

Impact case study (REF3b)

Institution: University of Glasgow
Unit of Assessment: C18 Economics and Econometrics
Title of case study: Influencing the Creation and Development of the Office for Budget Responsibility
1. Summary of the impact (indicative maximum 100 words)

University of Glasgow research, undertaken in collaboration with the Universities of Exeter and Oxford, directly influenced the Government decision to create the Office for Budget Responsibility (OBR). The Conservative Party cited the research as part of the rationale for the creation of such a fiscal body in its policy paper in 2008; the research was subsequently presented to the Strategy Unit of the Cabinet Office, No.'s 10 and 11 Downing Street and the Institute of Government throughout 2008 and 2009. The proposal was implemented by the coalition government in 2010, with the research team then using the findings to advise a Treasury Select Committee as well as the Bank of England on the appropriate remit, expectations and functions of the newly-created OBR.

2. Underpinning research (indicative maximum 500 words)
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Campbell Leith, (Professor of Macroeconomics, University of Glasgow (UoG) 2005-present; UoG Staff since 1999) was the Principal Investigator for three Economic and Social Research Council (ESRC) projects between 2001 and 2011 which explored various aspects of the relationship between monetary and fiscal policy.

Leith worked closely on these projects with fellow economist, Professor Simon Wren-Lewis (University of Oxford), with whom Leith has a long-standing and well-established research relationship, and latterly also with Professor Tatiana Kirsanova, (University of Glasgow 2011-present).

One of the major research topics within this work was the exploration of the design of optimal fiscal policies in the context of micro-founded Dynamic Stochastic General Equilibrium (DSGE) models. DSGE models have grown in importance at many of the world's central banks as tools to inform economic outlooks and formulate policy strategies.

A benchmark result in the literature is that it is optimal for a benevolent policy-maker to allow the level of government debt to fluctuate permanently in response to shocks; essentially, based on tax smoothing arguments, the short-run costs of unwinding the fiscal repercussions of a shock are balanced by the discounted value of the long-term benefits of doing so. In other words, following the recent financial crisis policy-makers should act to stop government debt levels continually rising, but should not seek to return government debt to the levels enjoyed before the crisis. Of course, in actuality, policy-makers may not choose to act in the same manner as the benchmark result assumes. The research outlined here explored the implications of introducing extensions to the benchmark results to reflect the diverse options and behaviours adopted by policy-makers who are often also subject to competing party political pressures.

Moreover, Professor Leith and his co-authors sought to draw out the policy implications of this work. Previously, by analogy with the rules versus discretion debate in monetary policy, it was often assumed that adopting policy rules provides a feasible means of tying the hands of policy-makers in order to reduce policy mistakes, increase transparency and limit political influence on policy. Accordingly, policy-makers in the UK adopted the Golden Rule for fiscal policy whereby the

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government's budget (excluding public sector investment) should be balanced over the economic cycle, while in Europe the Stability and Growth Pact was designed to do something similar within the Eurozone. However, an analysis of optimal fiscal policy reveals that while such rules may overcome some problems, unlike monetary policy rules, they fall significantly short of mimicking fully optimal policy and have often been dropped by policy-makers as soon as difficulties emerge.

Accordingly, in their paper 'Optimal Debt Policy, and an Institutional Proposal to help in its Implementation' published in *European Economy* in 2007, Leith, Kirsanova, and Wren-Lewis proposed the creation of a fiscal council in the UK which would closely monitor the fiscal activities of the government so as to prevent unsustainable policies being followed, while at the same time allowing a flexible response to shocks in the short-run. The importance of achieving both flexibility and credibility in fiscal policy in this way was further highlighted by the ongoing sovereign debt crisis and recession in the Eurozone.

Leith's and his colleagues' research demonstrated that there are substantial economic benefits from the creation of such a body in that it would support the credibility of fiscal policy, in a manner which previous fiscal rules failed to do, without compromising the government's ability to deal with economic shocks.

