11 January 2016

Dear Kenneth

**SCOTTISH FISCAL COMMISSION BILL – STAGE 1 REPORT**

I welcome the Committee’s support for the general principles of the Scottish Fiscal Commission Bill, as set out in your Stage 1 report. I am grateful to the Committee, and all those who provided evidence at Stage 1, for a detailed consideration of the Bill and underlying policy issues. I would like to share my reflections on the Stage 1 report with the Committee in advance of the Stage 1 debate on Thursday 14 January as I believe there are issues of substance which we will each wish to consider and challenge in the course of that debate.

Many of the Committee’s Stage 1 recommendations relate to the operation of the Commission and how it discharges its scrutiny functions. These are clearly matters for the Commission and over which the Scottish Government rightly has no jurisdiction, so I will not comment on these in my response. I continue to emphasise that the Scottish Government recognises that it is critical to the effectiveness and credibility of the Commission that it is structurally, operationally and visibly independent of Government. Furthermore, the Bill expressly provides that the Commission will not be subject to the direction or control of any member of the Scottish Government in performing its functions.

**Forecasting**

I note the Committee’s recommendation that the Commission should prepare the official forecasts which underpin the Scottish Budget. I remain firmly of the view that the current policy position, whereby the Commission provides independent scrutiny of forecasts prepared by Scottish Government, maximises transparency and public value in safeguarding the integrity of the forecasts in the Scottish Budget and ensures that Scottish Ministers are properly and democratically accountable to Parliament for those forecasts.
While I recognise that there are multiple options available to us in designing the functions of the Commission, and that stakeholders expressed a range of views on this issue in providing evidence to the Committee at Stage 1, I consider that the Bill as introduced reflects the most effective solution in support of the responsible exercise of the modest tax powers devolved to the Scottish Government.

Under current arrangements, a detailed account of the Scottish Government’s forecasting approach, the findings of an independent evaluation of that approach and the changes which the government has made to forecasts or assumptions in response to those findings are all publicly available. This is clearly evidenced by the devolved taxes forecasting methodology paper which we published alongside the 2016-17 Draft Budget\(^1\) and by the Scottish Fiscal Commission’s independent report assessing those methodologies\(^2\). The Commission also published minutes of forecast challenge meetings which it held with my officials as an annex to its report.

It may also be useful to reflect upon how the OBR forecasts for individual taxes are produced – the OBR relies upon HM Revenue and Customs to prepare such forecasts, which are then passed to the OBR for scrutiny and subsequent publication. This form of scrutiny is less transparent than the model which we propose for the Scottish Fiscal Commission as it not clear either how this scrutiny operates or the effect which it has on the final forecasts. Indeed, Edward Troup, Second Permanent Secretary at HMRC, told the Committee in January 2015 that: “although the OBR has been praised for its independence, from our perspective, the process feels very much the same as it was when the Treasury was doing the forecasting”.

Should the Commission prepare official forecasts, the independent scrutiny function which we propose would be lost and there would be no formal institutional arrangements to provide timely assurance over the reasonableness of each forecast produced by the Commission. It is not clear how the Parliament, the Government or the public would be assured as to the robustness of forecasts which are critical to determining the level of resources available for allocation in the Scottish Budget and to the responsible management of Scotland’s public finances.

Members of the Scottish Fiscal Commission raised similar concerns in evidence to the Committee on 25 November 2015. I have included some relevant extracts from the Official Report below.

Lady Susan Rice CBE – “We think that there needs to be one producer and one assessor of the official forecast. If you were to turn to the Fiscal Commission and say ‘Actually, we’ve changed our minds. You do the official forecast’, we would need to be assessed by someone… If we did our own forecast and then needed to defend it, we, too, might be biased.”

Professor Andrew Hughes Hallett – “Then there is the question of second opinions. We are doing a kind of second-opinion exercise – the Government will produce its forecasts and we will provide a second opinion… Doing this way round gives us the freedom to compare the Government’s forecasts with other forecasts… I think that being asked to do the official forecasts would seriously compromise our independence.”

\(^1\) [http://www.gov.scot/Publications/2015/12/7589](http://www.gov.scot/Publications/2015/12/7589)
\(^2\) [http://www.fiscal.scot/media/media_437935_en.pdf](http://www.fiscal.scot/media/media_437935_en.pdf)

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I therefore question whether the alternative approach put forward by the Committee would meet a public interest test, and I would welcome the Committee’s observations on this point.

Should the Commission prepare the official forecasts, this would inevitably lead to duplication of resources and effort. As I have previously set out to Committee, the Scottish Government would need to retain in-house forecasting expertise to support policy development and to support budget planning and management. The resources required by the Commission would increase, without any commensurate decrease in the forecasting resource required within the Scottish Government.

I believe that our policy position is supported by international evidence. As I and others have previously highlighted to the Committee, both the OECD and the International Monetary Fund (IMF) recognise that the precise form and functions of an IFI should be determined by local needs and the fiscal and institutional environment. The SPICe briefing on the Bill (SB 15/67) notes that it is “usually the Ministry of Finance that produces official fiscal forecasts, while other publicly funded agencies, including IFIs, prepare alternative fiscal forecasts” and demonstrated that of 23 IFIs in operation in OECD countries, only three have a role in preparing official forecasts with the remaining 20 assessing official forecasts, which may include the preparation of alternative forecasts.

The IMF provided written evidence to the Committee which made explicit that “there is no need for the SFC to present its own forecasts” and Robert Chote, Chairman of the OBR, told the Committee on 4 November 2015 that “we are relatively unusual in doing it ourselves and providing the official forecast. The Netherlands is the only other obvious example of that approach.”

