



Fiscal Governance for the UK

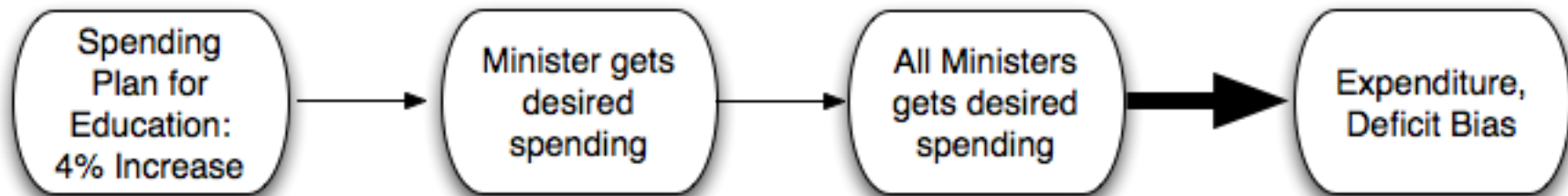
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1. Need for centralization of the budget process
2. Two alternative ways to do it
 - a. “Delegation” to a strong finance minister
 - b. “Fiscal contracts” that appear in coalition agreements
3. Fiscal Performance--Comparison with other countries (if time)

Common Pool Resource (CPR) Problem

- **Premise:** politicians care about the benefits of spending and costs of taxes to pay for that spending *on their constituencies*
 - They ask for more spending if they consider only constituency tax burden, not the full tax burden
 - If they decide their own budget, they get this amount
 - If all decision-makers get these amounts, the total amount of spending and taxes much higher than anyone wants
- **Centralization of the budget process**
- Make sure the full tax burden is considered in all spending decisions, not just the tax burdens of a given actor's constituency

Illustration--Secretary of State for Children, Schools and Families IF no centralization



Stage 1: Formulate Plan

Stage 2: Vote in Cabinet on Proposal

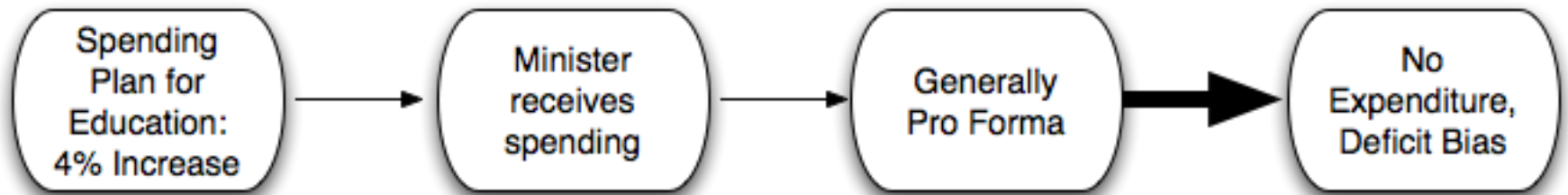
Stage 3: Vote on all Proposals

Stage 4: Results

Solutions to CPR Problem

1. Delegation

- Finance Minister (FM) Considers the full tax burden, has no stake in a particular budget
- FM Privileged in Budget Process
 - FM an agenda-setter on budget decisions
 - FM negotiates one-on-one with spending ministers to prevent log rolls in cabinet
 - FM can unilaterally cut spending both during the budget's proposal and its execution



Stage 1: Formulate Plan

Stage 2: Negotiation with Finance

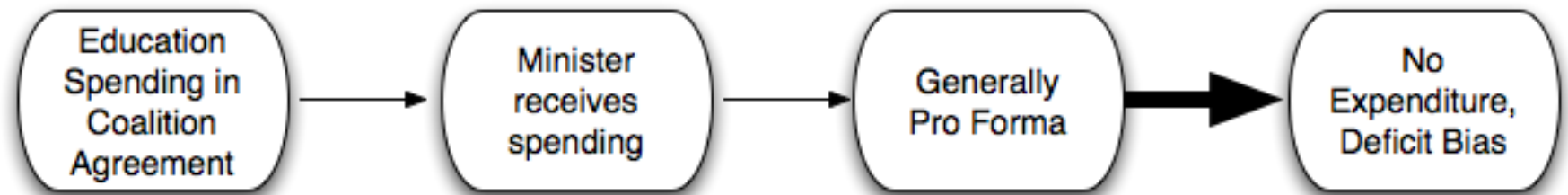
Stage 3: Vote on all Proposals

Stage 4: Results

Ideal Types of Fiscal Governance

2. Contracts (Netherlands)

- The parties negotiate spending limits for every ministry, and they include the limits in the coalition agreement
- The negotiations make them consider the full tax burden
- they take out the ability of the minister to increase spending for its ministry unilaterally
 - Contracts in practice embedded in detailed multi-annual programs, include contingencies for what to do if underlying assumptions about the economy are inaccurate



Stage 1: Formulate Plan

Stage 2: Cabinet Meeting

Stage 3: Vote on all Proposals

Stage 4: Results

Political Logic

Type of Governance	Delegation	Contracts
Political Imperative	Benefit from trusting one central player	Benefit from Explicit Fiscal Targets
Type of Government	One-Party Majority Government, Two Parties Closely Aligned	Multi-Party