3. References to the research (indicative maximum of six references)

1. Leith, C and Wren-Lewis, S (2000), Interactions Between Monetary and Fiscal Policy Rules, *Economic Journal*, 110,93-108. (doi:[10.1111/1468-0297.00523](https://doi.org/10.1111/1468-0297.00523))
2. Leith, C, and Wren-Lewis, S (2005) Fiscal stabilization policy and fiscal institutions. *Oxford Review of Economic Policy*, 21. pp. 584-597. (doi:[10.1093/oxrep/gri033](https://doi.org/10.1093/oxrep/gri033))
3. Leith, C and Wren-Lewis, S. (2006), Compatibility Between Monetary and Fiscal Policy under EMU, *European Economic Review*, 50(6), pp 1529–1556. (doi:[10.1016/j.euroecorev.2005.04.003](https://doi.org/10.1016/j.euroecorev.2005.04.003))
4. Kirsanova, T., C. Leith and S. Wren-Lewis, (2007), "Optimal Debt Policy, and an Institutional Proposal to help in its Implementation", commissioned by the European Commission and published in *European Economy*, No. 275 and reprinted in Ayuso-I-Casals, J., S. Deroose, E. Flores and L. Moulin (eds), *Policy Instruments for Sound Fiscal Policies*, Pub. Palgrave Macmillan. [available from HEI]
5. Leith, C., and Wren-Lewis, S. (2008) Interactions between monetary and fiscal policy under flexible exchange rates. *Journal of Economic Dynamics and Control*, 32 (9). pp. 2854-2882. ISSN 0165-1889 (doi:[10.1016/j.jedc.2007.11.005](https://doi.org/10.1016/j.jedc.2007.11.005))
6. Leith, C. and S. Wren-Lewis (2013), "Fiscal Sustainability in a New Keynesian Model", *Journal of Money Credit and Banking*. ISSN 0022-2879 [in press]. [available from HEI]

Grants and Commissioned Work:

ESRC Grant £40,850 (2001-2004) "Interactions Between Monetary and Fiscal Policy" joint with Simon Wren-Lewis (University of Exeter): PI: Campbell Leith *Rated as 'outstanding'*.

ESRC Grant £99,999 (2005-2008), *Reinstating Fiscal Policy as a Stabilisation Device* joint with Simon Wren-Lewis (University of Oxford). PI: Campbell Leith *Rated as 'outstanding'*.

ESRC Grant £126,636 (2008-2011), *New Directions in Monetary and Fiscal Policy Analysis at the Macroeconomic Level*, with Simon Wren-Lewis (University of Oxford).

HM Treasury (2004) *Fiscal Stabilisation in Economic Monetary Union (EMU): A Survey of Policy Issues and Design Issues*, Campbell Leith with S. Wren-Lewis (University of Exeter).

HM Treasury (2005-2008) *Fiscal Stabilisation in EMU*, Campbell Leith with S. Wren-Lewis (University of Exeter).

4. Details of the impact (indicative maximum 750 words)**Influencing UK Fiscal Policy**

Amid the ongoing financial crisis in 2008, the Conservative Party announced its plan for 'economic recovery and long-term prosperity' in its policy paper *Reconstruction: Plan for a strong economy*, launched at the annual party conference on 28 September 2008.

The proposal put forward by Professors Leith, Kirsanova and Wren-Lewis – for a fiscal monitoring commission for the UK – was cited by the Conservative Party in this 2008 policy paper. Considering practices abroad, such as independent central banks or regulatory systems, the Conservative paper concluded that: "Instead, economists increasingly see independent fiscal councils as a way of creating the right mix of constrained discretion. By creating institutional pressure for responsible fiscal policy, fiscal councils can eliminate deficit bias while maintaining the flexibility to respond to unforeseen events." Specifically referring to the proposal for such a body outlined in the researchers' 2007 paper, *Optimal Debt Policy, and an Institutional Proposal to help in its Implementation*, the Conservative paper then went on to outline the Party's manifesto policy for the creation of an Office for Budget Responsibility.

