Foreword
On behalf of the Fiscal Commission Working Group (FCWG), I welcome this opportunity to submit a summary of the group’s work and findings to the Economy, Energy and Tourism Committee to assist in their enquiry into Scotland post-2014.

The economic landscape of Scotland post-2014 will clearly depend upon the outcome of the referendum on Scottish independence on the 18th of September this year. While the choice is a political one, the economic decisions and opportunities that will follow whatever the outcome are at the heart of the debate.

The FCWG was established in early 2012 to oversee the work of the Scottish Government on the design of a macroeconomic framework for an independent Scotland. Crucially, we also see our work as providing a vital contribution to help inform the wider debate on constitutional reform.

To this aim, we have published a series of papers covering a diverse range of issues such as choice of currency, financial stability, management of oil revenues, fiscal policy and tax.

Taken together, I believe that our programme of work provides the most comprehensive examination of the key issues available and has enabled us to set out a coherent set of proposals and recommendations for an effective and workable macroeconomic framework for Scotland in the event of a yes vote.

Across our work, we have taken a holistic and whole economy approach, concentrating on the strengths and key challenges in the Scottish economy and its unique economic structure and circumstance.

Our analysis highlights the importance of establishing a robust and credible framework, with a commitment to long-term stability, transparency, and sustainability. A robust macroeconomic framework provides the flexibility to respond to changing economic circumstances and is essential for long-term economic success and prosperity.

We have always made clear that certain proposals will require agreement with key partners. With this in mind, we have developed our recommendations with the aim of proposing a framework that is attractive, not only to Scotland, but also to the rest of the UK and the EU should there be a yes vote.

I appreciate that pre-referendum comments may cloud discussions around these issues. However, I am confident that the detailed propositions put forward represent a coherent and workable model that would be in the interests of all. They have at their heart the goal of ensuring economic growth and stability and continued market integration, partnership and cooperation across these islands.
With this in mind, I repeat my call for early engagement between both governments on our proposals. While not all areas can be agreed upon in advance of the referendum, I believe that such discussions would help to inform the debate in a positive and constructive manner.

I would like to extend my thanks once again to the members of the FCWG whose time and input has been extremely valuable and informative.

Crawford Beveridge (CBE), Chair Council of Economic Advisers
January 2014

**Summary**

The Fiscal Commission Working Group (FCWG) is a sub-group of the Council of Economic Advisers tasked with assisting the Scottish Government in the design of a robust and comprehensive macroeconomic framework for an independent Scotland. The group is chaired by Crawford Beveridge, and the members are Professors Andrew Hughes Hallett, Sir James Mirrlees, Frances Ruane and Joseph Stiglitz.

The FCWG has produced a series of publications including:

- **‘Assessment of Currency Options’** – is a detailed technical annex which analyses the currency options open to an independent Scotland and informed the recommendations in The First Report on a Macroeconomic Framework for Scotland.
- **‘Stabilisation and Savings Funds For Scotland’** – focusses on the optimal framework to best manage revenues from Scotland’s oil and gas reserves both in the short-term through the creation of a stabilisation fund and over the long-term through a savings fund to invest for future generations.
- **‘Principles for a Modern and Efficient Tax System’** sets out four principles – simplicity, stability, neutrality, and flexibility – that could shape the design of a modern and efficient tax system for Scotland. It also examines the opportunities, responsibilities and choices that an independent Scotland would face in setting tax policy in the 21st Century.
- **‘Fiscal Rules and Fiscal Commissions’** discusses the options for managing Scotland’s public finances and in particular, the effective use of fiscal rules and the establishment of an independent Scottish Fiscal Commission.

Alongside this, the Working Group also issued an update of our analysis in May 2013 crystallising the arguments in favour of a currency union. The Working Group believes that a shared currency is in the economic interests of both Scotland and the UK in the event of Scottish independence.

The Working Group also engaged with economic policy development in the Scottish Government and provided advice to the development of ‘Building Security and
Creating Opportunity: Economic Policy Choices in an Independent Scotland. This report is a Scottish Government publication.

R emit of the Fiscal Commission Working Group
In 2009 the Council of Economic Advisers (CEA) recommended the establishment of an independent Fiscal Commission to help inform the future direction of Scottish fiscal policy. Scottish Ministers accepted this recommendation, agreeing to the establishment of a Fiscal Commission alongside moves to greater autonomy.

The creation of Fiscal Commission Working Group was announced in March 2012 (www.scotland.gov.uk/News/Releases/2012/03/fiscal-commission25032012).

The Working Group was tasked with overseeing the design a robust macroeconomic framework for Scotland post-independence.

The constitutional future of Scotland is a decision for the electorate, and it is not the role of the Fiscal Commission Working Group to offer an opinion on independence. Instead the aim of the group is to use its expertise to provide advice and guidance to the government and to offer options for reform should a vote for independence be forthcoming.

The Working Group was tasked with:

- Overseeing the Scottish Government’s Office of the Chief Economic Adviser’s work on establishing a macroeconomic framework for an independent Scotland;
- Supporting the engagement with key institutions and external experts to help develop the Scottish Government’s proposals;
- Identifying any external academic expertise or consultancy work required to provide analytical rigour to the Scottish Government’s proposals.

The outputs of the Fiscal Commission Working Group represent a collective view from the membership of the group.

Membership of the Fiscal Commission Working Group
Membership of the Fiscal Commission Working Group is drawn from the First Minister’s Council of Economic Advisers. The Chair is Crawford Beveridge CBE.

Crawford Beveridge CBE (Chair) – Crawford Beveridge is a technology industry veteran with more than 35 years of experience. This included working as an Executive at Sun Microsystems for over 15 years. In 1991, Beveridge left Sun to become Chief Executive of Scottish Enterprise. Beveridge returned to Sun in April 2000 as Executive Vice President of People and Places and Chief Human Resources Officer. In addition to being the Non-Executive Chairman of the Board of Autodesk, Beveridge is Chairman of Scottish Equity Partners Ltd, and a Non-executive board member of eSilicon and Iomart Group PLC. He was awarded a C.B.E. in the New Years Honours list in 1995.
**Professor Andrew Hughes Hallett** - Professor of Economics and Public Policy at George Mason University in the US, visiting Professor at Harvard University and Professor of Economics at the University of St Andrews. Professor Hughes Hallett specialises in international economic policy and has acted as a consultant to the World Bank, the IMF, the Federal Reserve Board, the UN, the OECD, the European Commission and central banks around the world.

**Professor Sir James Mirrlees** – Professor Emeritus at Cambridge University and distinguished professor-at-large at the Chinese University of Hong Kong. In 1996 Sir James was awarded the Nobel Prize for his work on economic models and equations about situations where information is asymmetrical or incomplete. In 2010, he led the Mirrlees Review of taxation which examined the principles and characteristics of a good tax system for open developed economies in the 21st century.

**Professor Frances Ruane** – Professor Ruane is Director of Ireland’s Economic and Social Research Institute and Honorary Professor of Economics at Trinity College, Dublin. She has published widely in the area of international economics and industrial development.

