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The UK's fiscal targets

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Contents

Summary

Since the 1990s UK governments have adopted targets to constrain its management of the public finances. The public finance targets (or fiscal targets) have changed regularly but they have generally focused on government borrowing and government debt.

The latest iteration of the targets came into force in February 2023 under the Conservative government. The new Labour government proposes changing some of the targets. The targets are included in the Charter for Budget Responsibility (the Charter). The House of Commons must approve changes to the Charter.

What are the existing (February 2023) targets?

There are currently targets for government borrowing and government debt. There is also a cap on welfare spending.

If the government wants to spend more than it raises from taxes and other sources of income, it borrows. The government's borrowing target is for:

- government borrowing to not exceed 3% of GDP in the fifth year of the forecast period.

Government debt is, broadly speaking, the stock of government's past borrowing. The target for government debt is for:

- government debt to be falling, as a % of GDP, in the fifth year of the official forecasts.

The debt target focuses on public sector net debt excluding the Bank of England, which is sometimes described as the government's underlying debt.

The debt target is the government's main target, or 'fiscal mandate'.

The government also has a spending cap for welfare, which sets limits on the amount that can be spent on certain social security benefits and tax credits.

The fiscal targets are set out in the Charter for Budget Responsibility which explains how the government manages the public finances.

Are the targets being met?

The Office for Budget Responsibility (OBR), the UK's public finances watchdog and producer of the official forecasts, reports on whether the targets are being met. In its March 2024 forecast, the OBR said that both the borrowing and debt targets are being met.

The welfare cap won't be formally assessed until the first OBR forecast in the next Parliament. Currently, the OBR forecasts that the welfare cap will be missed when it is formally assessed.

What changes does the Labour government propose?

Labour's manifesto for the 2024 General Election says it will change the fiscal rules. The manifesto proposes the following rules:

- balancing the current budget, so that day-to-day costs are met by revenues
- debt must be falling as a share of the economy by the fifth year of the forecast

If introduced, the first of these rules would replace the existing borrowing rule with one that focuses on the 'current budget'. The current budget excludes government's investment spending.

On the face of it, Labour's proposed debt rule is very similar to the existing debt rule. However, the details are yet to be set out. There has been speculation that Labour might target a different measure of government debt, rather than the underlying debt used in the existing rule. The government says it "will set out the precise details of our fiscal rules at the Budget on 30 October, alongside an updated OBR forecast."

To change the existing rules, the Chancellor will need to lay a revised Charter before Parliament. The Charter will come into force once it has been approved with a vote of the House of Commons.

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 manages the public finances.

The fiscal framework is largely set out in the Charter for Budget Responsibility (the Charter).[1] 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 February 2023.[2] It was proposed in the 2022 Autumn Statement.[3]

1.2 What's in the Charter for Budget Responsibility?

Among 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 should 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 HM Treasury. Charter for Budget Responsibility: Autumn 2022 update, 26 January 2023
2 HC Deb 6 February 2023 [Charter for Budget Responsibility].
3 HM Treasury, Charter for Budget Responsibility: Autumn 2022 update, 17 November 2022

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

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 with a vote of the House of Commons.[4]

Modifying the Charter's guidance for the OBR requires an additional step. When the Treasury wishes to modify the Charter's guidance for the OBR, it publishes a draft of the revised guidance at least 28 days before it lays the revised Charter before Parliament.[5]

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 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 and Labour's proposed targets in section 3.

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.

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4 Budget Responsibility and National Audit Act 2011, section 1

5 Budget Responsibility and National Audit Act 2011, section 6

2 The current Charter (February 2023) and fiscal targets

The current fiscal targets were proposed by the then Chancellor, Jeremy Hunt MP, alongside Autumn Statement 2022.[6] They came into force in February 2023, once a revised Charter for Budget Responsibility was approved by the House of Commons.[7] The previous Charter and targets had been in place since January 2022 (see section 5 and Appendix 1).

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 fiscal targets set out how the government plans to meet the objective.

2.2 Fiscal targets

For most of the past quarter of a century, UK fiscal targets have focused on debt and some measure of government borrowing. The current targets do likewise, and they are supplemented by a welfare spending cap, which was first introduced in 2014.

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 fifth year of the OBR's forecast
- for public sector net borrowing to not exceed 3% of GDP by the fifth year of the OBR's forecast
- to ensure that spending on welfare is contained within a predetermined cap set by the Treasury

6 HM Treasury, Charter for Budget Responsibility: Autumn 2022 update, 17 November 2022
7 HC Deb 6 February 2023 [Charter for Budget Responsibility].

