



HOUSE OF LORDS

Library Note

Fiscal Responsibility Bill (HL Bill 24 of 2009–2010)

The Fiscal Responsibility Bill imposes a statutory duty on the Treasury to meet specific targets for the reduction of government borrowing and debt. The Bill gives Parliament a greater role in fiscal policy. It has completed its passage through the House of Commons and is due for its second reading debate in the House of Lords on 10th February 2010.

This House of Lords Library Note summarises the second reading debate and the other stages of the Bill's passage through the House of Commons.

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1. Introduction

The Fiscal Responsibility Bill (HC Bill 24) was introduced in the House of Commons on 9th December 2009—the same day as the Pre-Budget Report—and was read for a second time on 5th January 2010 (HC *Hansard*, cols 63–137). An amendment to oppose the second reading moved by George Osborne, Shadow Chancellor, was defeated by 280 votes to 182.

Following the Bill's second reading, a programme motion was passed that committed it to a committee of the whole House. The motion specified that all stages of the Bill's consideration would be completed in one day's sitting. The Bill was considered by a committee of the House and proceeded unamended to receive its third reading in the Commons on 20th January 2010. The Bill (HL Bill 24, 2009–10) was presented to the House of Lords on 21st January.

The Fiscal Responsibility Bill is being introduced at a time of extremely high levels of public sector borrowing due to the financial crisis. The Bill aims to ensure that there is always in place a duty to secure sound public finances in the UK. A Treasury press notice issued alongside the Bill said that it would enhance the government's fiscal framework and "requires the government to set out at all times a legislative fiscal plan for delivering sound public finances, to be approved by Parliament, and places a binding duty on the government to meet that plan" (HM Treasury Press Notice, 'Fiscal Responsibility Framework', 9th December 2009).

The Bill requires the Treasury to meet three targets on public borrowing and debt and holds the government to account by requiring it to report to Parliament and to provide an explanation if the targets are missed. There is no legal sanction other than the requirement to report to Parliament. If the fiscal targets are not achieved, the government must set out actions to remedy the situation.

Comprising six clauses, the Bill:

- imposes a duty on the Treasury to ensure that for each of the financial years ending in 2011 to 2016 public sector net borrowing as a percentage of GDP is lower than the previous year;
- imposes a duty on the Treasury to ensure that by 2014 public sector net borrowing as a percentage of GDP is at least halved from its level for the financial year ending 2010;
- imposes a duty on the Treasury to ensure that public sector net debt as a percentage of GDP is lower as at 31st March 2016 than it was as at 31st March 2015;
- provides that the Treasury may impose, by Order, further duties on the Treasury for the purposes of securing sound public finances and consistent with the key principles (specified in section 155(2) of the Finance Act 1998) for any or all of the financial years ending 2011 to 2016;
- requires the Treasury to impose, by Order, subsequent duties on the Treasury for the purpose of securing sound public finances and consistent with the key principles, to apply in relation to future financial years;

- imposes a duty on the Treasury to report on progress towards and compliance with the duties at the time of laying before Parliament relevant Economic and Fiscal Strategy Reports and Pre-Budget Reports;
- provides that the Treasury's accountability in relation to the duty and future duties is to Parliament alone, by way of the reporting requirements of clause 3;
- provides that the lawfulness of anything done, or not done, is not to be affected by the fact that the duty has not been or may or will not be complied with; and
- provides for explanations of key terms to be set out in the code for fiscal stability.

(HL Bill 24–EN, para 8)

The House of Commons Library has produced a Research Paper on the Bill: *Fiscal Responsibility Bill* (22nd December 2009, RP 09/96) was prepared for the second reading in the House of Commons and provides background on the public finances, describes the government's fiscal policy framework, sets out the Treasury's forecast for the public finances and considers Parliament's role in fiscal policy.

This Note summarises the second reading debate and the other stages of the Bill's passage through the House of Commons.

2. Second Reading

Opening the debate, Alistair Darling, Chancellor of the Exchequer, said that the severe financial crisis had affected every country in the world and that, "we are now taking steps as we emerge from the recession to secure growth while reducing the deficit, but... we have got to do that in a way that does not risk wrecking the recovery and damaging the economy, and our ability to secure growth over the medium and long term". The deficit reduction plan contained in the Fiscal Responsibility Bill set out obligations to halve the deficit and to halve public sector net borrowing over a four-year period. The Chancellor continued: "Whatever the economic circumstances under whatever government, we need rules and objectives to govern fiscal policy" (HC *Hansard*, 5th January 2010, col 63).