EU Countries, (Expected) Delegation and Contracts



General Empirical Patterns

Type of Governance	Delegation	Contracts
Overall Performance	Generally good if institutions consistent	Generally good if institutions consistent
Bias in Forecasts	tend to be overly optimistic	tend to be pessimistic
Independent Fiscal Councils	not common	common

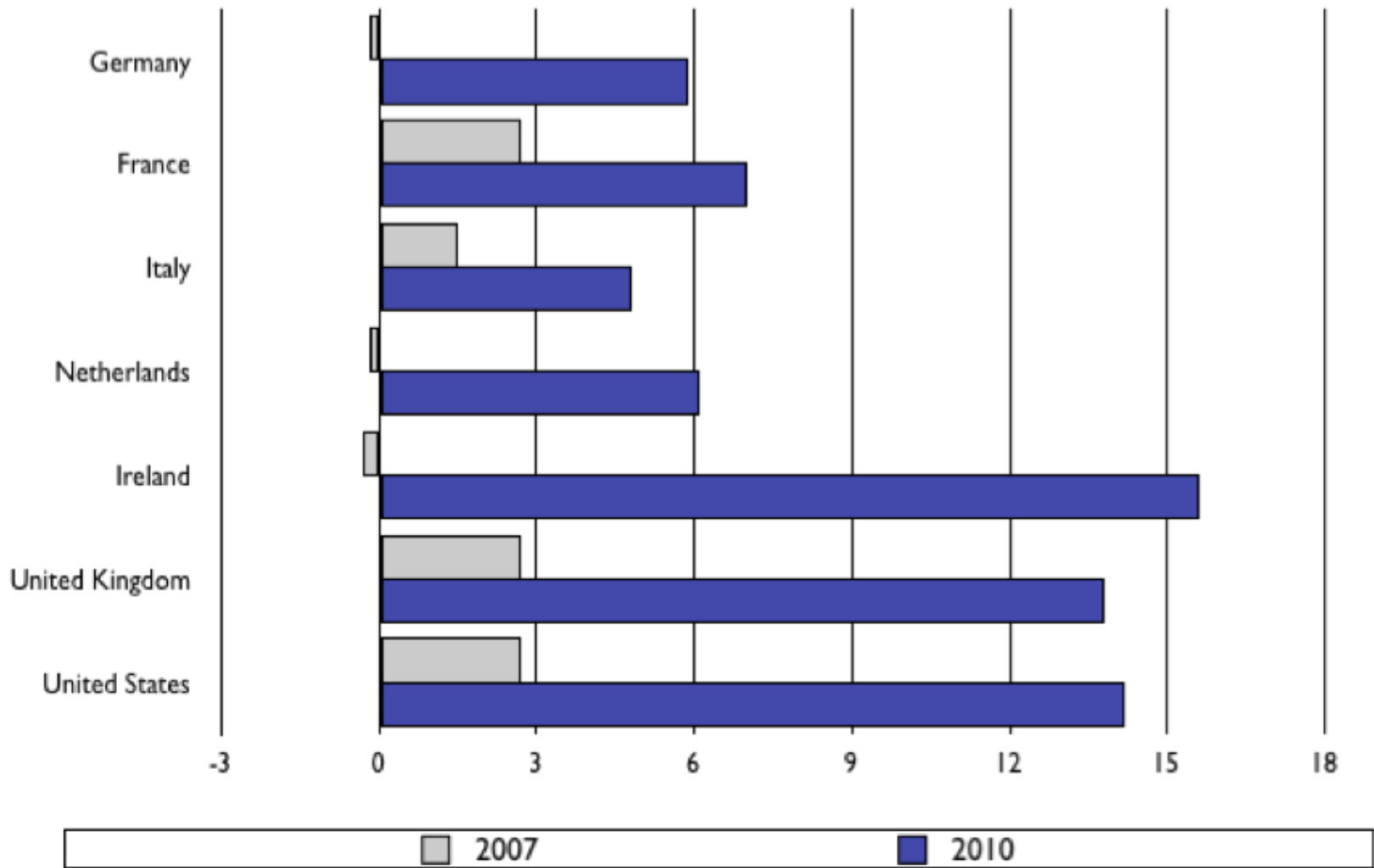
Implications for the UK Today

- **Usually have one-party majority governments**
 - Delegation expected, and indeed this form of fiscal governance has generally been the norm
 - Note that the “fiscal rules” were the Chancellor’s rules
- **Policy Recommendation**
 - Reinforce the role of the Treasury (or at least do not weaken it)

