporarily suspend the targets. The Charter doesn't say what would constitute a significant shock.

If the targets are suspended, at each subsequent Budget the Chancellor must set out to Parliament how the Government plan to get to a position where the suspension can be lifted.

The Treasury will not be required to seek approval for changes to the welfare cap if these are made at the point the suspension is lifted. This includes changes to the year the cap applies, the level of the cap and the level of the margin for the cap.

2.3 Management of fiscal policy

The revised Charter includes a new subsection on the management of fiscal policy. It says that the Treasury will use a broad set of indicators and tools to assess the affordability of public debt and the strength of the public sector balance sheet.

Debt interest costs have recently been at historical lows but spending on debt interest is now more sensitive to changes in inflation and interest rates than was previously the case.[24] The Treasury will monitor the affordability of debt interest costs, including its sensitivity to changes in the wider economy,

[24] For more on this see OBR Fiscal Risks Report – July 2021, paras 4.40 – 4.43

such as changes in inflation and interest rates. The Treasury will also monitor wider risks, including the proportion of government debt held overseas.

The **public sector's balance sheet** includes its assets and its liabilities. UK fiscal targets have traditionally focused on a narrow measure of the balance sheet, which is public sector net debt. The Treasury say that looking into wider measures of the balance sheet will improve policy "by revealing the full nature of public assets and non-debt liabilities" and providing a fuller outlook to inform decisions.

Affordability of debt

The Government makes interest payments on its debt. In recent years government's debt interest costs have been low. In fact, relative to tax revenues, debt interest costs had reached a 320-year low, before recent increases.[25] The Chancellor says that "it is sensible to take advantage of lower interest rates to invest in capital projects that can drive our future growth" but "given how high our debt now is, we need to pay close attention to its affordability."[26] The Treasury will, therefore, monitor the affordability of public debt.

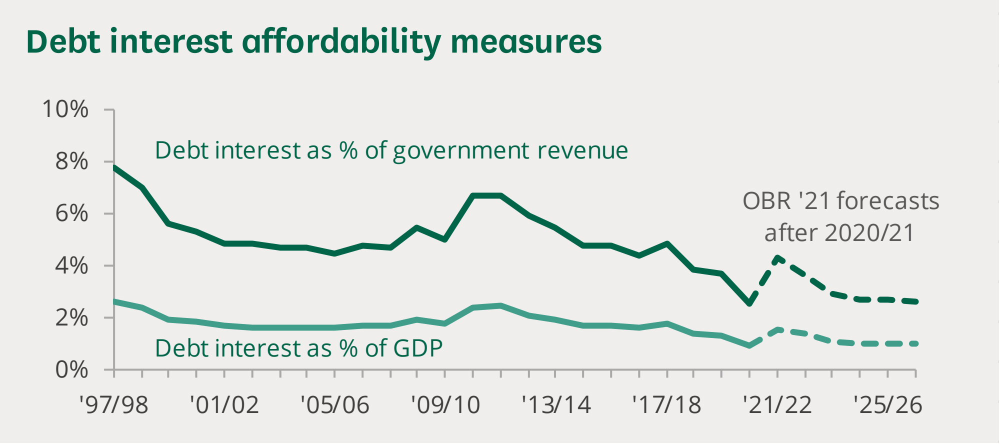
While debt interest costs have been low, the government's elevated level of debt is more exposed to changes in interest rates than pre-pandemic and more so than pre-financial crisis. This is because the Government has more debt and a greater proportion of it is held by the Bank of England (a by-product of the Bank's quantitative easing programme).[27] When the Bank of England raises the UK's main interest rate (Bank Rate), government spending on the debt held by the Bank of England increases overnight.

The Government's debt interest spending has also become more sensitive to changes in inflation. This is because a greater proportion of government's debt interest is linked to inflation, than was the case in the past.

Recently, inflation has risen to a level last seen in March 1991.[28] Consequently, Government's spending on debt interest has increased. The Office for Budget Responsibility estimate that higher than expected inflation during late 2021/early 2022, has meant that debt interest costs in the financial year-to-January 2022 are £8 billion higher than forecast.