The Chancellor also stated that since 1998 the government had abided by two fiscal rules in order to deliver its objectives: the 'golden rule', that over an economic cycle the government would only borrow to invest and not to fund current spending; and the 'sustainable development rule', that public sector net debt as a proportion of GDP would be held over the economic cycle at a stable and prudent level. However, he noted that the government had announced in the 2008 Pre-Budget Report that these fiscal rules would be suspended and that a temporary operating rule was set in response to the economic climate. The fiscal rules had "stood our economy in good stead" but the economic situation affecting the global economy meant that policies needed to adapt to reflect this. Despite the recent economic "disruptions", the fiscal objectives remained important and borrowing needed to be reduced on a reasonable timescale (*ibid*, cols 65–67).

The Chancellor went on to say that the Bill gave Parliament a greater role in scrutinising the government's medium-term fiscal plan for delivering sound public finances by allowing it to approve the plan and to hold the government to account if they failed to meet it. He stated that the Bill "represents a substantial strengthening of the fiscal policy framework in response to the challenges we face while enabling the House to exercise greater scrutiny, not just through Select Committees, but through the House sitting in this Chamber" (*ibid*, cols 67–68).

The Shadow Chancellor was critical in his response and said that the short Bill had been hastily drawn up, and had already attracted criticism from leading economists and the business community (*ibid*, cols 72–75). He went on to say that placing duties on the Treasury, contained in clause 1, to reduce public sector borrowing and the deficit was not a guarantee that that would happen. He also accused the Chancellor and his predecessor of failing to meet similar previous promises to reduce net debt and of inaccurately forecasting total borrowing (*ibid*, col 73).

George Osborne attacked clauses 3 and 4 which include the sanction, if the targets on borrowing and debt have not been met, of forcing the government to report to Parliament to explain why not and to introduce new legislation to address it. He criticised the lack of penalties, saying: "This must be the first law introduced in Parliament that contains absolutely no legal sanction whatever for those who break it" (*ibid*, col 74).

There followed an interchange between the Chancellor and Shadow Chancellor on the speed of the reduction of the deficit. The Shadow Chancellor quoted the views of the OECD and the Governor of the Bank of England who, he said, believed that plans to reduce the structural deficit should be quickly developed. The Chancellor responded that the Governor also warned of the dangers of going too fast and too far with the deficit reduction, a fear shared by the government (*ibid*, cols 76–78).

Finally, the Shadow Chancellor went on to outline the Conservative Party's intention, if they were elected to power, to create an independent office for budget responsibility. This body would be accountable to Parliament and would provide independent judgements of the UK's public finances (*ibid*, cols 78–80).

Speaking on behalf of the Liberal Democrats, Jeremy Browne, Shadow Chief Secretary to the Treasury, described the Fiscal Responsibility Bill as, "a pathetic and dangerous piece of legislation... Because we should not need a new law to make the government do their job" (*ibid*, col 86). Referring to the targets on borrowing and debt in clause 1, he continued:

How can we know what the world will face in 2016? We may confront the scale of threat to our national security that demands the wholesale economic sacrifice that helped us to win the Second World War, which we have discussed in this debate. What are we meant to say if that happens—"Sorry, we are not fighting. We can't due to our obligations under clause 1 of the Fiscal Responsibility Act 2010?" We may face another recession—it is entirely possible... We all hope that it is unlikely, but it is entirely possible. What then? What are we meant to do? Are we meant to say, "Sorry, all the hospitals are going to have to close. That is our obligation under clause 1 of the Fiscal Responsibility Act 2010?" The Chancellor said today that that would not happen because the Chancellor of the day would come to the Dispatch Box, rip up the Act and say, "Don't worry, I never meant it in the first place". That raises the question why we are all here pretending that this is a serious piece of legislation.

(*ibid*, col 87)

Speaking from the backbenches, Frank Field (Labour) aimed to “inject a note of seriousness, if not horror, into the debate”. He compared the costs of the new debt to the closure of several government departments and the programmes that they ran. He criticised “all the political parties [who] have been saying that they are going to spend more”, while the government had been printing money, the majority of which had been used to buy government debt. He added, “in my view, if we do not cut enough and soon enough, we will not have a currency” (*ibid*, col 82).