Subsequent to this, their research calling for the creation of a fiscal monitoring body in the UK was also presented to the Strategy Unit of the Cabinet Office in October 2008.

The research was then used as the basis for discussions at a meeting with the Senior Adviser on the Economy at No. 10 Downing Street on 29 January 2009; on the basis of the research Wren-Lewis attended a meeting with the Chancellor of the Exchequer along with between 3 and 5 other participants drawn from academia, business and journalism to discuss issues related to the macroeconomic outlook for the UK.

On 15 October 2009 the research team presented the research during an expert panel discussion on *Fiscal Institutions and Budget Oversight* at the Institute of Government alongside the former Chief Economic Adviser to the Treasury and Robert Chote, (formerly of the Institute of Fiscal Studies) who later became Director of the newly created OBR.

Following the election and the establishment of the coalition government in May 2010, the independent Office of Budget Responsibility (OBR) was created the same year.

The OBR acts as an independent yet official fiscal watchdog for the UK's public finances. Among other things, it produces forecasts which include the projected impact of policy or spending decisions in the government's annual budget; assesses the Government's performance against fiscal targets; monitors and advises on the long-term sustainability of the public finances; and scrutinises the Treasury's costing of Budget measures. These duties and responsibilities resonate closely with those suggested by the researchers in their paper published in *European Economy* featured in the Conservative Party's policy paper, *Reconstruction: Plan for a strong economy* and presented to the Cabinet Office in October 2008.

Contributing to Decision-Making on the Remit and Functions of the OBR

Leith and Wren-Lewis were involved in the debate surrounding the creation of the OBR, ongoing at the time, as well as discussions that were held to further refine the remit of the new institution. The research undertaken during their collaborative projects underpinned these interventions

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Professor Leith was a speaker at the Bank of England's Roundtable event in July 2010, alongside Robert Chote, for an exploration of the impact of the Emergency Budget and creation of the OBR on the conduct of monetary policy at the Bank of England. Also in July 2010, the Treasury Select Committee met to discuss the proposed remit for the permanent OBR. Professor Wren-Lewis appeared before the Committee and, drawing on his collaborative research with Leith, provided evidence and answered questions on the OBR's proposed remit and function. The Committee recognised the similarities between the proposal for a fiscal council put forward in the research described above and the proposed OBR.

Informing the Creation of a 'Scottish OBR'

In addition to communicating the research to central banks and policy-makers beyond the UK, Leith has recently begun working with the Scottish Government as part of an Inquiry into Proposals for an Independent Fiscal Body, which would function in a similar manner to the OBR.

Leith drew from the research on fiscal monitoring conducted with Wren-Lewis and Kirsanova to prepare written submissions for the Inquiry and has been invited to provide oral evidence to assist the Inquiry in November 2013.

5. Sources to corroborate the impact (indicative maximum of 10 references)

Influence on policy

1. *Reconstruction: Plan for a Strong Economy*, the Conservative Party's proposals for a new Office for Budget Responsibility: [Link](#) (pg 8)
2. Invitations to Wren-Lewis to meet with the Senior Economic Adviser at No. 10 Downing Street and with the Chancellor of the Exchequer [Available from HEI].

Contribution to decision-making on OBR remit and functions

3. House of Commons Treasury Committee *Report on the Office for Budget Responsibility*, Volume 1, 21 September 2010. London: The Stationery Office Limited: [Link](#)
4. Invitation to Leith to participate in Bank of England Roundtable on Monetary Policy [Available from HEI].
5. Bank of England Roundtable on Monetary Policy Report July 2010: [Link](#)

Informing creation of Scottish OBR

6. Chief Economist at the Scottish Government can provide a statement to corroborate Leith's involvement in advising the Scottish Government on its plans for a Scottish OBR [Contact Details Provided].
7. Invitation to Leith to provide oral evidence to the Scottish Government Finance Committee's Inquiry into Proposals for an Independent Fiscal Body [Available from HEI].