The revised Charter doesn't pick out any specific indicators of affordability to monitor, but the OBR discuss debt interest as a % of GDP and as a % of revenues.

25 IFS. Green Budget 2020: Chapter 4, 13 October 2020, Figure 4.14
26 HC Deb 3 March 2021 [Financial Statement].
27 For more on this see Box 10 of Coronavirus: Economic impact
28 ONS series CZBH



Source: OBR. Economic and fiscal outlook – October 2021, Chart 4.3

Measures of the public sector balance sheet

Traditionally, UK fiscal targets have focussed on a single measure of the public sector's balance sheet – public sector net debt (PSND). This measure offers a limited view of the overall health of the public sector's balance sheet as it includes only a limited range of the public sector's assets and liabilities.

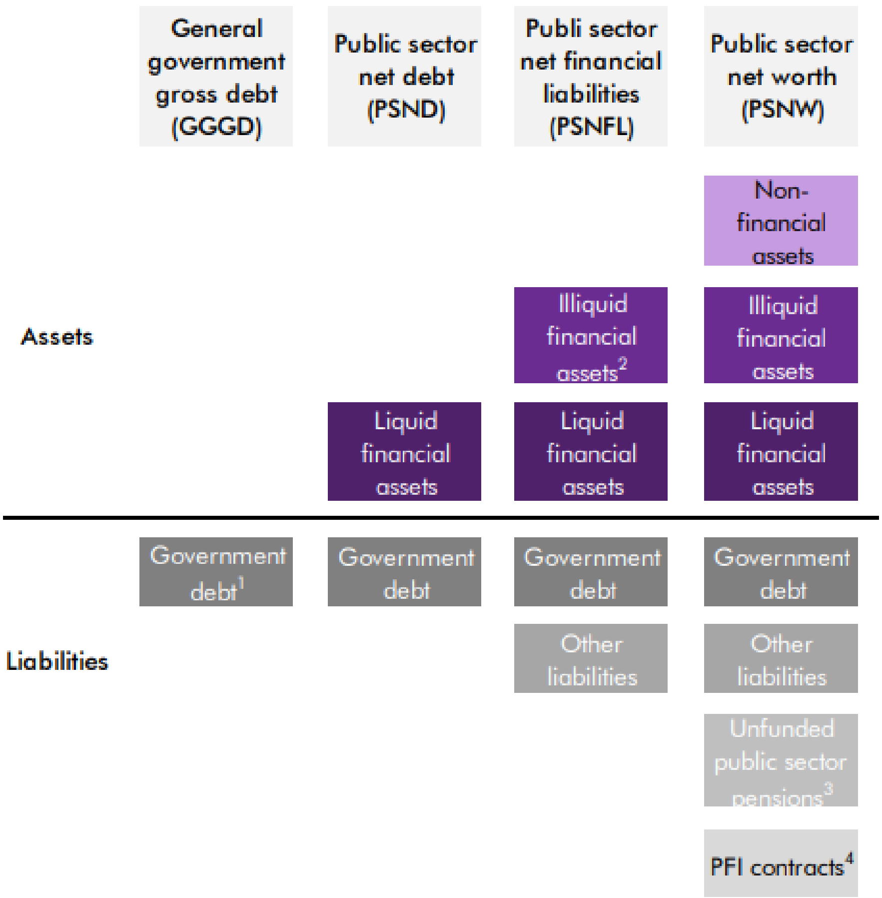
The Treasury say that to improve fiscal policy they will assess the public finances from a broader perspective, considering the entire balance sheet. They will aim to strengthen a range of measures including PSND, Public Sector Net Financial Liabilities (PSNFL) and Public Sector Net Worth (PSNW). Figures overleaf provide comparisons of the different balance sheet aggregates. PSNW is the broadest balance sheet measure. It compares the public sector's liabilities with all its assets, including non-financial assets such as buildings, vehicles, machinery etc. [29]

The OBR say that focusing on the wider balance sheet could reduce a risk that arises out of PSND's narrow definition.[30] PSND only includes only a small range of the public sector's assets – those which are or can most easily be turned into cash, such as foreign exchange reserves. This has meant that past governments could sell other assets not reflected in PSND, such as student loans, and the cash raised would reduce PSND. As such assets are included in the wider measures (PSNFL and PSNW) they would not be improved by the sale of the asset.