Also speaking from the backbenches, John Redwood (Conservative) said, “we cannot solve a crisis of over-borrowing by borrowing too much in the state sector”. He said that the deficit was growing too quickly and needed to be controlled within the next four to five years but that there was disagreement about the timing of when one should start to control borrowing (*ibid*, col 97). Commenting on clause 1 of the Bill, John Redwood said that in order to cut the deficit on the scale required by the Bill, there would have to be cuts in public spending, and though the Bill contained targets aimed at reducing debt and borrowing, “there is not a single item in the supporting papers or speeches to tell us how they would achieve it” (*ibid*, col 99). More fundamentally, Mr Redwood argued that “the Bill is shoddy and unacceptable because there is no professionally and internationally agreed definition of the debt and borrowing that they are trying to measure” (*ibid*, cols 100–101).

David Gauke, Shadow Exchequer Secretary to the Treasury, concluded the debate for the Conservatives:

The challenge that the Treasury faced at the time of the PBR was to restore fiscal credibility, and what did we get—a clear acknowledgement of the scale of the crisis, details of departmental spending in the years ahead, a general sense of direction on how the deficit would be reduced, or even just policies to improve the dismal and discredited forecasting record of the Treasury? No, we got this Bill: a Bill that sets out targets but no enforcement mechanism—no sanctions if they are breached. That is not a credible response; it is a distraction policy.

(*ibid*, col 119)

Summing up for the government, Sarah McCarthy Fry, Exchequer Secretary to the Treasury, reiterated the key parts of the government’s fiscal strategy:

First, we will base policy decisions on a realistic fiscal forecast, based on a range of assumptions, some of which are designed to provide caution for uncertainty. Secondly, we will ensure that the fiscal policy framework is set to deliver the government’s fiscal policy objectives. To that end, the government have introduced the Bill. Thirdly, we will set out a credible plan to deliver sustained consolidation in the medium term to ensure sound public finances in a time frame that is consistent with economic recovery and growth. In line with that, the pre-Budget report outlines plans to more than halve the deficit in four years, and the fiscal consolidation plan included in the Bill embeds the deficit reduction. That is the sharpest reduction in the budget deficit of any G7 country.

(*ibid*, col 123)

An amendment to oppose the second reading moved by George Osborne, Shadow Chancellor, was defeated by 280 votes to 182. The House then divided on the second reading of the Bill with 285 MPs voting in favour of the Bill and 196 voting against.

3. Committee

At committee stage on the floor of the House of Commons, there were two divisions on amendments to clause 1. Both were defeated. A further amendment was debated but withdrawn and a further vote on a new clause 1 did not receive sufficient support at division. The Bill moved without amendment to third reading.

The first amendment that the committee debated and also divided on was moved by David Gauke, Shadow Exchequer Secretary to the Treasury, and aimed to specify that the target to reduce public sector net borrowing should focus on the structural element. Several similar amendments were discussed at the same time.

David Gauke criticised the Bill as “conceptually flawed” and referred back to the second reading debate in which the Chancellor had been questioned about what would happen if a further recession occurred over the period that the Bill covered. David Gauke summarised the Chancellor’s response: “If there is a crisis, the targets do not apply”. He continued:

However, that does not quite answer the question, “What would happen if there was something not of the scale of the bank bail-out that we saw a couple of years ago, but a substantial slowing of the economy and, perhaps, a recession?” Clearly, the targets would become much harder to hit. Unemployment would go up and tax receipts would fall; and, if we look at borrowing as a percentage of GDP, we find that GDP falls so the percentage of borrowing would go up.

I find it hard to see how anyone who has argued consistently, as the government have, for a discretionary fiscal stimulus when the economy slows down, can support this Bill on reading it, because the targets are focused on public sector net borrowing, not on the structural or cyclically adjusted element.

(HC *Hansard*, 20th January 2010, col 324)

Speaking for the Liberal Democrats, Jeremy Browne, Shadow Chief Secretary to the Treasury, said that he agreed with the views of David Gauke and also questioned why the government was introducing a Bill that prevented the operation of automatic stabilisers that would “protect some of the most disadvantaged people in society” (*ibid*, cols 325–326).

John Redwood (Conservative) also spoke in support of the amendment and questioned whether the government’s rationale for legislating to prevent the operation of automatic stabilisers was politically motivated. He said that the Bill would:

... pre-empt all the Budgets of the next Parliament by laying down in law what the overall shape of [future] Budgets should be. Moreover, they are doing so in such a way that if they leave a mess that results in a further downturn, or even a period of very disappointing growth, which is a possibility, the automatic stabilisers would not come into effect on the scale that they naturally would otherwise, so there would have to be offsetting action.