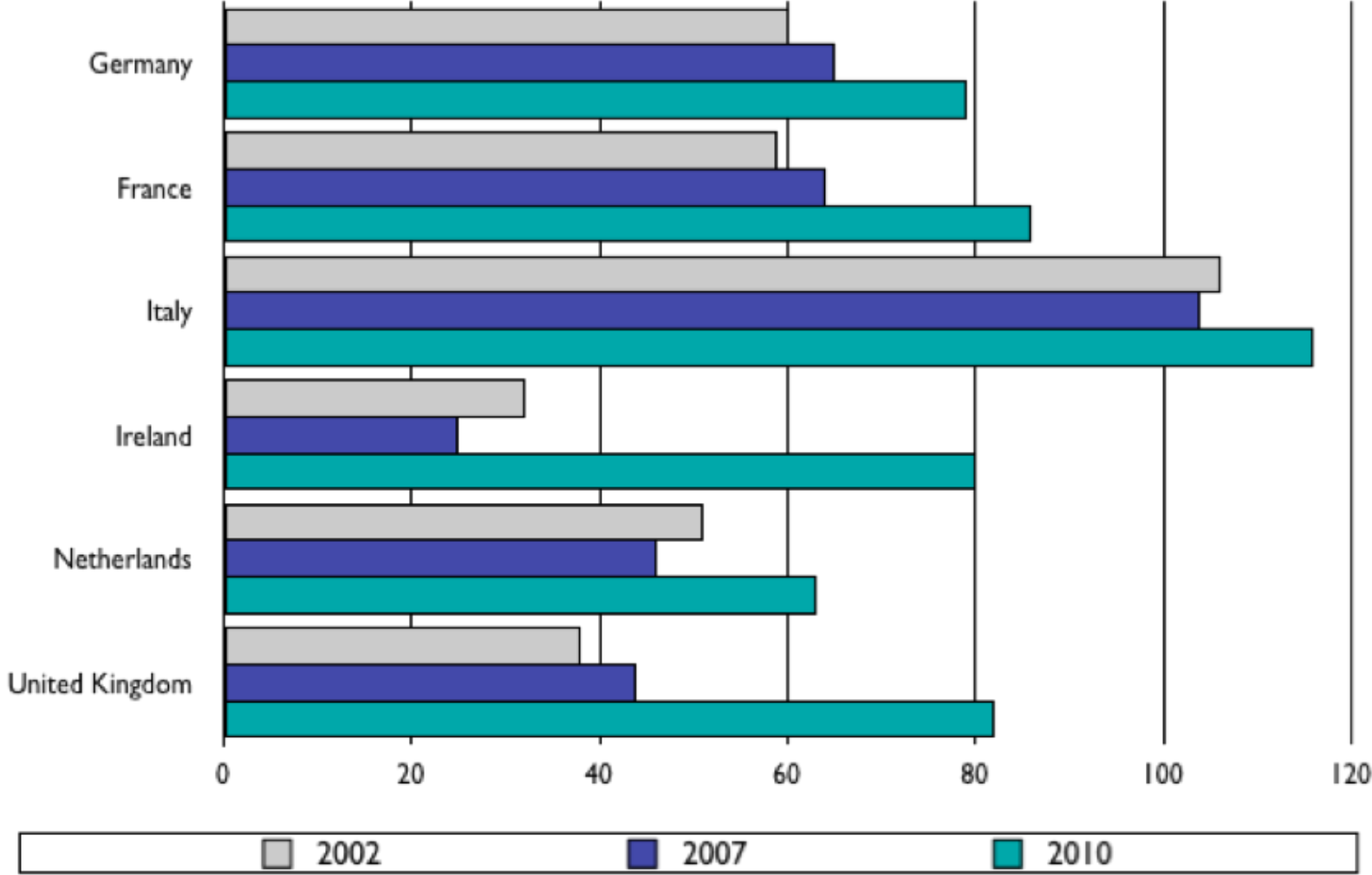
Two Additional Issues

- **Revenue policy and revenue forecasts**
 - have been too optimistic after the first Labour government
- **More reliance on financial sector, housing markets**
 - greater volatility in revenues--they are harder to predict
- **Policy recommendation**
 - independent scrutiny of the forecasts
 - introduce a “golden hamster”

Comparison of Deficit Levels in 2007 and 2010 (Est)



Comparison of Debt



Further Reading

- Hallerberg, Mark, Rolf Strauch, and Jürgen von Hagen. 2009. *Fiscal Governance: Evidence from Europe*. Cambridge: Cambridge University Press.
- Hallerberg, Mark, Carlos Scartascini, and Ernesto Stein, Eds. 2009. *Who Decides the Budget? A Political Economy Analysis of the Budget Process in Latin America*. Cambridge: Harvard University Press.
- Hallerberg, Mark, and Guntram B. Wolff. 2008. “Fiscal institutions, fiscal policy and sovereign risk premia in EMU.” *Public Choice*. 136. 3-4: 379-396.
- Hallerberg, Mark, and Joshua Bridwell. 2008. “Fiscal Policy Context: Co-ordination and Discipline, the Stability and Growth Pact, and Domestic Fiscal Regimes.” In Dyson, Kenneth (Ed), *The Euro at Ten: Europeanization, Power, and Convergence*. Oxford: Oxford University Press, 69-86.
- Hallerberg, Mark. 2004. *Domestic Budgets in a United Europe: Fiscal Governance from the End of Bretton Woods to EMU*. Ithaca, NY: Cornell University Press