[29] OBR. Working Paper No.16 Forecasting the balance sheet: Public Sector Net Worth, October 2021

[30] OBR. Economic and fiscal outlook – October 2021, paras 4.26-4.28

Comparison of public sector balance sheet aggregates

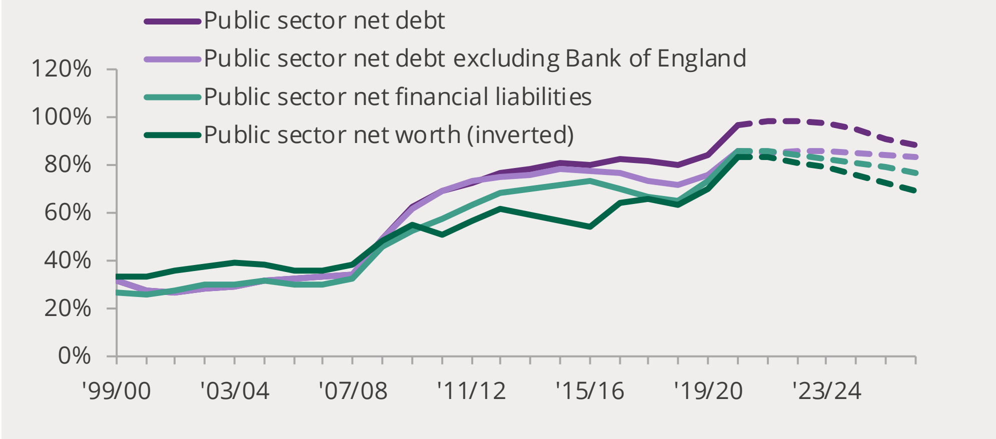


Notes:
1. Includes cash, debt securities and loans.
2. Includes funded public sector pensions.
3. Included in GFSM 2014 net financial liabilities and net worth but not ESA10.
4. Contracts in addition to those already included under ESA10.

Source: OBR. Working paper No. 16. Forecasting the balance sheet: Public Sector Net Worth, Figure 2.2

Alternative measures of the public sector balance sheet

% of GDP



Source: OBR. Economic and fiscal outlook – October 2021, Chart 3.19

2: Alternative ways of measuring government borrowing

Borrowing targets can focus on different measurements of the government's budget. Below are some definitions for the most widely used measures internationally:

Overall borrowing: the difference between total government spending and total government revenues from taxes and other sources. In the UK this is known as public sector net borrowing and is often referred to as the budget deficit.

Current borrowing: the difference between government current spending – day-to-day spending on running public services, grants and administration – and government revenues from taxes and other sources. The current budget excludes investment spending. In the UK this is known as the public sector current budget deficit.

Structural borrowing: estimates the size of borrowing that would be expected if the economy was running at a sustainable level of employment and activity – it adjusts for the ups and downs of the economy. In the UK this is often referred to as cyclically-adjusted net borrowing.

Primary borrowing: the overall budget balance excluding net debt interest payments.

The Office for National Statistics (ONS) maintains a glossary of public finances terms.

3 Fiscal targets: Alternative approaches

3.1 Labour Party

At Labour Party Conference 2021, the Shadow Chancellor, Rachel Reeves, said that a Labour Government would "put in place fiscal rules that will bind the next Labour government to ensure we always spend wisely and keep debt under control". [31]

The Financial Times reported that in the medium term, Labour would target a current budget surplus and a falling debt-to-GDP ratio. [32] This approach is similar to the Government's current fiscal targets.