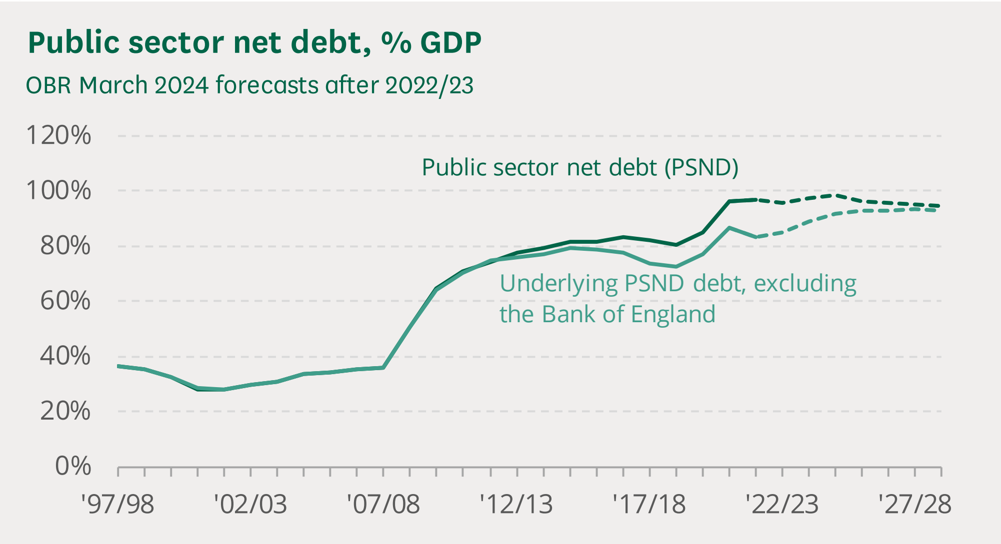
Government debt (public sector net debt)

When governments spend more than they receive from taxes and other income, they borrow. The borrowing adds to the stock of government debt. Governments borrow in most years, so a significant stock of outstanding debt has built up over time. The total stock of government debt is officially known as public sector net debt.

The government's debt target focuses on 'underlying' public sector net debt. The underlying measure of public sector net debt excludes the net debt of the Bank of England.[8] The target – which is described as the fiscal mandate – is to have public sector net debt (excluding the Bank of England) as a % of GDP falling by the fifth year of the rolling forecast period.

By excluding the Bank of England, underlying public sector net debt is more closely associated with the government's choices around spending and tax.[9] It is thought to be a better measure of the government's underlying debt, because it removes some Bank of England schemes that add to debt only temporarily.[10]

The debt target is being met in the OBR's latest assessment.



Source: OBR. Public finances databank – March 2024 (accessed on 21 March 2024)

[8] Box 3.1 of IFS Green Budget 2021 explains that the Bank contributes to "public sector net debt through its purchases of government gilts and (to a much smaller extent) corporate bonds in the context of quantitative easing, and through its two Term Funding Schemes which offer loans to firms to support the economy in the wake of the 2016 referendum and the COVID-19 pandemic (the TFSME, or Term Funding Scheme for small and medium enterprises)"

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

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

Is the target being met?

The OBR say that the debt target is being met (March 2024). It estimates that, based on currently government policy, there's a 54% change of debt falling in the fifth year of the forecast (2028/29).[11]

The OBR's March 2024 has the underlying debt-to-GDP ratio (excluding the Bank of England) falling by 0.3% of GDP (a margin of £8.9 billion) in 2028/29.[12]

Borrowing target

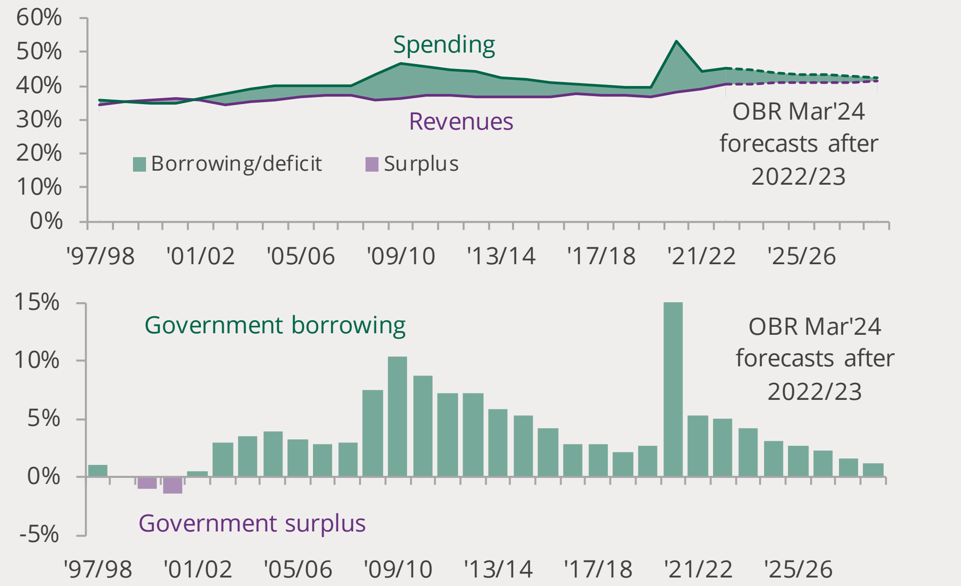
Public sector net borrowing is the difference between total government spending and total government revenues from taxes and other sources. It is often referred to as the budget deficit.

