FINANCE COMMITTEE CALL FOR EVIDENCE

REVENUE SCOTLAND AND TAX POWERS BILL

SUBMISSION FROM FISCAL COMMISSION WORKING GROUP

1. 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 Finance Committee to assist in their enquiry into the Revenue Scotland and Tax Powers Bill.

2. 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.

3. To this aim, we have published a series of papers on Scotland’s macroeconomic framework, including issues such as the choice of currency, financial stability, the management of oil revenues, fiscal policy and taxation.

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

5. Across all 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.

6. Our analysis highlights the importance of establishing a robust and credible framework, with a commitment to long-term stability, transparency, and sustainability.

7. A credible fiscal framework is an essential part of this overall approach. Two publications in particular – ‘Principles for a Modern and Efficient Tax System’ and ‘Fiscal Rules and Fiscal Commissions’ – have set out a practical and workable fiscal framework for an independent Scotland.

8. Putting a successful framework in place would provide Scotland with a major competitive advantage – and crucially a tool for promoting economic growth, competitiveness and tackling inequalities across Scotland.

9. The Working Group’s proposals and recommendations are relevant in the context of the transfer of additional fiscal powers contained in the Scotland Act 2012, and as such are hopefully of value to the Committee.

10. 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, February 2014
Summary

11. 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.

12. The group is chaired by Crawford Beveridge, and the members are Professors Andrew Hughes Hallett, Sir Jim Mirrlees, Frances Ruane and Joseph Stiglitz.

13. The Fiscal Commission Working Group have 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, http://www.scotland.gov.uk/Publications/2013/10/7805)
- Principles for a Modern and Efficient Tax System (November 2013, http://www.scotland.gov.uk/Publications/2013/10/4839)

14. The two papers detailing the principles for a modern and efficient tax system and fiscal rules and fiscal commissions – together with the other work of the Group – provide a clear blueprint for a comprehensive fiscal framework for an independent Scotland.

15. The framework includes both the principles and the institutional infrastructure that should be employed in order to help deliver essential elements of a successful independent country - fiscal sustainability, sustainable economic growth, resilience and fairness.

16. We recommend that the Scottish Government should take a system wide approach to taxation policy, taking account of key inter-linkages with wider policy objectives and guided by four clear principles – simplicity, stability, neutrality, and flexibility. This will allow the Scottish Government to meet its objectives in the most effective manner.

17. A credible and long term commitment to fiscal sustainability needs to be built upon the foundations of effective fiscal rules and monitoring – this is reflected in the Working Group’s recommendations to establish one or more Fiscal Rules, as well as an independent Fiscal Commission, responsible for delivering impartial and transparent assessments on the sustainability of the public finances.
18. Overall, this framework could represent both a significant international advantage for Scotland and an improvement over the current framework.

Remit of the Fiscal Commission Working Group

19. 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.

20. The creation of Fiscal Commission Working Group was announced in March 2012 (http://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.

21. The constitutional future of Scotland is a political decision, and it the not the task 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.

22. The Working Group was tasked with:

- Oversee the Scottish Government’s Office of the Chief Economic Adviser’s work on establishing a macroeconomic framework for an independent Scotland;
- Support the engagement with key institutions and external experts to help develop the Scottish Government’s proposals;
- Identify 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

23. 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**

24. Since February 2012, there have 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.

25. 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;
- The transition to independence, and;
The finalisation of FCWG papers.


28. A further meeting of the Working Group will take place on the 6th March.

Summary of Fiscal Commission Working Group Engagement and Publications

29. 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. (February 2013, http://www.scotland.gov.uk/Resource/0041/00414366.pdf)

- ‘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. (October 2013, http://www.scotland.gov.uk/Publications/2013/10/7805)

- ‘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 out the opportunities, responsibilities and choices that an independent Scotland would face in setting tax policy in the 21st Century. (November 2013, http://www.scotland.gov.uk/Publications/2013/10/4839)


30. Taken together, these papers provide a holistic and whole of economy approach to a macroeconomic framework for an independent Scotland. Alongside this, the Working Group also issued an update of analysis in May 2013 crystallising the arguments in favour of a currency union with the rest of the United Kingdom.
31. Summaries of and recommendations from the two papers directly addressing the transfer of additional fiscal powers contained in the Scotland Act 2012 - ‘Principles for a Modern and Efficient Tax System’ and ‘Fiscal Rules and Fiscal Commissions’ - are in the following Annexes.
Annex A: Principles for a Modern and Efficient Tax System in an Independent Scotland

32. Available at: http://www.scotland.gov.uk/Publications/2013/10/4839

A.1 Introduction

33. 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.

34. 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.

35. 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.

36. The Working Group recommends 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.

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

A.2 Summary of Principles for a Modern and Efficient Tax System

38. 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) has 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 key 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.

A.3 Recommendations from Principles for a Modern and Efficient Tax System
39. 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
40. **Recommendation:** A Scottish system should be clear and principles based – any exemptions and tax reliefs should be carefully targeted

41. **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

42. **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
43. **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**

44. **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

45. **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**

46. **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

47. **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

48. **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.

49. **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**

50. **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

51. **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).

52. **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**

53. **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.

54. **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.

55. **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 B: Fiscal Rules and Fiscal Commissions**


**B.1 Introduction**

57. 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.

58. This report builds on the recommendations from the Working Groups First Report to develop a fiscal framework focussing on both the use of fiscal rules, and the establishment of an independent fiscal commission.

59. 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.

60. 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 taxation and expenditure is just as vital.

61. 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.

62. The Working Group recommends 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 suggests 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 welcomes 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.

B.2 Summary of Fiscal Rules and Fiscal Commissions

63. 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.

64. 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.

65. 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 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 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.

A.3 Recommendations from Fiscal Rules and Fiscal Commissions

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

Fiscal Rules

67. 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.

68. 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

69. 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.

70. 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.

71. 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.