Labour would also:

- sanction borrowing for investment in infrastructure
- introduce a mechanism for suspending the fiscal targets if there is an economic shock
- look at public sector assets as well as liabilities, which would stop a government from selling assets to "massage public debt lower"

3.2 Economists' opinions

Three of the UK's prominent economics think tanks – the National Institute of Economic and Social Research (NIESR), the Institute for Fiscal Studies (IFS), and the Resolution Foundation – have said what they think would make good fiscal targets.

National Institute of Economic and Social Research (NIESR)

NIESR say that the fiscal targets should be scrapped and there should be more focus on evaluating policy. Their analysis argues that fiscal rules:

[31] 2021 Conference speech, Rachel Reeves MP

[32] "Labour to slash tax reliefs and hit wealthy in pursuit of balanced UK budget", FT, 26 September 2021

> have limited use, both over time and across space, given the difficulties in setting rules that give enough flexibility to respond to unforeseen circumstances and given the difficulties in meeting the pre-set targets due to uncertainties about the state of the economy. [33]

NIESR say fiscal policy should be based around a new framework, in which:

- there is a more structured timetable of fiscal events (such as budgets)
- budget speeches focus on the state of the economy and the government's socio-economic objectives and extensively debated and scrutinised by Parliament and a Fiscal Council
- the OBR publishes pre-fiscal event reports with key issues to which the Chancellor should respond
- the Chancellor provides more guidance as to how fiscal policy would respond if certain risks materialise and the OBR produces economic forecasts and scenarios to inform government on fiscal choices
- a new independent body evaluates key fiscal choices, both before and after they happen
- fiscal strategy is joined up across the UK, with particular attention paid to distributional effects, productivity, wellbeing and ecological sustainability.

Resolution Foundation

The Resolution Foundation reason that fiscal rules should focus more on the public sector's balance sheet, potentially focusing on measures such as public sector net financial liabilities (PSNFL), public sector net worth (PSNW) and intergenerational balance, which includes all public sector assets and liabilities and the present value of future taxes and spending obligations.[34]

In 2019, the Resolution Foundation recommended that the Government should follow the below rules. They have continued to do so following the coronavirus pandemic: [35]

- to deliver an improvement in public sector net worth as a share of GDP over five years.
- to achieve a cyclically-adjusted public sector current balance of 1 per cent of GDP (and no less than -1 per cent) over five years
- to ensure the proportion of revenue spent on debt interest does not exceed 10%

[33] NIERS. Time to scrap current fiscal rules – and focus on more explicit policy evaluation, NIESR research shows, 23 April 2021

[34] Resolution Foundation, Seeking public value, 29 September 2019

[35] Resolution Foundation. Unhealthy finances, November 2020, page 56. A similar approach was also supported by the FT - "Britain can afford to loosen its fiscal rules", *FT*, 12 September 2019

- the net worth and structural current balance targets would be suspended if the economic outlook deteriorates significantly.

The Resolution Foundation also looked at international experience and found that 'effective and durable rules' should:[36]

- reflect a broad and durable political consensus
- be enshrined in higher law
- be comprehensive in coverage
- be based on recognised accounting concepts
- be medium-term in orientation
- ensure sustainability under a range of scenarios
- allow fiscal policy to stabilise the macroeconomy
- have built-in escape clauses
- include a self-correction mechanism
- be supported by sound budget management

Institute for Fiscal Studies

For the Institute for Fiscal Studies (IFS), well designed fiscal targets need to:[37]

- be forward-looking
- look through temporary factors that can depress or flatter headline measures of the public finances
- help ensure fairness for different generations
- be credible
- be communicable and, ideally, stable.

They say that having a current budget surplus for the medium term is commendable: "it allows borrowing for investment purposes and gives some time for policy to adjust to shocks." However, they point out that "the split between capital and current spending will not always align with what spending does and does not benefit future generations." For example, spending on education and training is treated as current spending, which means it is part of the budget, but will be expected to deliver future benefits.