**Professor Joseph Stiglitz**– Professor Stiglitz is Professor of Economics at Columbia University. He won the Nobel Prize in Economics in 2001 and was a member of the US Council of Economic Advisers (CEA) from 1993-95, serving as CEA Chair from 1995-97. He was Chief Economist and Senior Vice-President of the World Bank from 1997-2000. In 2009 he was appointed by the President of the UN General Assembly as Chair of the Commission of Experts on Reform of the International Financial and Monetary System.

**Meetings and Minutes of the Fiscal Commission Working Group**

Since February 2012, there has been regular engagement between the Fiscal Commission Working Group and Scottish Government Ministers and officials. This has taken the form of regular meetings, teleconferences and ad-hoc correspondence, with secretariat support provided by the Office of the Chief Economic Adviser.

Over this period, the topics that have been comprehensively discussed include:

- Currency options and the choice of Sterling as the currency for Scotland post-independence;
- Fiscal framework, including the use of fiscal rules and fiscal commissions and the design of an oil stabilisation and long-term savings fund;
- The management of government debt;
- Design of economic institutions;
- Financial regulation and financial stability;
- Economic and competition regulator;
- Economic performance of comparable countries;
- Economic policy opportunities for Scotland post-independence;
- Design of an appropriate tax system for an independent Scotland;
- Transition to independence, and;
Finalisation of FCWG papers.

A full summary of the Scottish Government's on-going engagement with the Fiscal Commission Working Group, including minutes of meetings is published on the Scottish Government website (www.scotland.gov.uk/Topics/Economy/Council-Economic-Advisers/FCWG).


Whilst the Working Group has completed the initial programme of papers the group remains active and continues to offer advice on economic issues related to the macroeconomic framework

Summary of Fiscal Commission Working Group Engagement and Publications

The Fiscal Commission Working Group has produced a series of publications focusing on the design of a macroeconomic framework for an independent Scotland. These papers looked at:

- Stabilisation and Savings Funds for Scotland (October 2013, www.scotland.gov.uk/Publications/2013/10/7805)
- Principles for a Modern and Efficient Tax System (November 2013, www.scotland.gov.uk/Publications/2013/10/4839)

Taken together, these papers provide a holistic and whole of economy approach to a macroeconomic framework for an independent Scotland.


Summaries of these publications, and their recommendations, are in the following Annexes.
Introduction

By international standards Scotland is a wealthy and productive country. The macroeconomic framework of a country relates to the structure and institutional design for monetary policy (including the choice of currency), fiscal policy (including government spending, taxation and borrowing) and financial stability (including monitoring of systemically important firms, resolution and deposit protection). All of these are linked and subject to interdependencies. Increasingly they are often developed in partnership with other countries.

A robust macroeconomic environment – characterised by low and stable inflation, currency stability, a strong balance of payments position, sound public finances and financial stability – is an essential ingredient in creating the right conditions for trade, commerce, job creation and efforts to tackle inequality.

A sound macroeconomic framework is also a pre-requisite for effective economic policy in key areas, such as investment in education, skills, and infrastructure, which are in turn vital for economic growth.

Economies are however, subject to fluctuations leading to changes in incomes, employment and the distribution of wealth over time. Managing these fluctuations, both in terms of boosting resilience and flexibility is a key goal of macroeconomic policy.

The Working Group’s first report puts forward a practical and workable macroeconomic framework for an independent Scotland, offering recommendations for the monetary policy, financial stability and fiscal policy of an independent Scotland.

The key proposals from our work are outlined below:

Macroeconomic framework proposals

The proposed framework takes the status quo as a starting point and considers the challenges and opportunities that independence would bring.

The timing of the constitutional debate, and the nature of relationships and partnerships in the modern global economy, mean that much of the detail of any framework will be subject to negotiation with these partners post the referendum. In that respect, it is important to acknowledge that political considerations will play a role and may cloud pre-referendum comments and policy statements. However, these are likely to differ from the actual decisions taken post-referendum when agreement is likely to take place where there are common interests.

Ultimately, the exact framework will be subject to negotiation, and many of these discussions may not take place until after the referendum. However, the Working
Group encourages all interested parties to engage on this proposition in advance of the referendum. The Working Group is confident that the broad outline of this framework will be attractive to key partners including the UK and the EU if there is a vote for independence.

In particular, the overarching framework would be in the economic interests – in terms of trade, competition and financial stability – of the UK post-independence.

The Working Group is of the clear opinion that such technical negotiations and discussions should take place in advance and that this would be in the interests of clarity and predictability for both the UK and Scotland.

The central objective has therefore been to design a workable proposition that delivers a robust and credible system that could operate from the first day of independence. It has drawn upon recent experiences across a range of countries and has been designed to be flexible to allow for variations in specific technicalities, such as institutional structures, following the outcome of any negotiations.

As with other successful macroeconomic frameworks, the system aims to be sufficiently flexible to evolve in the light of new economic developments and future preferences in the decades ahead. A key aspect of this is the gradual establishment of relevant macroeconomic institutions in Scotland.

Monetary policy
- Formal monetary union with UK, with Bank of England (BoE) as central bank.
- Ownership and governance of BoE undertaken on an explicit shared basis, reflecting Scotland’s current implicit share of existing assets.
- Monetary policy set according to economic conditions across Sterling Area.
- The Scottish Government to input into appointment process to key positions within Bank of England (for example, MPC and FPC), its remit and objectives.
- Representative from Scottish Treasury attends MPC meetings in similar capacity to existing HM Treasury representative (i.e. in a non-voting capacity).
- Matters of collective decision making on governance addressed within an overarching agreement between both governments. An institutional arrangement, a ‘Macroeconomic Governance Committee’, to be established.

Financial stability
- Objective of the Scottish Government should be to promote financial stability and ensure that taxpayers are never again forced to step-in and bail-out private institutions.
- The proposition centres on two key aspects of financial stability from a macroeconomic perspective - Supervision and Oversight; and, Crisis Management, Resolution and Deposit Guarantee.

Supervision and oversight
- Scotland to establish one (or more) independent competent authorities to oversee financial regulation.
Given the close linkages between macroeconomic stability and financial stability, key elements of prudential regulation (micro and macro) to be discharged on a consistent basis across the Sterling Area.

Other areas of financial regulation (i.e. non-prudential elements), such as consumer protection, form a linked, though distinct, aspect of the regulatory environment. These could be discharged in Scotland, however a degree of consistency across the Sterling Area is likely to be desirable given the integrated financial services sector and links to prudential regulation.

*Crisis Management, Resolution and Deposit Guarantee*

- Financial crises require close coordination of monetary, fiscal and macroprudential policy.
- Issues of financial stability – including lender of last resort facilities for financial institutions – and crisis management to be coordinated on a pan-Sterling Area basis.
- If and when any input was required from a fiscal authority – for example an indemnity – this could be coordinated through the ‘Macroeconomic Governance Committee’.
- This could be discharged by both governments in accordance with the shareholder framework set out above.