The government's borrowing target is to ensure that public sector net borrowing does not exceed 3% of GDP in the fifth year of the forecast period.

The borrowing target is being met in the OBR's latest assessment.

Government borrows when spending is higher than revenues

Government spending, revenues and borrowing, % of GDP, from 1997/98



Source: OBR. Public finances databank – March 2024 (accessed on 21 March 2024)

Is the target being met?

The OBR say that the borrowing target is being met in its latest forecast (March 2024). It estimates, based on currently government policy, there's a

11 OBR, Economic and fiscal outlook – March 2024, para 5.4

12 OBR, Economic and fiscal outlook – March 2024, para 5.4

72% chance of public sector net borrowing being below 3% of GDP in the fifth year of the forecast (2028/29).[13]

In 2028/29, public sector net borrowing is forecast to be equivalent to 1.2% of GDP. The target is therefore being met with a margin of around 1.8% of GDP, which is equivalent to £56.8 billion.[14]

1: Rolling targets

Both the debt and current budget targets are rolling targets to be achieved in the fifth year of the forecast. The OBR's latest forecast was produced during 2023/24, so the target year is 2028/29. Once we move into 2024/25, the target year will roll onto 2029/30. The Treasury could have alternatively chosen to use fixed date targets, fixed on a specific year or period.

Rolling targets and fixed year targets each have 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. This is because Chancellors can loosen fiscal policy in the near years, but present tighter plans in the future target year to meet the target.[16]

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.[17] The cap covers around 50% of welfare spending, excluding pensions and Jobseekers Allowance payments, but including tax credits, child benefit and disability benefit.[18]

The cap is currently set at £134.7 billion in 2024/25. A margin of 2% applies so the effective cap is £137.4 billion.[19]

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[13] OBR, Economic and fiscal outlook – March 2024, para 5.4
[14] OBR, Economic and fiscal outlook – March 2024, para 5.4
[15] OBR. Economic and fiscal outlook – October 2021, paras 4.29-4.32
[16] as above
[17] It entered into the Charter in the March 2014 update.
[18] OBR. Economic and fiscal outlook – October 2021, Table 3.20
[19] OBR. Economic and fiscal outlook – March 2024, Table 5.2

How does the cap work?

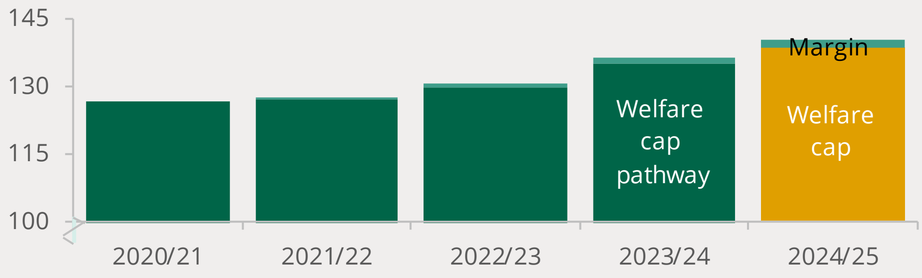
The Treasury sets the level of the cap and the year in which it will apply, at or before the first fiscal event of each new Parliament.[20] At the same time the Treasury sets a pathway for relevant welfare spending in each year running up to year of the welfare cap. The Treasury also sets the percentage margin for the cap and pathway in each year. The margin is set as a percentage of either the pathway or the cap. The margin can be used for general pressures on welfare spending, as well as changes in the forecast.

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.[21] The cap was reset in line with the OBR's October 2021 forecast. The OBR reports that "[t]he 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."[22]

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

£ billion



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

The only formal assessment of the welfare cap comes in the first Budget or fiscal event of a Parliament. However, the OBR monitors progress between these official assessments. In its March 2024 forecast, the OBR assesses that the welfare cap is on course to be missed by around £7.4 billion.[23] This isn't a formal assessment, so the cap hasn't officially been broken.

[20] Fiscal events are understood to mean budgets, autumn statements or spring statements.