The IFS say that setting an appropriate target for debt is difficult, not least because there is no consensus over the right level of debt. They do, however, say that "there is a case for setting policy so that over the long term, debt is reduced as a share of national income". This could provide space for governments to deal with future economic shocks and reduce future debt interest spending. The IFS also say that there should be a focus on the

[36] Resolution Foundation, Britannia waives the rules?: Lessons from UK and international experience with fiscal rules, October 2019, page 11

[37] IFS. Green Budget 2021: Rewriting the fiscal rules, 12 October 2021

broader public sector balance sheet, so that assets aren't sold simply to keep headline debt down.

In the IFS's opinion, rather than having firms and fixed fiscal targets, it would be better to have "rough rules of thumb that Chancellors should strive to keep to in most periods".

3.3 Fiscal rules around the world

The International Monetary Fund (IMF) estimate that as of end-2021, about 105 countries have adopted at least one fiscal rule. [38] Their main aims are to:[39]

- commit policymakers to sustainability in the public finances;
- enhance transparency; and,
- signal to the financial markets the course of the government's fiscal policy

Some countries have budget rules, which focus on government borrowing/surpluses (the difference between government spending and revenues). Some fiscal rules focus on the stock of government debt, while some focus on government spending (or items of spending) and/or government revenues. Often, countries have a combination of different types of rules.

The rules are not uniform; in fact, there is quite a lot of variation. Take budget rules: some countries target reaching an overall budget surplus; some target reaching a surplus after adjusting for the ups and downs of the economy; some allow borrowing for investment purposes; some look at keeping borrowing below a certain level relative to GDP; some have a forward-looking rolling target date; some have targets for different levels of government.

The IMF's fiscal rules dataset provides information on the use and design of fiscal rules in 106 countries from 1985 to 2021. The IMF's related background paper provides details on the rules in operation in each country. The European Commission also has a fiscal rules database.

Below are examples of the approach taken on budget balances by a small selection of countries, prior to the coronavirus pandemic. **Their policies may have changed since the coronavirus pandemic began:**

- EU Member States followed the rules of the Stability and Growth Pact. This included a requirement to keep borrowing below 3% of GDP. In March 2020, the EU activate the general escape clause of the Stability

[38] IMF. Fiscal Rules and Fiscal Councils: Recent trends and performance during the COVID-19 pandemic, January 2022, page 6

[39] IMF. Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability, April 2018, Executive Summary

and Growth Pact to allow "Member States to react swiftly and adopt emergency measures to mitigate the economic and social impact of the pandemic." The escape clause is expected to be deactivated in 2023.[40]

- Structural borrowing (borrowing adjusted for the ups and downs of the economy) of the German federal government is capped at 0.35% of GDP in the country's constitution.[41] The rule was suspended in March 2020, following the onset of the pandemic.[42] Germany also has targets for the Länders (states);
- A 'debt brake' operates in Switzerland. This has different components, but its cornerstone is that the budget must at least be balanced across the economic cycle. The rule works by linking spending and revenues and adjusting for the ups and downs of the economy.[43]
- New Zealand's Budget Responsibility Rules 2018 includes five fiscal rules, one of which is to "deliver a sustainable operating surplus across an economic cycle". The rules are consistent with principles set out in the Public Finance Act 2018, which set out that operating surpluses should be run when debt levels aren't 'prudent'. Once 'prudent' levels are achieved on average total operating balances should not exceed total operating revenues.[44] During the pandemic, New Zealand suspended some of its rules.[45]
- There is no budget balance rule for the US federal government. Many US states have laws that require a balanced budget, but what this means in practice differs across states.[46] The US has a debt limit – often referred to as the debt ceiling – which is the maximum amount of debt that the Department of the Treasury can issue to the public or to other federal agencies. The amount is set by law and has been increased over the years to finance the government's operations.[47]

In October 2019, the Resolution Foundation published a report that looked at international experience highlighting the types of fiscal rules used.