*Fiscal policy*

- Fiscal policy (along with other economic policies such as regulation) would provide the principle new levers to grow the economy and to tackle key challenges in Scottish society.
- As part of the negotiation of a fair and equitable share of UK public sector liabilities and assets, a transitional arrangement whereby outstanding debt was gradually transferred to both governments would be a sensible and efficient solution.
- To promote stability within the proposed monetary union, there is merit in devising a ‘fiscal sustainability agreement’. This should cover both governments and be credible. This would not cover individual taxes and/or spending but overall net borrowing and debt. This would provide the flexibility to develop policies to promote growth and maintain economic performance.
- Given the importance of oil and gas revenues, a stability fund should be established, with the government planning budgets on a cautious estimate for oil revenues and then investing any upside variability in a fund to guard against future unexpected falls in revenue or asymmetric shocks.
- Fiscal Commission to be established, with an advisory role.
- The Scottish Government should establish an independent Scottish Monetary Institute and would be responsible for setting its remit.
- This Institute could take responsibility for a number of key functions, which it could undertake independently, including, research, monitoring developments in the financial sector and data collection. It would work closely with BoE.
- There is merit in placing key macroeconomic functions, such as designated financial regulator, in such an independent body. Such a body would also be a key focal point and reporting body for EU-wide institutions and structures and other international organisations.
An update of the executive summary of the report can be found below.

**Updated Executive Summary**

By international standards Scotland is a wealthy and productive country.

Even excluding North Sea oil output, GVA per head of population in Scotland is the highest in the UK outside London and the South East. With North Sea output included, it is estimated that in 2011 Scotland would be ranked 8th in terms of GDP per capita in the OECD.

However, over the last 30 years, Scotland’s economic growth rate has lagged behind that of many of its peers.

Under the current macroeconomic framework, fiscal policy, monetary policy, financial regulation and key elements of industrial policy and economic regulation are reserved to the UK Government. The Scottish Government has no distinct input into these areas, and there is no form of accountability to the Scottish Parliament where the majority of spending allocations are made.

Under independence, the Scottish Government would be responsible for the design and implementation of its own macroeconomic framework. There would be a number of choices open to Scotland as to how it could organise and manage its macroeconomy post-independence.

The design of a macroeconomic framework typically revolves around three key pillars – monetary policy (including the choice of currency), financial stability and fiscal policy.

A sound fiscal framework will be essential for a newly independent Scotland. This will be particularly true during the early years of independence, with clear benefits from demonstrating stability, competence and fiscal sustainability.

Macroeconomic frameworks can – and should – evolve over time. At their heart however, should be a commitment to long-term stability, transparency and sustainability, whilst providing flexibility to respond to unforeseen events.

The Working Group was asked to oversee the design of a macroeconomic framework and what is proposed in this report is designed to be robust, flexible and work from the first day of independence.

Ultimately the exact framework will be subject to negotiation, and many of these discussions may not take place until after the referendum. However, the Working Group encourages all interested parties to engage on this proposition in advance of the referendum. The Working Group is confident that the broad outline of this framework will be attractive to key partners including the UK and the EU if there is a vote for independence.

In particular, the overarching framework would be in the economic interests – in terms of trade, competition and financial stability – of the UK post-independence.
The propositions for monetary policy, financial stability, fiscal policy and their interactions offer fully engineered solutions to some of the challenges that have been highlighted with both monetary unions and macroeconomic frameworks more generally.

It is designed to be flexible and evolve should the people of Scotland wish for further reform in the future and/or should economic conditions change. This is a key aspect of economic sovereignty.

The framework proposed would represent a substantial step-change in the economic powers of the Scottish Parliament and greatly increase the economic and social policy levers at the disposal of policymakers in Scotland. Alongside this would flow new responsibilities and commitments.

Summary of report
The report provides a detailed analysis of the Scottish economy and assessment of the key issues that an independent Scotland would face when designing a macroeconomic framework. It also provides a series of recommendations for the Scottish Government to consider and outlines a workable proposition for a macroeconomic framework for Scotland post-independence.

- Chapter 1 sets out the background and motivation for the report, briefly outlining the membership and remit of the Working Group. It makes clear that the Working Group is committed to providing impartial advice and putting forward a framework that is practical and workable from day one of independence.
- Chapter 2 highlights the recommendations of the Working Group, including the retention of Sterling as part of a formal monetary union with the UK. The Working Group also recommended that the Scottish Government should explore frameworks for the effective management of the public finances, financial stability and scope out further work around economic policy and technical capabilities in the Scottish Government. The full set of recommendations are set out below.
- Chapter 3 summarises the proposed macroeconomic framework. The framework is designed to meet two goals – long term competitiveness and short-run responsiveness. It comprises a robust framework covering monetary policy & currency arrangements (including retaining the pound), financial stability, and fiscal policy.
- Chapter 4 provides an overview of the Scottish economy.
  - By international standards, Scotland is a wealthy and productive country. It is the third most prosperous part of the UK and would rank eight in the OECD in terms of GDP per capita. Scotland has international advantages in key sectors such as food and drink, energy, life sciences, education and finance and underlying strengths in human capital and institutions. Scotland also has a global reputation for science, engineering and creativity and continues to remain an attractive location for international investment.
  - The Scottish economy also faces challenges. Many of these have persisted over decades. Scotland’s long-term historical growth rate has
lagged behind many of its peers. Scotland’s business start-up, entrepreneurship and innovation rates have been lower than both the UK average and key competitors. Scotland is also part of a UK economic model and society which is one of the most unequal in the OECD. Moreover, the UK economy has become unbalanced and indebted, with growth increasingly concentrated in London and the South East.

- Chapter 5 introduces the key elements of macroeconomic frameworks. Such frameworks should be designed to promote long-term stability, transparency and sustainability while also providing flexibility to respond to unforeseen events. In many countries, including the UK, the frameworks that were in place were not sufficiently robust to prevent and/or withstand the effects of the 2008-09 financial crisis. In the light of this, there is a recent trend of greater coordination between countries.

- Chapter 6 reviews the current macroeconomic framework in the UK. As a devolved administration, the Scottish Government has virtually no input into the framework for monetary policy, financial regulation and the overall fiscal stance and approach to sustainability. The Scottish Government does have responsibility for key elements of public spending which can influence the long-term growth rate of an economy, including health and education. However, after the Scotland Act 2012 has been introduced, the Scottish Government will only be responsible for around 15% of revenues raised in Scotland. The Scottish Budget is therefore largely determined by a Block Grant determined by the UK Government.

- Chapter 7 looks at the design options for monetary and financial stability – including a review of the four key currency options for an independent Scotland and frameworks for delivering the shared public good of financial stability across the UK.

- Chapter 8 provides a summary of the design options for a fiscal framework. The Working Group recommends that the Scottish Government should implement Fiscal Rules, establish a permanent Fiscal Commission and establish mechanisms to manage North Sea Oil revenues.

- Chapter 9 pulls together the detail of the preceding chapters to set out the overall macroeconomic framework for Scotland post-independence, emphasising the key recommendations on monetary policy, financial stability and fiscal policy. The proposed framework balances continuity, flexibility and stability with policy autonomy. It is a workable model for day one of independence.