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

[22] OBR. Economic and fiscal outlook – October 2021, para 4.16

[23] OBR, Economic and fiscal outlook – March 2024, para 5.4

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 explain what constitutes a significant shock.

If the targets are suspended, at each subsequent Budget the Chancellor must set out to Parliament how the government plans 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 Commentary on the targets

The current targets, in effect since February 2023,[24] are looser than the ones they replaced, as they're focussing on the fifth year, rather than the third year, of the forecast period.

Looser targets

Paul Johnson, Chair of the Institute for Fiscal Studies, says that the Chancellor has set himself the "loosest of fiscal rules".[25] The Resolution Foundation agrees that the targets are "looser than their predecessors" as they give the Chancellor significant flexibility on the timetable over which he reduces debt and borrowing and how he does it.[26]

The Chancellor says it's reasonable to have a later target year for the fiscal rules given the recent Covid-19 pandemic and the energy crisis:

> It is reasonable to change the time period over which our fiscal rules operate from three years to five years, given that we are dealing with a once-in-a-century pandemic and an energy crisis that is the biggest since the 1970s. People still want to know that there is a serious intention to reduce our debt. That is why it is important to have fiscal rules. [27]

He has also argued that tighter fiscal rules following the Covid-19 pandemic and energy crisis would have meant further spending cuts or tax rises:

[24] HC Deb 6 February 2023 [Charter for Budget Responsibility].
[25] IFS. Autumn Statement 2022: IFS analysis, 18 November 2022
[26] Resolution Foundation, Help today, squeeze tomorrow: Putting the 2022 Autumn Statement in context, November 2022, Box 4
[27] Treasury Committee. Oral evidence: Autumn 2022 Fiscal Events, HC 740, 23 November 2022, Q438

> If I had stuck with tighter fiscal rules in that context, I would have had to do an even bigger consolidation than I had to in the autumn statement of 2022. It would have choked even more growth out of the economy, whether it was through spending cuts or tax rises.[28]

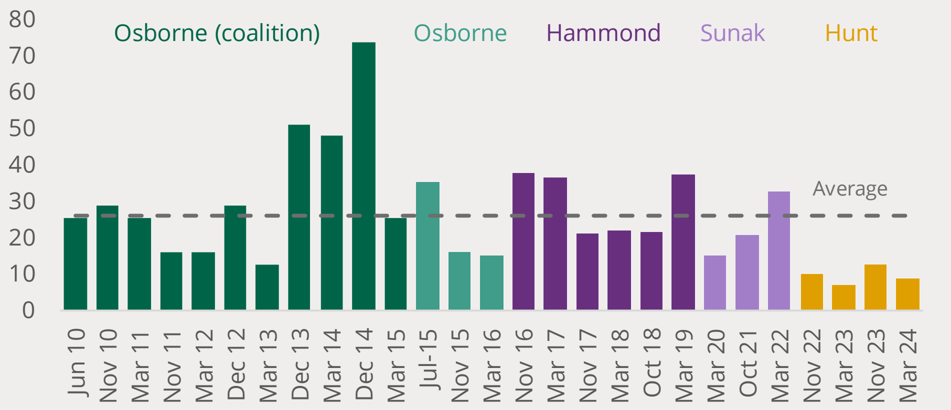
When introducing the current targets, the Treasury said that the targets share the principles of their immediate predecessors. However, sticking with the previous 3-year targets would have required "at least an additional £11.4 billion of spending cuts or higher taxes at this event [Autumn Statement 2022] on top of the difficult, but necessary, decisions already taken."[29]

Meeting the targets

Since being introduced, the latest debt target has been met by a relatively small margin. In the OBR's March 2024 forecast, the margin against the fiscal mandate (the debt target), was the second lowest since the OBR was established in 2010.[30]

Chancellor Hunt has a small margin against his fiscal target

Successive forecasts for headrooms against fiscal targets, £ billion



Notes: For comparability with headroom against the current fiscal mandate, past headrooms have been calculated in percent of GDP as forecast at the time and multiplied by the OBR's latest forecast for nominal GDP in 2028/29. For November 2016 and March 2020, the OBR have used the Chancellor's headroom against his proposed mandate at the time.

Source: OBR. Economic and fiscal outlook – March 2024, Chart 5.3

Government debt wasn't the focus of the main fiscal rule (the fiscal mandate) for all previous Chancellors.