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40 European Commission Press Release. European Semester Spring Package: Paving the way for a strong and sustainable recovery, June 2021

41 Federal Ministry of Finance, Germany's Federal Debt Brake, 2015

42 Federal Ministry of Finance, German Stability Programme 2021, 21 April 2021, para 3.1

43 Federal Finance Administration, Debt brake, May 2018

44 The Treasury (New Zealand), Fiscal Strategy. [accessed on 17 January 2018]

45 IMF. Fiscal Rules and Fiscal Councils: Recent trends and performance during the COVID-19 pandemic, January 2022, page 6

46 National Conference of State Legislatures, State balanced budget provisions, 2010

47 Congressional Budget Office, Federal Debt and the Statutory Limit, February 2019

4 Fiscal targets: The UK's experience

Since introduced, in the late 1990s, UK governments' fiscal rules have often focused on government borrowing and the debt-to-GDP ratio.[48]

For much of **Labour's last period in office** (1997-2010) it operated two fiscal rules:

- the 'golden rule' which required borrowing only to pay for investment. This was judged on average over the economic cycle, rather than every year;
- the sustainable investment rule which required the Government to keep the public sector's debt (net of its short-term financial assets) at a 'stable and prudent' level. The Treasury defined this as less than 40% of national income (GDP) at the end of each financial year of the economic cycle.

When the 2007-2008 financial crisis came, these rules were suspended and a new framework was introduced.[49] The rules were replaced in the Fiscal Responsibility Act 2010.[50]

In terms of a borrowing rule, the **2010 Coalition Government** had a forward-looking rolling target for the cyclically-adjusted current budget to be balanced in the fifth year of the forecast period. This was later shortened to the third year of the forecast period.

Focusing on the cyclically-adjusted budget allowed for the ups and downs of the economy to be accounted for, while focusing on the current budget meant that the rule allowed borrowing for investment purposes.

The Coalition Government's debt target required the debt-to-GDP ratio to be falling in 2015/16. For a short period, the target date was shifted to 2016-17.

At the start of the 2015-2017 Parliament **David Cameron's Conservative Government** revised the borrowing target, introducing a target for the budget to be in surplus by 2019/20. Once a surplus was reached it was expected to be maintained in subsequent years, so long as the economy was in 'normal times'. The debt target required the debt-to-GDP ratio to be falling

[48] A summary is available in paragraph 8.9 of the OBR's Fiscal Risk Report – July 2019

[49] HM Treasury. Pre-budget report 2008, page 15

[50] Further information is available in the Library briefing Fiscal Responsibility Bill (2009-10).

in all years to 2019/20. The Conservative Government's fiscal rules could be overridden in the face of a significant adverse economic shock. [51]

Theresa May's Conservative Government introduced new rules – which the current rules replaced – following the EU referendum result. The fiscal objective was to bring a budget balance "at the earliest possible date in the next Parliament". The medium-term borrowing target was for cyclically-adjusted borrowing to be below 2% of GDP by 2020-21. The debt target was for public sector net debt as a percentage of GDP to be falling in 2020-21. The rules could be reviewed in the face of a significant adverse economic shock.

Appendix 1 summarises the revisions to the fiscal targets, and introduction of the welfare cap, in the four versions of the Charter.

Comment on their use

According to the OBR some broad points can be made about UK governments' use of fiscal rules over the past decade: [52]

- changes have been made frequently;
- changes have been made to the rules in response to the fiscal outlook, rather than policy changing to meet the rule;
- Chancellors have consistently chosen to keep a headroom of around £20 billion against breaching the fiscal mandate operating at the time; and,
- Chancellors have pursued several less formal objectives. For example, in the October 2018 Budget, the Government adapted its policies to ensure that its headroom against the fiscal mandate remained at the same level as in the previous forecast
- The OBR says that there is a risk to changing the fiscal rules when the fiscal outlook changes, rather than adjusting policy to meet the rules. They say that "[r]elative to a world in which fiscal rules acted as a greater constraint, the path of debt can be expected to be higher." Although, that isn't to say that the OBR believe a rule should be followed in all circumstances, they reason that some shocks will warrant it being overridden.