- Chapter 10 presents the conclusions of the report. The chapter also set out the key areas for future analysis from the Working Group.

Recommendations from the First Report of the Fiscal Commission Working Group

The recommendations from the First Report of the Fiscal Commission Working Group – Macroeconomic Framework are grouped under five key themes:
Macroeconomic framework
The Working Group commends to the Scottish Government retaining Sterling as part of a formal monetary union, and believes that this provides a strong overarching framework for Scotland post-independence.

The Working Group also believes that – post independence – a shared currency would be in the interests of the UK given the trade and financial links with Scotland. The Working Group also recognises that macroeconomic frameworks evolve over time as economic and political circumstances develop.

Recommendation: the Scottish Government should refine the detail of the proposition set out for a macroeconomic framework which can operate from day one of independence and through any period of transition and indefinitely if required. The framework should ensure monetary and price stability, financial stability and fiscal sustainability.

Recommendation: the Scottish framework should be sufficiently flexible to retain the capacity to evolve the framework in the medium or long term if economic circumstances warrant it.

Fiscal framework
The Scottish Government should look to establish a fiscal framework – including the use of fiscal rules and an independent fiscal commission – which maximises economic policy flexibility and provides opportunities to promote economic growth, deliver greater economic resilience and address inequalities in Scotland.

Recommendation: the framework should focus on long-term sustainability through effective management of the public finances alongside ensuring growth, economic policy flexibility and creating opportunities.

Recommendation: the Scottish Government should seek, in principle, to establish a stabilisation fund such as an Oil Fund, to help manage its natural resources and to enhance future economic resilience.

Financial stability
The Working Group stresses the importance of delivering a stable financial framework, both as part of the evolving UK and EU financial services market, given the need to ensure a properly regulated and functioning financial system at the heart of a successful economy.

The Working Group recognises the benefits from maintaining an integrated financial services sector that creates opportunities to address key internationally shared challenges, strengths and opportunities, subject to the need to ensure stability of the system and resilience of the Scottish economy. In principle, this should be based upon a foundation of effective supervision, resolution and deposit protection mechanisms.

Recommendation: the framework for financial stability should look to support economic growth across the whole of the Scottish economy and, given the presence of major cross-border institutions in the UK and the EU, seek effective coordination of financial oversight and supervision. As part of this, the government of an
independent Scotland should use its international representation to press for strict and effective guidelines at the international level. **Recommendation:** there should be a clear framework and structure to separate the link between the balance sheet of financial institutions and government and ensure the presence of clear mechanisms for crisis management and resolution.

**Economic levers**

Independence would provide a substantial step change in the economic and social policy levers open to future Scottish Governments. A clear, evidence based and robust debate should take place to discuss how best to meet key priorities.

**Recommendation:** the Scottish Government should take forward a programme of work to identify and develop key economic and fiscal policy opportunities and choices within the proposed framework to deliver economic growth, resilience, fairness, opportunity and sustainability.  
**Recommendation:** as part of this work, lessons should be drawn from the successful use and application of economic levers from other economies of comparable size.  
**Recommendation:** in particular, in addition to boosting economic growth, the Government should explore and prioritise opportunities to address inequalities and to promote inter-generational equity and environmental sustainability.  
**Recommendation:** the Scottish Government should take forward a programme of work to scope out and design an efficient and cost effective tax system.

**Institutional structures**

Countries of Scotland’s size are not simply scaled down versions of larger economies. Instead they develop their own unique structures and institutions. Establishing these institutions and ensuring that the relevant skills and expertise are developed will be a key initial task for an independent Scotland.

**Recommendation:** institutions, skills and capacity should be developed to support the Scottish Government through the process of negotiation, transition and achieving full independence.  
**Recommendation:** as part of their work on institutional structures the Scottish Government should:

- Consult key stakeholders about the detail of the proposals in advance of the publication of the White Paper.  
- Develop a detailed transition plan.  
- Explore options for establishing relevant institutions (e.g. debt management, fiscal, monetary and regulatory) and building the necessary in-house capacity and expertise to support macroeconomic policy development in the Scottish Government.  
- Ensure that the design of any new institutions is efficient, flexible and credible.  
- Establish a permanent independent ‘Fiscal Commission’ and a ‘Scottish Monetary Institute’ whose role and remit would be set by the Scottish Government. However they could act independently to advise stakeholders, including the Scottish Government, on the Scottish economy, public finances and international developments. Such institutions would play a key role as part of the evolution of the macroeconomic framework.
• Work with partner institutions to improve the coverage of economic data for Scotland and develop in-house macroeconomic technical expertise within the Scottish Government.
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<th>Framework Summary</th>
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<tr>
<td><strong>Status Quo (incl. Scotland Act)</strong></td>
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<tr>
<td><strong>Monetary &amp; Financial Stability</strong></td>
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<tr>
<td><strong>Monetary Policy</strong></td>
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<tr>
<td>- Central Bank – Bank of England (the ‘BofE’)</td>
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<td>- Day-to-day monetary policy discharged independently (operationally) by the BoF.</td>
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<td>- Interest rates set to promote price stability across UK</td>
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<tr>
<td>- Scottish Government has no input into governance and remit (including key committees such as the MPC) of the BoF.</td>
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<tr>
<td>- Macroeconomic Governance Committee to coordinate governance and oversight of formal monetary union.</td>
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<td>- Scottish Monetary Institute established</td>
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<td><strong>Financial Stability</strong></td>
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<tr>
<td>- Financial regulation reserved to UK – significantly driven by EU regulations and directives.</td>
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<td>- Financial Policy Committee oversees macroprudential regulation and the Prudential Regulatory Authority oversees significant microprudential regulation.</td>
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<tr>
<td>- Financial Conduct Authority responsible for other aspects of regulation including consumer protection.</td>
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<td>- Financial stability monitored and delivered across the UK</td>
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<tr>
<td>Fiscal Policy</td>
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| **Principal Funding Source** | - Block Grant  
- Size and pattern of funding determined by UK Government | - Full tax raising potential of Scotland |
| **Revenue Autonomy** | - Limited - 16% of tax revenues to be devolved by 2016  
- Restricted to 2 Devolved taxes (landfill tax & stamp duty) and 2 local taxes (council tax and business rates)  
- Sharing of income tax revenues, although most key decisions on rates, allowances and tax bands retained by UK Government | - Full Autonomy (rates, bands, allowances and administration)  
- 100% of revenues responsibility of Scottish Parliament. |
| **Expenditure Autonomy** | - Current devolved responsibilities (Health, Education etc).  
- Scottish Parliament responsible for allocating around 60% of public spending | - Full Autonomy to determine priorities  
- Maximum opportunities to integrate and align key spending priorities with revenue autonomy  
- 100% of expenditure (including welfare and defence) responsibility of Scottish Parliament |
| **Fiscal Responsibility (including debt management)** | - Fiscal envelope determined by UK Government  
- Modest capital borrowing but no opportunity to stimulate economy during downturn | - Scottish Government fully responsible for fiscal sustainability  
- Overarching joint ‘fiscal sustainability agreement’ to govern level of borrowing and debt within Sterling Area |
- Limited borrowing powers not available until April 2015 and future changes at discretion of HM Treasury
- Arrangements for financing existing UK debt agreed as part of post-referendum negotiations
- Independent Fiscal Commission to advise Scottish Government on sustainability of fiscal policy