Following the 2022 Autumn Statement, the Chancellor said that the margin for the debt target, which was then £9 billion, was "very small". He explained that:

[28] Treasury Committee. Oral evidence: Budget 2024, HC 625 (PDF), 23 November 2022, Q236
[29] HM Treasury. Autumn Statement 2022, November 2022, para 1.16
[30] OBR. Economic and fiscal outlook – March 2024, 6 March 2024, para 5.10

> If we are going to be sensible about this, we have to have a central scenario based on our best guess of what is going to happen to energy prices, produce a set of accounts based on that and recognise that, when it comes to the spring Budget and next year's autumn statement, these things may change.[31]

The OBR says that getting the debt-to-GDP ratio falling in the medium term is now harder than it has been since the OBR was established in 2010. This is due to weaker growth prospects, a larger stock of debt and interest rates tripling since 2022.[32]

2.4 Management of fiscal policy

Since January 2022, the Charter includes a 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 had, up until recently, been at historical lows but spending on debt interest has become more sensitive to changes in inflation and interest rates than was previously the case, as we explain below.[33] The Treasury is monitoring the affordability of debt interest costs, including its sensitivity to changes in the wider economy, such as changes in inflation and interest rates. The Treasury is also monitoring 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 says 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. It is currently making relatively high payments, but up until mid-2021 government's debt interest costs were relatively low. In fact, relative to tax revenues, debt interest costs reached a 320-year low during the coronavirus pandemic.[34] As Chancellor, Rishi Sunk said 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

[31] Treasury Committee. Oral evidence: Autumn 2022 Fiscal Events, HC 740, 23 November 2022, Q439

[32] OBR, Economic and fiscal outlook – March 2023, para 1.26. Box 5.1 of the OBR's March 2023 forecast explores why reducing debt has eluded successive Chancellors since the 2008 financial crisis and why recent developments have made this task harder.

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

[34] IFS. Green Budget 2020: Chapter 4, 13 October 2020, Figure 4.14

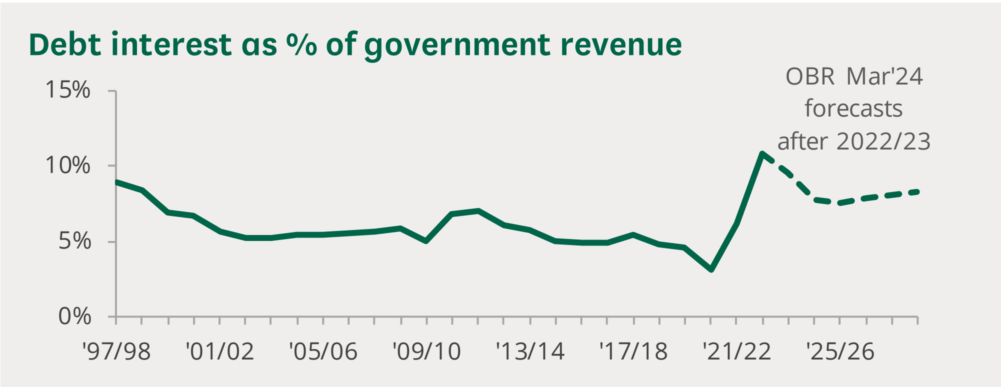
high our debt now is, we need to pay close attention to its affordability."[35] The Treasury is therefore monitoring the affordability of public debt.

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).[36] 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 more 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 the early 1980s and Bank Rate has increased from 0.25% in December 2021 to 5.25% today (March 2024).[37] Government's spending on debt interest has quickly increased.[38]

The Charter doesn't set out specific indicators of debt affordability to monitor, but the OBR discusses debt interest as a % of GDP and as a % of revenues. As the chart below shows, government's spending on debt interest, as a % of revenues, was higher in 2022/23 than it has been in the recent past. Forecasts suggest that debt interest will remain at a level last seen in the mid-1990s, relative to revenues.



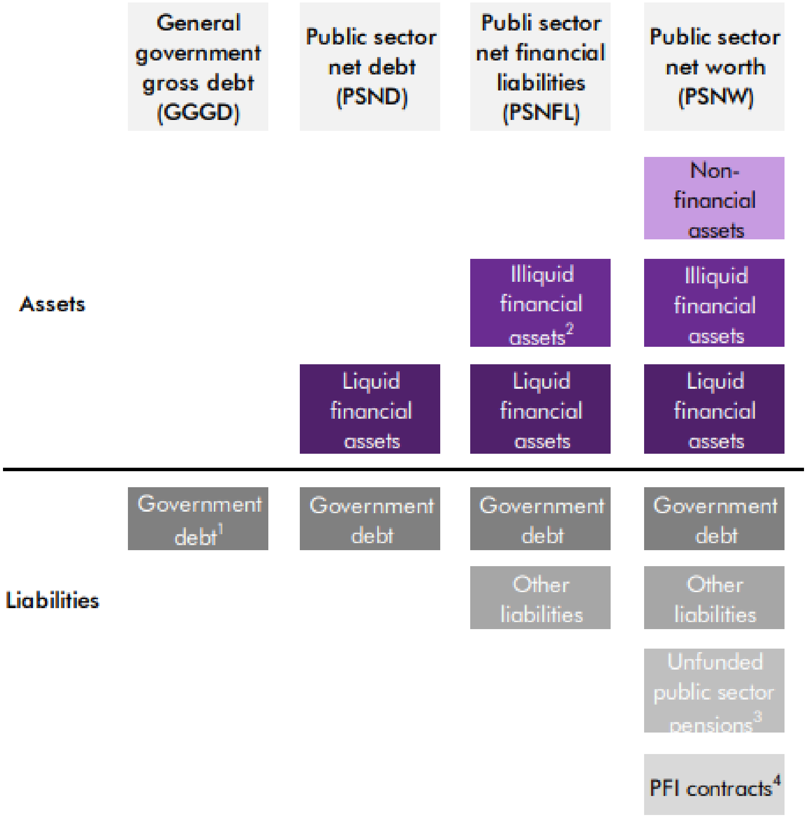
Source: OBR. Economic and fiscal outlook – March 2024, Chart 4.12