[51] Defined as real GDP growth of less than 1 per cent on a rolling 4 quarter-on-4 quarter basis, which was to be assessed by the OBR

[52] OBR. Fiscal risks report, July 2019, paras 8.3 – 8.16.

5 Why have fiscal targets?

Broadly speaking, governments use fiscal targets to constrain future behaviour so that difficult choices about tax and spending are taken. Fiscal rules can be used to enhance transparency and signal a government's intentions to voters and financial markets. They can also help the Treasury manage competing bids for increased spending or tax cuts.

Effective targets can lead to lower borrowing, and debt over the long term, than would otherwise be the case. [53] They can enhance the sustainability of the public finances.

Effectiveness

The International Monetary Fund (IMF) has found fiscal rules are associated with better performance in the public finances. However, this doesn't necessarily mean that the rules cause better outcomes. Rules might be adopted at a time when there has been a crisis that is then followed by a period of consolidation, which may well have happened regardless of a rule being in place. Also, countries using fiscal rules may actively prefer effective management of the public finances. [54]

The IMF argue that for fiscal rules to be effective they should have three main properties:

- simplicity;
- flexibility; and,
- enforceability. [55]

The IMF found that successful rules are linked to objectives for keeping the public finances sustainable, are easy to understand, and support fiscal policies that adapt to the economic cycle.

[53] IFS. Green Budget 2019, October 2019, Chapter 5

[54] IMF. Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability, April 2018, Executive , page 15

[55] ibid. page 7

Appendix 1: Previous fiscal rules from the Charter for Budget Responsibility

Fiscal rules since the introduction of the Charter for Budget Responsibility		
April 2011 Charter	Fiscal mandate	A forward-looking target to achieve cyclically-adjusted current balance by the end of the rolling, 5-year forecast period
	Supplementary debt target	a target for public sector net debt as a percentage of GDP to be falling at a fixed date of 2015-16
March 2014 Charter	Fiscal mandate	Same as April 2011 Charter
	Supplementary debt target	Same as April 2011 Charter
	Welfare cap	the cap on welfare spending, at a level set out by the Treasury in the most recently published Budget report, over the rolling 5-year forecast period, to ensure that expenditure on welfare is contained within a predetermined ceiling
December 2014 Charter	Fiscal mandate	a forward-looking aim to achieve cyclically-adjusted current balance by the end of the third year of the rolling, 5-year forecast period
	Supplementary debt target	an aim for public sector net debt as a percentage of GDP to be falling in 2016-17
	Welfare cap	Same as March 2014 Charter
October 2015 Charter	Fiscal mandate	In normal times, once a headline surplus has been achieved: a target for a surplus on public sector net borrowing in each subsequent year
		For the period outside normal times: a target for a surplus on public sector net borrowing by the end of 2019-20
	Supplementary debt target	[for the period until 2019/20] a target for public sector net debt as a percentage of GDP to be falling in each year
	Welfare cap	Same as March 2014 Charter
January 2017 Charter	Fiscal objective	return the public finances to balance at the earliest possible date in the next Parliament

	Fiscal mandate	to reduce cyclically-adjusted public sector net borrowing to below 2% of GDP by 2020-21
	Supplementary debt target	public sector net debt as a percentage of GDP to be falling in 2020-21
	Welfare cap	a target to ensure that expenditure on welfare in 2021-22 is contained within a predetermined cap and margin set by the Treasury at Autumn Statement 2016
January 2022 Charter	Fiscal mandate	to have public sector net debt (excluding the Bank of England) as a percentage of GDP falling by the third year of the rolling forecast period
	Supplementary target	a target to balance the current budget by the third year of the rolling forecast period
	Welfare cap	a target to ensure that expenditure on welfare is contained within a predetermined cap and margin set by the Treasury
	Investment limit	a target to ensure that public sector net investment does not exceed 3% of GDP on average over the rolling forecast period

Source: OBR. Legislation and related material [accessed on 20 September 2021]