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<th>Status Quo (incl. Scotland Act)</th>
<th>Macroeconomic Framework Proposal</th>
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<tr>
<td><strong>Summary</strong></td>
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<tr>
<td><strong>Economic Levers</strong></td>
<td></td>
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<tr>
<td>• Responsible for many ‘supply-side’ drivers such as education and local economic development</td>
<td>• Full flexibility to manage fiscal and economic policy to support the Scottish economy.</td>
</tr>
<tr>
<td>• Monetary policy and financial stability set for UK economy</td>
<td>• Monetary policy and financial stability set for Sterling Area</td>
</tr>
<tr>
<td>• Limited autonomy over taxation and other policy levers to improve competitiveness and social outcomes.</td>
<td>• Full autonomy over tax and other ‘competitive’ policy levers, target explicit challenges &amp; opportunities facing Scotland</td>
</tr>
<tr>
<td>• Rely upon UK Government for key decisions in reserved areas (‘one-size-fits-all’)</td>
<td>• Scottish Parliament fully responsible for economic growth, inequality and sustainability</td>
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<tr>
<td><strong>International Representation</strong></td>
<td></td>
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<tr>
<td>• No specific international representation</td>
<td>• Greater representation in Europe allowing Scottish circumstances to be reflected in the design, transposition and enforcement of economic policy and regulation</td>
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<tr>
<td>• Limited scope to assert Scotland’s distinct position in international economic decision making arenas</td>
<td>• Opportunity to work in partnership with interested parties in areas of mutual benefit</td>
</tr>
<tr>
<td>• Reliant upon UK and Scottish interests always being fully aligned</td>
<td>• Full membership and representation of international organisations</td>
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| Economic Sovereignty | • Determined by UK Government  
• Future powers at discretion of UK Government | • Full economic sovereignty with Scottish Parliament  
• Ability to evolve economic framework to future opportunities, pressures and demands of the people of Scotland |

Available at: www.scotland.gov.uk/Resource/0041/00414366.pdf

Introduction
The technical annex looks at the key currency options for an independent Scotland – retention of Sterling, adoption of the Euro and the establishment of a separate Scottish currency.

The choice of currency, by dictating both the fundamental structure of the monetary framework and the relationship with other countries, will also have implications for the overall framework for fiscal policy and financial stability.

Countries of comparable size to Scotland have adopted a range of different currency frameworks to suit their economic situation. The annex provides a summary of the key options for Scotland and provides an analytical assessment of their respective strengths and weaknesses.

There are a variety of economic factors and technical assessments which are worthy of consideration when assessing the merits of the currency options available to an independent Scotland. These can be useful in helping to inform the debate.

In analysing the currency choices for Scotland, the annex views each option through five broad areas of assessment –

- Are the fundamental structures of the Scottish economy currently suited to such an arrangement?
- Are there any benefits/implications for short-term macroeconomic stabilisation?
- What are the potential benefits/implications for trade and investment?
- How straightforward would the transition arrangements be? and,
- What policy levers would be open to future Scottish Governments to address the key challenges and take advantage of new opportunities in the Scottish economy?

Summary
The Working Group conclude that retaining Sterling in a formal monetary union with the UK will be the best option, both for Scotland and the rest of the UK.

Retaining Sterling would be a practical option for Scotland immediately post-independence. In addition to the long-term structural benefits that are highlighted below, retaining Sterling would assist with a smooth transition to independence (e.g. practicalities of sharing assets and liabilities and establishing the necessary economic, financial and fiscal institutions). It would ensure a functioning monetary system from day one of independence.

Over the medium-term it may well be in Scotland’s interests to move to an alternative arrangement, should there be changes in either the performance of the Scottish economy or the preferences of the people of Scotland. It may also be in Scotland’s interest to retain Sterling.
This would be a decision for the future.

A currency union makes sense for a number of reasons –

- Exports to the rest of the UK account for around two thirds of total exports. There is also a high degree of labour and capital flows between the two economies. A currency union would facilitate continued high levels of trade and integration.

- Scotland is a key export destination for the rest of the UK. The UK is estimated to export more to Scotland than to Brazil, South Africa, Turkey, Russia, India, South Korea, China and Japan put together – and is the UK’s 2nd largest trading partner.

- Promoting the single market will have advantages to both countries. This will be particularly important in sectors which are highly integrated and for firms with complex supply chains operating across the UK. Transaction costs and exchange rate costs will be eliminated.

- There is also a high degree of labour mobility between Scotland and the UK – helped by strong transport links, culture, recognised education qualifications and a common language.

- On long-term measurements of economic performance – such as GDP per head and productivity – the Scottish and the UK economies are broadly aligned. Employment levels are also broadly similar between Scotland and the UK.

- Past evidence of business cycles shows that while there have been periods of temporary divergence, overall there is a relatively high degree of synchronicity compared to other closely related economies. Analysis has shown that Scotland and the UK have closer economic cycles than most other Eurozone economies. The scale, length and frequency of asymmetric shocks is also limited, based upon historical evidence.

- Due to links between the short-term interest rate and consumer spending, variations between housing market structures can influence the way in which monetary policy, through the interest rate transmission mechanism, has an impact on different parts of a single currency area. Over the last two decades, home ownership in Scotland has significantly increased to broadly converge with the UK.

In addition, the framework proposed is much richer and more strongly engineered than the original Eurozone model. It proposes greater alignment of financial stability policy, mechanisms to ensure fiscal discipline and respond to asymmetric shocks.

In summary, this assessment suggests that monetary policy set to promote price and financial stability across a Sterling Area would, as an initial assessment, appear to be consistent with the objectives of delivering a stable macroeconomic system for Scotland.

Finally, retaining Sterling would be a useful mechanism to help assist the transition to independence.
The features that point in favour of a Sterling currency union are in contrast to the Eurozone. For example, productivity in Greece is 70% of the level in Germany. The institutional structures of Scotland and the rest of the UK, with shared institutions and practices which have developed over time, puts the Sterling Area in a more advantageous position than that of the current Eurozone model.

As a member of the EU, Scotland would have the option – once convergence criteria were met – to join the Eurozone. Independence within the Euro would provide Scottish Ministers with greater access to policy levers than the current framework. However, adopting the Euro at this stage would pose a number of challenges with the Scottish economy less well suited to such an arrangement.

Finally, an independent Scottish currency would have monetary and exchange rate policy set by a Scottish Central Bank. From a macroeconomic policy perspective this would provide the maximum degree of flexibility. An independent Scottish currency could – if valued more competitively than Sterling – offer a significant advantage to Scottish firms. However, using an independent currency would require more money-changing than either the continuation of Sterling or the adoption of the Euro.

On balance, the Working Group conclude that retaining Sterling as part of a formal monetary union with the UK would be a better option immediately post-independence.