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.

35 HC Deb 3 March 2021 [Financial Statement].
36 For more on this see Box 10 of Coronavirus: Economic impact
37 ONS series CZBH; Bank of England. Interest rates and Bank Rate [accessed on 27 November 2023]
38 OBR. Economic and fiscal outlook – March 2022, para 3.112

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 ESA 10.

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

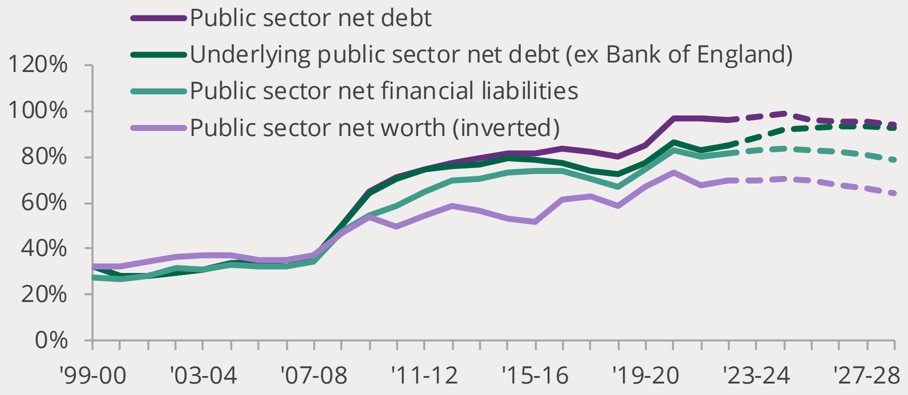
The Treasury says it is assessing the public finances from a broader perspective, considering the entire balance sheet, to improve fiscal policy. It will aim to strengthen a range of measures including PSND, Public Sector Net Financial Liabilities (PSNFL) and Public Sector Net Worth (PSNW). The chart above compares 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. [39]

The OBR says that focusing on the wider balance sheet could reduce a risk that arises out of PSND's narrow definition.[40] PSND 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

[39] OBR. Working Paper No.16 Forecasting the balance sheet: Public Sector Net Worth, October 2021
[40] OBR. Economic and fiscal outlook – October 2021, paras 4.26-4.28

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.

Alternative measures of the public sector balance sheet



Notes: PSNW has been inverted to facilitate comparisons with the other three metrics. PSNW is measured by assets minus liabilities, whereas the other three metrics are calculated as liabilities minus assets.

Source: OBR. Economic and fiscal outlook – March 2024, Chart 4.18

3 Labour government's proposed fiscal rules

3.1 Proposals in Labour's 2024 manifesto

Borrowing and debt rules

Labour's manifesto for the 2024 General Election proposed revising the borrowing target and continuing with a debt target that appears to be like the existing one.

Labour proposes the following fiscal rules:[41]

- the current budget (see Box 2) should move into balance, so that day-to-day spending is met by government revenues.
- debt must be falling as a share of GDP by the fifth year of the forecast.

Focusing on the current budget would allow borrowing for investment spending. Labour hasn't yet set a target year for reaching a current budget balance.

Labour's proposed debt rule appears to be very similar to the existing debt rule. However, the details of the rule are yet to be set out so it could be defined differently. For instance, there has been speculation that it could focus on all public sector net debt, not just underlying debt (public sector net debt excluding the Bank of England).[42] The government says it "will set out the precise details of our fiscal rules at the Budget on 30 October, alongside an updated OBR forecast".[43]

The Institute for Fiscal Studies' article, Definition of debt and the new government's fiscal rules, explains the key differences between the two debt measures.