(*ibid*, col 326)

John Redwood went on to express his views, shared he said by the Opposition and also by financial commentators, on the need for greater speed in reducing the deficit to prevent even greater cuts. He asked:

Why have some of us been growing hoarse saying to the government that they need to cut this deficit more rapidly than they are proposing? It is not because we are masochists who came to this place to cut public spending, but because we are deeply afraid that the government are losing the confidence of the financial markets... Why does that matter? It matters because it means higher mortgage rates and higher loan rates for small and big business, and because it will lead to lost jobs and lost dreams for people who want to make a living or make a go of something in this difficult economic situation. We are thinking ahead.

(ibid, col 327)

Responding to amendment 1, Ian Pearson, Economic Secretary to the Treasury, said that the Bill, which embeds into legislation targets to reduce the deficit in each year to 2015–2016, would “contribute to ensuring sustainable public finances in the medium term”. He went on to say that “legislating will provide certainty and stability for businesses and individuals in relation to the future path of fiscal policy”. The Economic Secretary also added that it was “right that Parliament should be given a role in setting and monitoring our fiscal plans”, that Germany’s approach was similar and that the IMF had suggested that such legislation was the right thing to do *(ibid, cols 343–344)*.

Addressing the issue of the required speed of deficit reduction, the Economic Secretary said that taking steps to reduce the deficit while securing growth was the right approach as growth would then make it easier to lower the deficit. The government also believed that tightening fiscal policy too quickly across 2010–2011 would present risks, a view he said was supported by the Governor of the Bank of England and the managing director of the IMF *(ibid, col 347)*.

Responding to the debate on the structural deficit, the Economic Secretary agreed that the structural deficit was an important fiscal aggregate, and that:

One of the key ambitions of the Bill is to provide certainty... About the future path of fiscal policy, and targeting a structural measure of the deficit when there is such uncertainty about the position of the economy and the size of the output gap runs counter to that ambition.

(ibid, col 349)

The committee divided on amendment 1. The amendment was not accepted, with 200 MPs voting in favour and 286 voting against.

Amendment 4, tabled by Jeremy Browne, Liberal Democrat Shadow Chief Secretary to the Treasury, would have allowed the provisions of the Bill to be suspended for one year, possibly more than once. This, Jeremy Browne said, would provide a procedure to deal with the economic circumstances in the event of a further recession or other unexpected events. He continued that, “to have no contingency, which is the case at the moment, seems ridiculous” *(ibid, col 358)*.

Responding to amendment 4, the Economic Secretary said that delaying the Bill would be the wrong approach and would jeopardise growth. He said that, “the fall in output following the global financial crisis has been the biggest factor in the increase in the

deficit, so the return of strong and sustainable growth will be crucial in cutting the deficit over the medium term and restoring fiscal balance". Addressing the issue of flexibility, he added:

It is worth noting that, subject to making progress on reducing borrowing every year, there is flexibility in the profile over which the deficit is halved by 2013–14. As I said earlier, there is the flexibility to accommodate lower growth and the greater impact of the automatic stabilisers so long as progress is made on reducing borrowing. It is important to recognise that.

(ibid, col 369)

Responding to potential restrictions caused by the Bill in the event of unforeseen economic events, the Economic Secretary contended that "the government would have to come back to Parliament if it were necessary to amend the targets in the Bill". He continued:

We think it right and proper that new primary legislation should be required in order to divert from the course set out in the Bill. The difficulty and seriousness of doing that should underline the government's commitment to meeting the Bill's targets. I agree with the Hon. Member for Taunton that it is important to consider alternative circumstances and scenarios. However, his amendment would make it too easy to change the targets when it is important that they are seen by everyone to be hard targets that could be changed only by going through the full parliamentary procedures required for new primary legislation.

(ibid, cols 369–370)

The committee divided on amendment 4. The amendment was not accepted, with 203 MPs voting in favour and 276 against.

Stewart Hosie, SNP Spokesperson on the Treasury, moved amendment 6 which was debated alongside a group of amendments and "was tabled with the purpose of preventing the government from taking any action or imposing any further duties—or damaging cuts, as we call them—if the principles of fiscal responsibility set out in new clause 14 are already being adhered to" *(ibid, col 379)*. New clause 14, Stewart Hosie explained, contained five principles closely based on those used in the New Zealand Fiscal Responsibility Act 1994, which related to the prudent management of public finances.

