



## Opinion

# A lesson from the British mini budget debacle

The best way to establish fiscal discipline probably is to delegate the business of assessing government budgets to an independent body like the Office of Budget Responsibility.

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The market reaction to the mini budget has been spectacular and must have taken by surprise many more people other than the Chancellor. Comments and explanations have flared up, by now they hopefully add up to an exhaustive explanation of what happened. This may be wishful thinking, but I believe that the British Former Chancellor has been of great service to the cause of fiscal discipline, in the UK and beyond.

On the face of it, the upheaval was prompted by reckless tax cuts and untargeted support to limit the impact of energy costs. Many commentators have rightly criticized these choices for dubious effectiveness to lift growth, the stated ultimate objective. The Chancellor's promise to do more of the same did not help but poor policy decisions do not usually elicit powerful reactions from financial markets, unfortunately. The absence of any measure to finance the costs of the mini budget at a time when the public debt is close to 100% of GDP was correctly identified as reckless but many other governments are also in the process of adding to even higher indebtedness without raising eyebrows on the financial markets.

The estimated costs of the measures were estimated to represent some 3% of GDP, which seems modest in international comparison these days. Of course, it did not

help that inflation is soaring particularly fast in the UK but this also means that the real value of the public debt is being eroded, mitigating the added costs of the mini budget. The gradual evidence that Brexit is hurting the economy is unlikely to come as a surprise. So what happened?

## **The Chancellor bypassed the watchdog**

One interpretation is that financial markets are subject to sudden yet foreseeable reactions, the multiple equilibrium syndrome. The accumulation of bad decisions and bad circumstances may well have added up to provoke a deep reassessment of the risks lying ahead. The fact that it was the first move from the new government probably played a major role. The discovery of specific vulnerabilities of pension funds amplified the panic, much like the revelation of the existence of subprime mortgages at the onset of the 2007-8 crisis in the US and beyond.

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the longer-term consequences of bad policy  
choices driven by the deficit bias.»**

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Yet, another non-exclusive interpretation warrants more scrutiny that it has received. The Chancellor did not ask for an evaluation of the mini budget by the Office of Budget Responsibility (OBR). Created in 2010 by Chancellor George Osborne, the OBR is one of many fiscal watchdogs adopted in a continuously growing number of countries. The rationale for these watchdogs is that many governments are subject to a budget deficit bias. It can be economically and political convenient to run a deficit this year or next while promising to close it thereafter. However, the incentive will not disappear when the time has come to be disciplined, so that revolving deficits end up piling up debt upon debt.

Fiscal watchdogs are intended to undermine the bias and restore fiscal discipline. In order to be effective, watchdogs need to be reasonably independent from their governments and to have enough authority to occasionally tie the hands of elected

officials, governments and parliaments. Dozens of experiments over the last decade or two have shown how delicate the endeavor can be.

## A bad precedent

In many ways, the OBR is among the best designed fiscal watchdogs. Although its management is appointed by the government, it enjoys quite a lot of independence. Importantly, the OBR has taken on the responsibility for evaluating budgets and the evolution of the public debt, which previously was a task of the Treasury. Indeed, treasuries, which usually operate under the Finance Minister, may be instructed to produce optimistic evaluations. The OBR has the necessary staff and access to information to carry out its mission and it is widely considered impartial and competent. Until now, all Chancellors have dutifully subjected their plans to the OBR, with a few exceptions for emergency and temporary measures to deal with the pandemic. Chancellor Kwarteng's decision to bypass this step for permanent tax cuts constituted a bad precedent. It also contributed to the markets' reactions.

This is good news for the UK, but also for all fiscal watchdogs around the world. They never have decision power, partly in deference to the democratic principle that taxation and public spending can only be a prerogative of elected representatives. Another reason is that the watchdogs are created by governments and no government will agree to cede this power. In the end, the watchdogs only have the influence that governments allow them to have. Many governments routinely ignore critical observations from their watchdogs, without any adverse reaction from the political bodies, the media or public opinions. There is even a case when a watchdog was created by one government only to be suppressed by the following one (yes, this is Hungary).

## We all need an OBR

Since the OBR is the official body in charge of evaluating the longer-term impact of fiscal decisions, the Chancellor did not reveal that his mini budget implied a lasting fiscal hole of some 3% of GDP. In addition to the other unusual circumstances that surrounded the mini budget, the result was an impression of inadequate preparation, and it was not just an impression. This was a futile effort, however. Since the OBR is required by law to publish economic and fiscal forecasts at least twice a

year, the impact of the mini-budget would have been revealed eventually. This is why the British watchdog arrangement is special, but not unique. In New Zealand, the Treasury itself is independent from government.

A lesson from the mini budget debacle is that the best way to establish fiscal discipline probably is to delegate the business of assessing budgets to an independent body. The government remains firmly in control, under the supervision of the parliament, as should be, but the measurement of its decisions and the forecasting of the consequences are delegated to independent technicians. Hopefully, other countries will rethink their own arrangements. Inevitably, some will argue that, without the OBR arrangement, a complacent Treasury could have produced a rosy picture supporting the Chancellor's enthusiastic expectations, thus possibly avoiding the turmoil. This is most unlikely but, anyway, two weeks of turmoil are well worth avoiding the longer-term consequences of bad policy choices driven by the deficit bias. We all need an OBR.

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