

# Rachel Reeves should rethink the fiscal rules

*During her first big speech as Chancellor, Rachel Reeves re-committed to following the fiscal rules during Labour's time in government. **Iain Begg** examines the shortcomings of the fiscal framework Reeves has inherited, and argues that the UK should learn from its European counterparts when it comes to using public expenditure to advance the Government's priorities.*

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Two perspectives on the public finances kept surfacing during the election campaign. The first was that all policy proposals had to be carefully costed to ensure that the fiscal rules, the restrictions governments impose on themselves with the aim of assuring the sustainability of the public finances, would not be breached. Research by [the IMF](#) offers definitions and shows how such rules have proliferated.

This perspective was, perhaps, unavoidable during an election campaign, especially for parties competing with each other on fiscal responsibility, except that there was scarcely any questioning of these rules or what they entail.

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Second, independent commentators (notably the Institute for Fiscal Studies) warned relentlessly that what parties were proposing in their manifestos did not add up and therefore lacked credibility. The message was that some public spending would have to be cut, taxes would have to rise, higher debt would have to be accepted, or all three at the same time – a trilemma that neither Labour nor the Conservatives, let alone the smaller parties, acknowledged.

In the short-term, accepting higher debt may be the easiest solution, not least because the likely fall in interest rates would lessen the burden of debt service. But it is no panacea and the new government will need to be wary of allowing the debt burden to

escalate. Rather it will need a medium-term strategy to lower the debt to GDP ratio, including by raising the level of GDP through stronger growth.

Following the global financial crisis, when public debt surged, the UK has had a framework for the governance of fiscal policy first established in the early years of the coalition government and set out in the [Charter for Budget Responsibility](#). Its key innovation was the establishment of the Office for Budget Responsibility with a mandate to assess government plans, alongside a new approach to fiscal rules.

The Charter has been revised several times and in the latest version, agreed in 2022 after the fiasco of the Truss premiership, the primary fiscal rule obliges the government to ensure that public debt will fall as a proportion of GDP in five years' time. This, as a scathing report from the [Institute for Government](#) asserts, incentivises “bad policy decisions shaped by short-termism and fictional spending plans – and does little to promote fiscal sustainability”.

It is also easily forgotten that, in the decade prior to the pandemic, the framework failed to curb the rise in debt, up by some fourteen percentage points of GDP between 2010 and 2019. Yet, in her [Mais lecture](#), Rachel Reeves said she proposed to abide by these rules. How, then, might a better fiscal framework be constructed?

There is no magic number of an optimal level of public expenditure, but the total has to represent a political choice about how much a country is prepared to tax its citizens and businesses.

First, experience from other countries with far more favourable fiscal arithmetic, measured either by the debt ratio or by the size of the current public deficit should be drawn upon to identify both alternatives for fiscal rules and other features of fiscal governance. In Sweden, Denmark and the Netherlands (with debt to GDP ratios well under half of the UK's) a medium-term approach, agreeing a programme for a full parliament rather than annual budgets is central. They also try to take account of longer-term challenges, notably demographic change.

All three of them also focus more on the medium term evolution of public expenditure (which the government controls directly) rather than the deficit or the debt. There is no magic number of an optimal level of public expenditure, but the total has to represent a political choice about how much a country is prepared to tax its citizens and businesses.

Expenditure rules have increasingly been seen as the better option elsewhere and are now at the heart of the revised [EU approach](#) in place since the start of May 2024.

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Second, economic growth, placed at the heart of Labour's economic policy, should also be reflected in the fiscal framework. In her 2024 Mais lecture, Reeves floated the idea of restoring a so-called golden rule under which borrowing for public investment would be treated differently from borrowing for current spending.

Such a rule had been introduced by Gordon Brown when he was Chancellor and had also been used in other countries, notably Germany. The idea is straightforward: if government is able to borrow to invest, it should facilitate an increase in growth and, because growth is the denominator of the debt to GDP ratio, better growth helps to improve fiscal sustainability.

The main problem with golden rules is that what constitutes public investment is somewhat arbitrary and prone to be equated with physical capital. Thus, building new schools is usually classified as public investment, whereas teaching is classed as current spending. Plainly, if the aim is to enhance human capital this makes little sense. However, widening the definition of what constitutes public investment risks opening Pandora's box, and can be self-defeating.

Instead, the focus should be on the quality of public investment based on criteria related to economic growth. Does the project offer a realistic prospect of adding to growth; what are the risks; can the business case make sense, and so on? The OBR could be asked to develop such criteria and to use them to vet the case for including categories of spending.

A new government, especially one with so huge a majority, has the opportunity to be bold and, in relation to budgetary rules, should take it.

Third, redressing the shortcomings in infrastructure should be a priority, not just in big projects but also maintenance (think the plague of potholes). It is well-known that governments typically cut public investment in fiscally-constrained times, rather than

welfare budgets and this has a deleterious effect on infrastructure. An option could be a revamped National Infrastructure Commission charged not only with advising on big projects, but (as in New Zealand) also helping to assemble private finance to fund them.

A new government, especially one with so huge a majority, has the opportunity to be bold and, in relation to budgetary rules, should take it. Fiscal prudence has its place and, as the Truss fiasco showed only too clearly, a cavalier disregard for the institutional framework can be severely damaging.

But so too is keeping to a flawed framework. It is time to jettison the austerity-era fiscal framework, to learn from what works elsewhere and to devise solutions tailored to the distinctive circumstances of the UK.

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