An escape clause and changes to the fiscal framework

The Chancellor, Rachel Reeves, provided further details about the fiscal rules in a speech in March 2024.[44] An escape clause will apply so the rules can be suspended if the OBR declares that the UK is in an economic crisis. What

[41] Labour. Labour Party 2024 maniesto
[42] Reeves plans to 'fiddle' fiscal rules to boost borrowing, claim Tories, FT, 4 September 2024
[43] HC Deb 4 September 2024 c377
[44] Labour. Rachel Reeves Mais Lecture 2024, 19 March 2024

constitutes an economic crisis hasn't been defined. This differs from the government's approach for suspending its fiscal rules (see section 2.2), where the OBR has no specific role.

Labour proposes changes to the wider fiscal framework:

- the OBR will report on the long-term impact of investment (capital) spending decisions;
- the Chancellor will report on wider measures of public sector assets and liabilities at fiscal events, showing how decisions affect these measures;
- any government making significant and permanent tax and spending changes will be legally required to commission an independent forecast from the OBR.

2: Different 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.

How will the government change the rules?

As discussed in section 1.2, to change the rules the Treasury needs to lay a revised Charter before Parliament. This will come into force once it has been approved with a vote of the House of Commons.[45]

A new Charter will be published on 30 October 2024, alongside the 2024 Autumn Budget.[46] The revised Charter is likely to also include changes to the guidance for the OBR.[47] If this is the case, 28 days will have to pass from the draft revised Charter being published to it being laid before Parliament (see section 1.2).

45 Budget Responsibility and National Audit Act 2011, section 1

46 HM Treasury. Chancellor letter to Richard Hughes: Forecast commission and spending audit, 29 July 2024

47 The Budget Responsibility Bill, which is currently passing through Parliament, will necessitate changes to the OBR's guidance, as set out in the Charter.

4 Fiscal targets: Alternative approaches

4.1 Economists' opinions

Prominent think tanks and other economists have discussed what good fiscal targets should look like.

Institute for Government

The Institute for Government (IfG) argue that the UK needs to reform its wider fiscal framework. It says that revised fiscal rules should continue to be part of a revised framework.[48]

Specifically, the IfG recommends that fiscal rules should:

- treat investment differently to current spending;
- specify targets as a range rather than specific points, for instance a rule which aimed to be met within +1% or -1% of GDP;
- focus on the third year of the forecast, rather than the fifth;
- have an escape clause, making clear the economic circumstances under which they should temporarily be suspended.

The IfG also says that the OBR's remit should be expanded so that:

- at every fiscal event, the OBR has greater flexibility in its assessment of both the government's rules and its performance against them with licence to consider progress against fiscal sustainability;
- whenever fiscal rules are changed, the OBR assesses whether they are consistent with the government's fiscal objectives – before the revised rules are voted on by Parliament;
- the OBR makes a recommendation of how much headroom the Chancellor should maintain against the fiscal rules, taking into account economic conditions and uncertainty;
- it can assess whether the conditions to trigger the fiscal rules escape clause are met.

[48] IfG. Strengthening the UK's fiscal framework: Putting the fiscal rules in their place, 29 February 2024

The IfG says that the fiscal framework would be strengthened by only having one fiscal event a year and a regular cycle of spending reviews, which set out government departments' budgets.

National Institute of Economic and Social Research (NIESR)

NIESR says that the fiscal targets should be scrapped and replaced with more focus on evaluating policy. Its analysis argues that fiscal rules:

> 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. [49]

NIESR says 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 are 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 reasons that fiscal rules should focus more on the public sector's balance sheet, potentially 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 (see section 2.4).[50]

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

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

In 2019, the Resolution Foundation recommended that the government should follow the below rules. It continued to do so following the Covid-19 pandemic: [51]

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

The Resolution Foundation also looked at international experience and found that 'effective and durable rules' should: [52]

- 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: [53]

- 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.

The IFS says 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, it points out that "the split

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[51] 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

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

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

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 says that setting an appropriate target for debt is difficult, not least because there is no consensus over the right level of debt. It does, 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 says that there should be a focus on the 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 firm and fixed fiscal targets, it would be better to have "rough rules of thumb that Chancellors should strive to keep to in most periods".

Other economists

Professor Joseph Stiglitz, recipient of the Nobel Memorial Prize in Economic Sciences, says fiscal rules need to be flexible and should be suspended in exceptional times. He also says that fiscal rules should pay attention to how governments spend money.[54]

Andy Haldane, former chief economist of the Bank of England, argues that the UK's fiscal rules have constrained investment and growth. He says that focusing on public sector net debt fails to recognise the assets created from public investment such as roads, hospitals, schools, intellectual property, and natural assets.[55] Focusing on a measure such as public sector net worth could address this issue.

