It's ridiculous! The disarray of our fiscal system leaves voters short-changed

Our fiscal policies are in disarray, and this will leave voters short-changed. ***Jagjit S. Chadha*** *(NIESR) explains that fiscal policy planning has just taken a huge retrograde step with the delay in a budget, spending plan and official economic forecast. Furthermore, he argues that whatever government we end up with is unlikely to reach its self-imposed fiscal mandate and that an unfunded spending spree risks unhinging fiscal policy even further.*

The fiscal framework adopted in 2010 built on the success of the experience with monetary policy. The basic mechanism, which was replicated to a great degree in the fiscal case, is that a macroeconomic target that suits society is pursued transparently with the support of independent forecasts of whether the target will be achieved. The target and instrument are bound together by a rule that explains how the instrument will respond to the state of the economy. The advantage of rules-based policies is that other participants in the economy can formulate their plans in a manner consistent with the target and if the policy-maker is going to miss the target, there is scope to explain why and how the economy will get back on track. By binding people into a common path of adjustment, it simply becomes easier to meet the target, which should be exactly what society wants anyway. While monetary policy has more or less been bound by such a framework, our fiscal policy is more or less in disarray.

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The basic approach to rules-based policy led to a number of excellent innovations in monetary decision-making. We first set a target consistent with price stability and moved from Treasury-determined interest rate-setting through to operational independence of the Bank of England. We have a fixed timetable for monetary policy decision-making, the quarterly production of an inflation forecast, the creation of a transparent decision-making process at the Monetary Policy Committee and a fillip to Parliamentary scrutiny of monetary policy at the Treasury Committee. As well as promoting a strong national interest in interest rate decisions, that might be more than just thinking about the mortgage, it has also focussed the attention of the key institution on meeting its target, which helped us deal with the shock and aftermath of the financial crisis. All of the above have contributed to nominal stability. Across town the story is woeful.

The fiscal targets have not only been rather opaque and portmanteau but have been changed as often as the instrument itself, the deficit. We have had nearly has as many different sets of fiscal rules in the nine years or so since we adopted rules-based fiscal policy. There are three fundamental problems here that explain why we keep changing targets. First, it is not really possible to write down a socially optimal level of public debt: as it is simply not a fixed point or timeless quantity. The second is that the quantity of debt, per se, does not really matter unless scaled by output and from year to year that is determined by fluctuations in demand and in the long run by the growth in supply potential and so is largely outside the control of the government. And finally that the key fiscal instrument, the year to year budget deficit, is rather complicated as it depends on each of public expenditures, taxes raised and the interest rate paid on debt. In the language of economics, it is a very noisy instrument rather than the direct control of Bank Rate available to the MPC.

And so it is hardly a surprise that targets have been missed and rules changed. Indeed we do not even have a clear timetable for fiscal events. We have shifted the date of the budget from spring to autumn and now are poised to move it back again. Currently, government departments are having to work with a one-year spending plan, rather than the three-year version that was promised. And to add insult to injury, the Office for Budget Responsibility that is responsible for modelling the government's fiscal plans has had its forecast shelved at the last minute. These independent forecasts would have allowed the electorate to understand whether the government would have hit its self-imposed targets, which the same government had decided on the day the previously announced budget had been cancelled to drop anyway, in favour of another set of rules. Yes: it is that ridiculous.

Fortunately, NIESR published its own analysis the previous week, which explained that the government would not reach its fiscal mandate and that an unfunded spending spree risked unhinging fiscal policy as well as missing the chance to set right the shortfalls in sustained public investment in physical and human that are required. Indeed the muting of the OBR also means that other parties do not feel the censor of an open discussion of their spending plans with a required explanation of accompanying plans for their funding – also known as taxes in grown-up circles. Where does this all end? It ends with increased risk of a further official downgrade of our fiscal position by the ratings agencies. In case you missed it, Moody's took the first step on 9 November by changing the outlook on its rating of the UK's debt from "stable" to "negative".

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