In summary, I am not persuaded by the case made in the Stage 1 report that the Commission should prepare official tax forecasts. I would welcome further clarification from the Committee as to the basis for this position, including responses to the specific concerns which I have outlined above, and look forward to debating these issues later in the week.

Alternative forecasts

I am aware that the Committee has shown considerable interest in the issue as to whether the Commission is able to prepare alternative forecasts on items within its remit.

As I first set out in my response of 28 August 2015 to the Committee’s report on Scotland’s Fiscal Framework, it remains open to the Commission to prepare alternative forecasts or assumptions to support its scrutiny of the government’s forecasts. I provided assurance to the Committee on 2 December that the Bill as drafted does not preclude the Commission from producing such alternative forecasts. The Commission is empowered to determine how it chooses to assess the reasonableness of our forecasts, which may include the preparation of alternative forecasts.

Independence

The Scottish Government is committed to legislating for a Scottish Fiscal Commission which is structurally and operationally independent of Scottish Ministers.

I welcome the Committee’s suggestions as to how the operational independence of the Commission could be strengthened. These recommendations generally pertain to non-legislative operational issues and are matters which I hope the Commission will reflect carefully on and take forward.
Where the responsibility for action falls to the Scottish Government, I will seek to take further actions to reassure Parliament that I am doing all that I can to promote the independence of the Commission. In particular, I would be willing to consider introducing an amendment at Stage 2 to require the SG and the Commission to agree and publish a protocol detailing the scrutiny process, respective responsibilities and procedures for handling the draft report and to regularly review that protocol. While I have reservations about the public interest which would be served by publishing multiple forecasts. I am willing to revisit the Committee’s recommendation that both the original and revised forecast should be published where changes are made to Scottish Government forecasts following Commission scrutiny. I have also asked my officials to consider further ways in which we could strengthen the transparency of administrative arrangements supporting the relationship and interactions between the Scottish Government and the Commission.

I am committed to take action to improve the robustness of our forecasting methodologies in response to Commission scrutiny and welcome the Committee’s recommendation that the Scottish Government should in future provide a written response to recommendations made by the Commission within four weeks of the publication of the Draft Budget.

**Appointments**

I welcome the Committee’s support for the appointment process provided for in the Bill.

I accept the Committee’s recommendations that the Bill should be amended to include term lengths and to allow members to serve two consecutive terms of appointment of no longer than five years each. I plan to bring forward associated amendments at Stage 2.

I am giving careful consideration to the Committee’s recommendation that the exercise of the power to alter the number of Commission members by regulations should first be agreed by Parliament, having been considered by the Finance Committee, as this may have wider implications for other bodies. Section 11 provides that the Commission should have at least 3 and no more than 5 members, one of whom is to serve as Chair. The Bill provides that regulations to change the size of the Commission would be subject to negative procedure. This is in line with legislative provisions for membership of other public bodies, including provisions in the Crofting Reform (Scotland) Act 2010, Police and Fire Reform (Scotland) Act 2012 and Historic Environment Scotland Act 2014.

**UK institutions**

I welcome the Committee’s recognition of the importance of the Commission having appropriate access to relevant information held by UK agencies and that this should be provided for on a statutory basis. This matter is beyond devolved competence, and would require changes to UK legislation. I am already in discussions with UK Government counterparts on this issue of statutory access to information and will continue to press for the Commission and for Scottish Ministers to have the appropriate access to data which is relevant for forecasting, scrutiny and policy formulation. This will build upon the requirements already set out in the Memorandum of Understanding agreed between HMRC and the Scottish Government concerning the Scottish rate of income tax (SRIT) which states that "HMRC must provide information to SG that will enable Scottish Ministers and officials to discharge their duties in respect of Parliamentary accountability, scrutiny, rate setting and forecasting in relation to SRIT".

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Additional functions

The initial statutory remit of the Commission will be reviewed and expanded to reflect further powers devolved to the Scottish Parliament, including those provided for in the Scotland Bill currently proceeding through Westminster. I plan to bring forward specific proposals for consultation and parliamentary scrutiny in due course, assuming enactment of the Scotland Bill and agreement of the associated fiscal framework.

While I note the Committee’s recommendation that the Bill should be amended to add additional functions to include assessing adherence to fiscal rules and an assessment of the long term sustainability of Scotland’s devolved public finances, I believe that these issues would most appropriately be revisited when we consider how the remit of the Commission should be expanded to reflect the Smith powers. I remain of the view that assessment of the long term sustainability of the public finances is primarily a role for elected Members of the Scottish Parliament, who should hold Ministers directly to account for the robustness of our financial judgements.

Financial memorandum

I note the Committee’s recommendation that the resources of the Commission should be proportionate to its remit and that the Committee does not anticipate that the full budget will be required on the basis of the functions proposed in the Bill. The resource estimates set out in the financial memorandum were developed in consultation with the Commission, and intended to reflect our collective best estimate of the resources which would be required by the Commission to both discharge its statutory functions, and to fulfil the governance and statutory obligations of a Scottish public body.

As I set out to Committee on 2 December 2015, I consider the resources proposed for 2016-17 to be of the order of magnitude required for the Commission to deliver its non-statutory functions and to transition to a non-ministerial department with effect from 1 April 2017. However, I have undertaken to look carefully again at the financial estimates for 2017-18 and beyond as the Commission’s transition programme is delivered.

As noted above, the resources available to the Commission would need to be reviewed and may be increased substantially if the Commission were to produce official forecasts.

I trust that this response is helpful to the Committee. I look forward to debating these issues on Thursday.

I am copying this letter to Lady Susan Rice CBE, Chair of the Scottish Fiscal Commission.

[Signature]

JOHN SWINNEY