Annex C: Stabilisation and Savings Funds for Scotland

Available at: www.scotland.gov.uk/Publications/2013/10/7805

Introduction

In the event of Scottish independence, the majority of oil and gas production, together with the majority of reserves, on the UK Continental Shelf (UKCS) will reside in Scotland’s territorial waters. The value of these reserves is substantial.

The First Report of the Working Group recommended that the Scottish Government should seek, in principle, to establish a stabilisation fund such as an Oil Fund, to help manage its natural resources and to enhance future economic resilience. This report builds on this recommendation.

Other countries with significant reserves of natural resources have set up fiscal mechanisms to manage such wealth. Indeed, the vast majority of significant oil producers in the world operate some form of national or sub-national Sovereign Wealth Fund, with the UK being a notable exception.

The economic rationale for establishing such funds is clear. They can help manage short term fluctuations in revenues caused by temporary shocks to commodity prices or production levels.

They can also ensure that the depletion of a country’s finite natural resources is at least partially offset by the accumulation of financial assets which can provide a lasting benefit for future generations. There is a strong case for an independent Scotland to establish such funds as part of any post-independence fiscal framework.
Considering the theory underpinning such mechanisms, how they have operated in other countries, and the Scottish context, the Working Group suggests that:

- In the short-term, an independent Scotland should plan its public finances considering a forecast of offshore revenue, and that any revenue received above this forecast should then be saved in a stabilisation fund.
- Resources in the fund could then be drawn down during years when offshore receipts came in below forecast, or to mitigate the impact of an economic shock.
- A long-term savings fund should be established to ensure that the extraction of Scotland’s oil and gas reserves is partly offset by the accumulation of financial assets that can provide a permanent income stream in the future.

To maximise their effectiveness, such funds should be embedded in the institutional management of Scotland’s public finances. As such it will be desirable to ensure that there is broad consensus on their underpinning objectives and principles.

A short-term stabilisation fund could initially involve the Scottish Government basing its spending plans on a cautious forecast of oil revenues. Then, if oil revenues exceed the forecasts, the excess could be transferred into the stabilisation fund. This in itself would represent prudent fiscal management and would reduce the risk of borrowing overshooting planned levels. The fund could also act as a liquidity buffer by providing an immediate, and potentially large, source of funding which the Scottish Government could draw upon.

The Working Group has also considered in detail the timeline for making investments into a long term savings fund. In principle, the Working Group sees merit in Scotland aiming to run some form of onshore budget balance. This would provide the optimal conditions for investment in a savings fund.

Given the fiscal position that an independent Scotland is likely to inherit, such a rule would make such investments unlikely in the years immediately following independence. However, the Working Group strongly endorses the merits of a long term savings fund and the importance of committing to its establishment as a central element of Scotland’s fiscal framework. This would ensure that the need for long term investment was balanced alongside more apparent – or politically appealing – short term spending priorities from day one of independence.

Such a fund should therefore be established immediately following independence. This would guarantee that the fund’s operation and guiding principles were embedded within the wider management of Scotland’s public finances from day one. It would also allow clear guidelines to be established to ensure that the Scottish Government’s fiscal framework facilitated the transfer of resources into a savings fund when conditions allow.

Such a process would help to lock in a strategy of prudent financial management and strengthen Scotland’s credibility on international financial markets.
Summary of Stabilisation and Savings Funds for Scotland
The report provides a detailed analysis of the public finance implications of Scotland’s north sea revenues. It also provides a series of recommendations for the Scottish Government to consider when establishing a robust framework for managing such wealth.

- Chapter 1 provides a brief introduction. On independence, the majority of North Sea oil and gas production and reserves is estimated to reside in Scotland’s territorial waters. As tax revenues from oil and gas are a finite revenue stream and are subject to larger year on year variations in receipts than many other revenue sources, the management of Scotland’s oil and gas reserves will be a key priority for an independent Scotland.
- Chapter 2 looks at the oil and gas sector, analysing recent trends in production and forecasts for remaining reserves. The sector is a major component of both the UK and Scottish economies in terms of jobs, investment and tax revenues.
- Chapter 3 reviews Scotland’s public finances. North Sea Revenues made up approximately 16% of Scottish tax receipts between 2007-08 and 2011-12. This is in line with other major oil producing countries.
- Chapter 4 considers the theory and rationale for establishing an oil stabilisation and savings fund and draws on the experience of other commodity producing countries. Stabilisation funds are designed so that a proportion of tax receipts is saved when revenues are above forecast, with resources withdrawn when receipts are below forecast. This helps to smooth budgets over time. Long term savings funds aim to save a share of the wealth generated from natural resources for the benefit of future generations. There are numerous examples of successful funds, including the Norwegian Government Pension Fund Global.
- Chapter 5 sets out the options for managing Scotland’s oil wealth. This includes discussions of how a fund can be established, rules which govern when payments are made (and revenues withdrawn), potential investment policies and the management and institutional structure of any such fund(s).
- Chapter 6 reports the conclusions and lists the recommendations of the Working Group. The Working Group recommend that the Scottish Government should establish a short-term stabilisation fund immediately following independence, with budget decisions based on transparent and credible forecasts of oil and gas revenue. A long term savings fund should also be established, with contributions being made when the public finances allow.

Recommendations from Stabilisation and Savings Funds for Scotland
The recommendations from the Stabilisation and Savings Funds for Scotland were:

Recommendation: The Scottish Government should establish a short-term stabilisation fund to manage year on year changes in oil and gas tax revenue immediately following independence. The fund’s operation should be embedded into the wider management of the public finances of an independent Scotland.

Recommendation: The Scottish Government should plan its public finances and borrowing requirements on the basis of a cautious forecast for oil and gas revenue. If
revenues exceed this forecast, the surplus should be transferred to the stabilisation fund. Conversely, if revenue is below this forecast, reserves could be withdrawn from the fund thereby allowing public spending to be maintained despite short term movements in oil and gas revenues.

**Recommendation:** The Scottish Government should ensure that the mechanisms used to forecast North Sea revenue, manage transfers into a stabilisation fund and integrate the fund into the wider fiscal framework, are transparent and credible. These processes should be assessed independently of government, for example, by an independent Scottish Fiscal Commission.

**Recommendation:** The Scottish Government should establish a long-term savings fund immediately following independence. This will ensure that a proportion of the wealth generated from the taxation of Scottish oil and gas production can be invested in financial assets and thereby provide a permanent revenue stream for future generations.

**Recommendation:** To maximise transfers into a savings fund, a long-run objective should be for the Scottish Government to run some form of onshore budget balance and to seek to invest a fixed percentage of North Sea revenues into a savings fund annually. In the short-run, the Scottish Government should consider starting to make modest investments into a long term savings fund once net borrowing was manageable and public sector net debt, as a share of GDP, was on a downward trajectory.

**Recommendation:** The operation of both a short-term stabilisation fund and long-term savings fund should be transparent and subject to clear guidelines covering the funds’ overall objectives, transfer arrangements, investment strategies, withdrawal rules, and day to day management.