Economists Olivier Banchard and Tim Leunig separately propose a departure from the UK's recent approach to fiscal rules:[56]

- Mr Leunig advises that instead of fiscal rules the OBR should, just before the Budget, write 250 words summing up the position of the UK's public finances. The Chancellor would be required to read out the statement as part of the budget statement.[57]

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54 Economic Affairs Committee. How sustainable is our national debt?, Q200-201 (PDF), 5 March 2024

55 "The case for rethinking fiscal rules is overwhelming", FT, 16 May 2023

56 Olivier Blanchard is the Robert M. Solow Professor of Economics emeritus at the Massachusetts Institute of Technology (MIT) and the C. Fred Bergsten Senior Fellow at the Peterson Institute for International Economics. Tim Leunig was economic adviser to Chancellors Sunak and Javid.

57 "A former adviser on the 250 words Jeremy Hunt should read out at the budget", The Economist, 4 March 2024

- Mr Blanchard says the OBR should carry out a "debt sustainability analysis" to show the likely trajectory of debt, taking into account the uncertainty, and the probability that it may be on an exploding path.[58]

4.2 Fiscal rules around the world

The International Monetary Fund (IMF) estimates that as of end-2021, about 105 countries have adopted at least one fiscal rule. [59] Their main aims are to:[60]

- 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 over 100 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.

A Resolution Foundation report, from October 2019, looks at international experience of fiscal rules.[61]

58 Economic Affairs Committee. How sustainable is our national debt?, Q170 (PDF), 20 February 2024
59 IMF. Fiscal Rules and Fiscal Councils: Recent trends and performance during the COVID-19 pandemic, January 2022, page 6
60 IMF. Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability, April 2018, Executive Summary
61 Resolution Foundation. Britannia waives the rules? Lessons from UK and international experience with fiscal rules, 21 October 2019

5 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.[62] Appendix 1 summarises the revisions to the fiscal targets, and introduction of the welfare cap in the various versions of the Charter for Budget Responsibility.

5.1 Labour government (1997-2010)

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 2007-2009 financial crisis came, these rules were suspended, and a new framework was introduced.[63] The rules were replaced in the Fiscal Responsibility Act 2010.[64]

5.2 Coalition government (2010-2015)

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.

62 A summary is available in paragraph 8.9 of the OBR’s Fiscal Risk Report – July 2019
63 HM Treasury. Pre-budget report 2008, page 15
64 Further information is available in the Library briefing Fiscal Responsibility Bill (2009-10).

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.

The welfare cap was first introduced by the Coalition government in March 2014.

5.3 Conservative government (2015-2022)

David Cameron's government

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 in all years to 2019/20. The Conservative government's fiscal rules could be overridden in the face of a significant adverse economic shock.[65]

Theresa May's government

Theresa May's Conservative government introduced new rules 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.

The operation of the welfare cap was changed in January 2017.

Boris Johnson's government

Boris Johnson's government announced new fiscal rules in the 2021 Autumn Budget and Spending Review.

The fiscal mandate was for underlying public sector net debt (excluding the Bank of England) to be falling as a percentage of GDP by the third year of the forecast period.

[65] 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

The medium-term borrowing target was for current budget to be balanced in the third year of the forecast period.

The Johnson government also introduced a cap for investment spending. 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 Johnson government put a limit on investment spending of 3% of GDP per year, across the OBR's 5-year forecast period.

5.4 Comment on the use of fiscal targets

According to the OBR some broad points can be made about UK governments' use of fiscal rules over the past decade: [66]

- 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." That isn't to say that the OBR believe a rule should be followed in all circumstances; it believes that some shocks will warrant it being overridden.

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

6 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, showing that it is committed to managing the public finances well. 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. [67] They can enhance the sustainability of the public finances.

The Institute for Government's Strengthening the UK's fiscal framework: Putting the fiscal rules in their place discusses these issues in more detail.[68]

6.1 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. [69]

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

- simplicity;
- flexibility; and,
- enforceability. [70]

[67] IFS. Green Budget 2019, October 2019, Chapter 5; Diaz Kalan, Popescu and Reynard (2018), 'Cost of not complying with fiscal rules: A European perspective', Second generation fiscal rules – background papers, IMF.

[68] IfG. Strengthening the UK's fiscal framework: Putting the fiscal rules in their place, 29 February 2024

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

[70] ibid. page 7

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.

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
January 2023 Charter	Fiscal mandate	to have public sector net debt (excluding the Bank of England) as a percentage of GDP falling by the fifth year of the rolling forecast period
	Supplementary target	a target to ensure public sector net borrowing does not exceed 3 percent of GDP by the fifth 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

Source: OBR. Legislation and related material [accessed on 9 January 2024]

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