A short debate took place and the Economic Secretary to the Treasury responded:

I very much agree with the spirit of the principles as set out in the Hon. Gentleman's new clause, but I believe that they are already adequately embraced in the government's current fiscal framework. The right approach in current circumstances is to build on those principles and to set out binding targets for consolidation that enhance certainty and confidence. Setting out quantitative targets in legislation will help businesses and investors make long-term plans, with assurance about the fiscal position and the financing environment.

(ibid, col 384)

In the event, amendment 6 was withdrawn and new clause 14 was not called. The committee proceeded to a vote on clause 1 of the Bill and it was accepted with 267 voting in favour and 201 against.

There followed a further division on new clause 1, introduced in the name of David Gauke, who had earlier said:

New clause 1, [which] would give an opportunity for full consultation on the Bill, for a report summarising those consultation responses to be put before the House, and for Members to be given the opportunity to debate in Committee of the whole House whether to bring in the Bill, would be a valuable addition. It would ensure that we do not implement legislation that serves no purpose, that persuades nobody and that undermines the credibility of this place and the government's policy on addressing our deficits. I hope that we will get the chance to vote on new clause 1.

(*ibid*, col 366)

New clause 1 was not passed, with 201 MPs voting in favour and 266 against.

4. Third Reading

Speaking for the Bill at third reading, Ian Pearson, Economic Secretary to the Treasury, said that it “places obligations on the government to cut the deficit at an appropriate and sensible pace, as well as allowing us to protect the economy and maintain key public services”. He warned that tightening fiscal policy too much across 2010–11 would risk the recovery and could cause deterioration in the fiscal position. More rapid tightening would be possible in the following year and the government would look to strengthen the fiscal framework. As a result of the global economic crisis, governments around the world were considering similar measures to this Bill and the IMF had also highlighted fiscal responsibility laws as a way forward (HC *Hansard*, 20th January 2010, cols 393–394).

He observed that much of the debate on the Bill concerned the pace of reducing the budget deficit and that the rationale of legislation “is to give confidence to the public and the markets that we are committed to taking these actions” (*ibid*, col 395).

David Gauke, for the Conservatives, commented on the lack of Labour backbenchers speaking in support of the Bill—none at second reading and one contributing at the committee stage. He disagreed with the Economic Secretary, who had earlier said that the House had had sufficient time to scrutinise the key provisions of the Bill. This, he argued, had been exemplified by the fact that they had not got beyond consideration of clause 1 in committee. He speculated that, “the Lords will not have an opportunity either to scrutinise the Bill sufficiently” and also pointed out that no evidence sessions with experts had been carried out, as would usually have happened at committee stage (*ibid*, col 396).

Speaking on behalf of the Liberal Democrats, Jeremy Browne also expressed disappointment at the “cursory examination” they were able to give to this, admittedly, short Bill. He wondered what the effects of a further recession in 2013 or 2014 might be and said that the effects of the Bill would be to “dramatically cut public spending” at a time when it would most be needed (*ibid*, cols 397–398).

A Labour backbencher was the last Member to speak at third reading. John McDonnell spoke of the effect of the Bill on “ordinary working people”, large numbers of whom would lose their jobs, and of the risk to essential community services. He said that the economic crisis should not be resolved within a four-year timescale set by the

government and that what was needed was a “planned approach to our economy” (*ibid*, cols 399–400).

The House divided on the third reading of the Bill, with 295 MPs voting in favour of the Bill and 197 voting against.

The Bill was introduced in the House of Lords on 21st January 2010, and is due to have its second reading on 10th February. As it is a “money bill”, the House of Lords cannot amend the Fiscal Responsibility Bill, so the remaining stages in the Lords will be taken formally immediately after second reading. However, Baroness Noakes, Conservative Treasury Spokesperson in the Lords, has tabled an amendment to the motion for second reading:

Baroness Noakes to move, as an amendment to the motion that the Bill be now read a second time, at end to insert “but this House regrets that the Bill may pass into law without consideration of clauses 2 to 6 in either House of Parliament, and affirms that the principle of full parliamentary scrutiny of proposed legislation in at least one House of Parliament is conducive to the proper conduct of constitutional government”.