**Recommendation:** There should be regular disclosure and reporting of the principles governing the fund, and the allocation and return on assets. All of the fund’s investment activities should be open and subject to independent audit and evaluation.

**Annex D: Principles for a modern and efficient tax system in an independent Scotland**

Available at: [www.scotland.gov.uk/Publications/2013/10/4839](http://www.scotland.gov.uk/Publications/2013/10/4839)

**Introduction**

The Scottish Parliament is currently responsible for around 7% of all taxes raised in Scotland. This will rise to 15% with the introduction of new responsibilities flowing from the Scotland Act 2012. Independence would provide responsibility for taxation with autonomy over tax design, collection and implementation.

It follows that an independent Scotland will have to develop its own taxation system. This provides an opportunity to consider what such a system might look like in a small modern country, and in particular consider Scotland’s specific circumstances and context. By not being bound by historical precedent, a new system – fit for the 21st century – could represent a major competitive advantage for an independent Scotland as well as a significant improvement over the complex and costly UK tax system.
This report from the Fiscal Commission Working Group sets out the principles of a modern and efficient tax system and the opportunities, responsibilities and choices that an independent Scotland would face.

The Working Group recommend that four principles—simplicity, stability, neutrality, and flexibility—should guide the design and operation of the tax system of an independent Scotland. This will allow the Scottish Government to use the tax system to meet its objectives—particularly raising revenues, fostering growth and competitiveness, and tackling inequalities—in the most effective manner.

Although focused on the tax system—the paper highlights the need to consider a whole system approach in the design of policy, crucially in regard to the interactions with the welfare system.

**Summary of principles for a modern and efficient tax system**
The report sets out key principles that could shape an independent tax system for Scotland and draws on the experiences of other countries. It provides a series of recommendations for the Scottish Government to consider.

- Chapter 1 introduces the substantial evidence base on taxation and tax reform, and briefly considers the potential advantages of a redesigned tax system for an independent Scotland.
- Chapter 2 reviews taxation in Scotland and the UK. An independent Scotland would inherit the UK tax and benefit system on day one of independence. This system performs broadly in line with similar economies in terms of international rankings, although there are clear concerns over cost and complexity. A key theme articulated in this chapter and throughout the report is that it is essential to consider the entire tax system rather than just one element.
- Chapter 3 provides an overview of the role principles in taxation. A tax system should fund expenditure and other obligations, help to achieve preferred levels of equality, influence key behaviours, help to smooth macroeconomic fluctuations and support growth, employment and a diversified industrial base. A tax system which is simple, transparent and stable will minimise costs and maximise tax revenues, investment and growth. In this regard, a well-designed tax system could represent a major advantage for an independent Scotland.
- Chapter 4 summarises international trends in taxation. Despite widespread variation in tax systems, some underlying patterns have emerged. For example, taxes targeted toward general consumption (such as VAT) have become more prominent alongside a broadening of the tax base. Meanwhile, revenues from corporate taxes have fallen as a proportion of total revenues raised, and headline rates of tax have decreased. The Scottish Government can learn from specific examples of tax reforms in other countries—both successful and unsuccessful reforms. Evidence highlights the importance of timing and transition and the benefits of independent experts and extensive consultation in the reform process.
- Chapter 5 looks at the range of choices, opportunities and responsibilities that an independent Scotland would face. Independence would allow for the redesign of the tax system according to specific Scottish circumstances and
needs. Taxation is a key lever in competitiveness, economic growth and tackling inequalities and plays a crucial role in a robust and successful macroeconomic framework.

- Chapter 6 sets out the conclusions and recommendations of this work. The Working Group recommend that a Scottish tax system should be clear and principles based, designed as part of the wider fiscal and macroeconomic framework focussed on addressing key priorities. The Scottish Government should build on the experiences from the implementation of tax powers in the Scotland Act 2012 in order to assist with the transition to a redesigned system.

**Recommendations from principles for a modern and efficient tax system**

The Working Group set out recommendations to Scottish Ministers based around 5 themes: a modern tax system; effective macroeconomic framework; competitiveness, economic growth and equality; transition and implementation; and the European and international context.

**Designing a modern tax system**

**Recommendation:** A Scottish system should be clear and principles based – any exemptions and tax reliefs should be carefully targeted.

**Recommendation:** The government should set out and develop a transparent framework for policy making – based around clearly defined objectives and principles of a good system, with decisions based on a robust and analytical assessment of costs and benefits.

**Recommendation:** A Scottish system should be built to ensure that there is a whole view approach to consumer and business taxation – including the use of unique identifiers to aid simplicity, transparency and compliance.

**Recommendation:** Scotland should look to have an efficient government structure and institutional landscape to maximise the effectiveness and efficiency of tax policy design and tax collection and links with wider socio-economic policies.

**Delivering an effective macroeconomic framework**

**Recommendation:** The Scottish Government should consider tax policy design as part of the wider fiscal and macroeconomic framework, including the use of fiscal rules and the establishment of an independent fiscal commission.

**Recommendation:** High levels of integrity and transparency should be brought to the system through the establishment of a tax policy forum – using independent experts would ensure that vested interests did not unduly influence the design.

**Promoting competitiveness, economic growth and tackling inequalities**

**Recommendation:** The Scottish Government should design a tax system built around Scottish circumstances and preferences to help increase productivity and economic growth while meeting the needs of the people of Scotland.

**Recommendation:** The tax and welfare systems are key levers for tackling inequality – both are strongly interlinked and should be considered as fundamentally part of the same system. Welfare and tax policy should therefore be developed in tandem to ensure policy integration and alignment.
**Recommendation:** Appropriate tax rates maximise receipts by creating the optimal level of economic activity and revenue raising potential. The Scottish Government should assess the optimal balance of tax rates and bases for key taxes, such as business and employee taxes, and levels of government spending.

**Recommendation:** An open and consultative approach with the industry, independent experts, employer groups, and the general public, should be adopted when designing and reviewing the effectiveness of tax administrative policy to ensure the system is comprehensive, inclusive and maximises compliance.

**Transition and implementation**

**Recommendation:** The Scottish Government should build upon the experiences and lessons from the implementation of the tax powers in the Scotland Act 2012 to assist with the transition and implementation of further new powers.

**Recommendation:** The government should focus on identifying key priorities and consider what can practically be achieved by the following milestones:
- Independence day;
- The short run (e.g. initial 5 years following independence);
- Medium to long run (e.g. beyond 5 years).

**Recommendation:** The Scottish Government should build up skills and capacity over a carefully planned transition period – but should also communicate clearly and early on the direction of travel it intends to take.

**The European and international context**

**Recommendation:** The government should put the issue of globalisation at the heart of its tax system - including how to tax modern multinational companies and considering how best to collect tax in a world of international supply chains and e-commerce. International agreement is critical to ensuring companies pay the appropriate level of taxation and the government should work with key international partners to ensure the fair collection of taxes due.

**Recommendation:** As part of this, the government should also use any new influence to support international bodies – including the EU and OECD – in their drive for greater tax cooperation, transparency and collection.

**Recommendation:** The government should liaise with other governments, including the UK, around defining and measuring core elements of the tax system, including what constitutes taxable income. This could minimise compliance burden, ensure fairness and avoid inefficient shifting of activities for tax purposes, particularly across the Sterling Area. Crucially, tax rates, thresholds, and allowances would remain the domain of the separate jurisdictions.

**Annex E: Fiscal Rules and Fiscal Commissions**
Available at: [www.scotland.gov.uk/Publications/2013/11/4732](http://www.scotland.gov.uk/Publications/2013/11/4732)

**Introduction**
Crucial to the success of any macroeconomic framework is the fiscal framework which underpins it. Ensuring that a country’s public finances are stable and sustainable, with the correct checks and balances, is key to fostering economic growth and resilience.
This report builds on the recommendations from the Working Group’s First Report to develop a fiscal framework focussing on both the use of fiscal rules, and the establishment of an independent fiscal commission.

Public sector borrowing is one of the most important and valuable tools of macroeconomic policy open to any independent government. Used effectively, it has the potential, not only to improve the long-term productive capacity of the economy by supporting investment, but also to provide valuable support during economic recessions.

However, too often borrowing has been used to offset a long term shortfall between tax receipts and public expenditure. Therefore, effective management of public sector borrowing is only one side of fiscal sustainability – sound management of revenue and expenditure is just as vital.

The report reviews recent fiscal trends, and draws on international examples of fiscal rules and fiscal commissions in order to highlight best practice. It then sets out a series of options for fiscal rules and commissions and puts forward a number of recommendations for the Scottish Government to consider.

The Working Group recommend that:

- The Scottish Government should set one or more fiscal rule(s), made on the basis of cautious oil price forecasts and to be monitored against the countries long term fiscal position. The Working Group suggest employing a balanced budget and a net debt rule, with a view to maintain the sustainability of any Sterling Area.
- The Scottish Government should establish an independent, transparent and accountable Fiscal Commission to assist in the management of the public finances. This Fiscal Commission should focus on advice on the government’s economic thinking and monitor adherence to its fiscal rule(s).
- As part of this, the Working Group welcome the commitment by the Scottish Government to establish an independent Fiscal Commission in time for the transfer of fiscal powers under the Scotland Act 2012.

**Summary of Fiscal Rules and Fiscal Commissions**

Scotland will face a challenging fiscal position irrespective of the constitutional settlement chosen in 2014 as adjustment continues to restore the public finances to health. Under independence, establishing credibility will be a key objective.

This report sets clear parameters within which fiscal rules for an independent Scotland could operate, something that is not borne out of necessity, but rather a strategic objective to signal a long term commitment to fiscal sustainability.

Fiscal commissions can strengthen the incentives for fiscal discipline by helping to deliver transparent independent macroeconomic and fiscal forecasts as well as impartial assessments of government policy on the sustainability of the public finances.
• Chapter 1 provides a brief introduction to fiscal rules and fiscal commissions, reviewing their role in ensuring fiscal sustainability and enhancing the credibility of the public finances.

• Chapter 2 looks at trends in public finances at a UK and international level. Over the long-term, many advanced economies have built up large levels of public debt, with the financial crisis having a significant negative impact on the public finances. Despite the presence of two fiscal rules, UK public finances deteriorated rapidly over the past decade.

• Chapter 3 looks at the theory behind fiscal rules and international examples of their use. There are four types of fiscal rule – balanced budget rules, debt rules, expenditure rules and revenue rules. The use of rules has grown rapidly in recent years. The design and oversight of these rules is critical to their success. The Working Group identify three characteristics of success: a clear link between the rule and the end objective, sufficient flexibility to respond to shocks and a pre-defined institutional mechanism to monitor rules and take corrective action when they are broken.

• Chapter 4 summarises the theory underpinning Fiscal Commissions, and looks at international experiences. These commissions are increasingly viewed as vital to enhancing the credibility of the public finances. Successful commissions tend to have high levels of technical competence, local knowledge and effective communication. In terms of governance, an unambiguous mandate, accountability to the wider public and independence from government, have been associated with successful outcomes.

• Chapter 5 considers the evidence from previous chapters in a Scottish context. With a view to fiscal sustainability underpinning the Sterling Area monetary union, a Scottish Fiscal Commission would help support the successful operation of fiscal rules in Scotland. The Working Group suggests this could take the form of two rules, one governing the short to medium-term path for net borrowing and the other governing the medium to long-term limit on net debt.

• Chapter 6 presents the recommendations of the Working Group, covering the introduction of one or more fiscal rules and a permanent fiscal commission. The Working Group recommend that fiscal rules should form part of a Sterling Area fiscal sustainability agreement, and should be forward looking and focus on the budget balance and net debt. The Working Group recommend that the Scottish Fiscal Commission should assess Scotland’s long-term fiscal position and the Scottish Government’s adherence to its fiscal rules. The Scottish Government should ensure that this commission is independent from government and that reporting structures encourage transparency and accountability.

Recommendations from Fiscal Rules and Fiscal Commissions
The recommendations from Fiscal Rules and Fiscal Commissions are grouped under two key themes:

Fiscal Rules

Recommendation: the Scottish Government should introduce one or more fiscal rules as part of its fiscal framework to set out the parameters in which it will operate
and to signal its long-term commitment to fiscal sustainability in an independent Scotland.

**Recommendation:** the Scottish Government would have a wide range of choices when establishing its fiscal rules. The Working Group believes that there is clear merit in establishing forward looking rules which focus on the budget balance and net debt. These should be designed as part of a Sterling Area fiscal sustainability agreement.

**Fiscal Commissions**

**Recommendation:** the Scottish Government should establish an independent Scottish Fiscal Commission and ensure that it is in place by the time key tax powers are fully transferred as a result of the Scotland Act 2012.

**Recommendation:** drawing upon the examples of the Swedish Fiscal Policy Council and the Irish Fiscal Advisory Council, the Scottish Fiscal Commission should assess Scotland’s long term fiscal position and the Scottish Government’s adherence to its fiscal rules. Such assessments should pay due attention to the resilience of overall economic performance in so far as this can impact on the sustainability of the public finances.

**Recommendation:** the Scottish Government should take the necessary measures to ensure the Scottish Fiscal Commission’s independence in order for it to function credibly and effectively, and design its reporting structure in a way that encourages transparency and accountability.


Available at: [www.scotland.gov.uk/Resource/0041/00419554.pdf](http://www.scotland.gov.uk/Resource/0041/00419554.pdf) (Scottish Government publication)


It addresses the currency option recommendations from the Fiscal Commission Working Group, and based on the of the Working Group analysis states that retaining Sterling is the preferred option of the Scottish Government.


Available at: [www.scotland.gov.uk/Publications/2013/11/2439](http://www.scotland.gov.uk/Publications/2013/11/2439) (Scottish Government publication)

In their first report, the Working Group recommended that the Scottish Government should take forward a programme of work to identify and develop key economic and fiscal policy opportunities of independence.

The Scottish Government produced a paper to address this recommendation. While this paper represents the views of Scottish Ministers, not the Fiscal Commission Working Group, the group provided technical assistance and advice to help shape the paper.