Finance Committee
Scottish Fiscal Commission Bill
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We are strongly supportive of an independent Scottish Fiscal Commission, but believe that its remit should be expanded relative to that envisaged within the Scottish Government’s Bill. We respond to each of the Committee’s requests in its Call for Evidence below.

Forecasting tax revenues

Is there a need for independent forecasts?

We believe that the provision of independent forecasts by the Commission would prove useful. The ability of the Commission to assess the Scottish Government forecasts/projections would be significantly enhanced if it had the capacity to generate its own forecasts for comparative purposes. This is in line with much international practice, and where such fiscal bodies do not provide their own forecasts they typically have access to sufficiently detailed independent forecasts.

However, at least in the shorter-term data limitations may limit the degree of sophistication that can reasonably be expected of forecasting models, which may be rather mechanistic, with little or even no modelling of behaviour. It would seem sensible perhaps to aim gradually to build internal forecasting/analytical capability, perhaps involving a range of modelling approaches, reflecting different policy concerns and data availability and the parallel development of modelling expertise within the Office of the Chief Economic Adviser (OCEA).

We are aware that Office of the Chief Economic Adviser (OCEA) is developing expertise in macro-econometric, micro-simulation, computable general equilibrium (and, in the wider policy context, various energy system) models of the Scottish economy, and our view is that these models will enhance the Scottish Government’s understanding of the likely impact of its fiscal (and other) policies.¹ To the extent that any subset of these models is ultimately employed to assist with system-wide forecasting of Government revenues and expenditures (most likely with the use of a macro-econometric model for short-term forecasting in the first instance) and become a key input into the Government’s fiscal projections, it would be helpful for the Commission to have the ability to run similar models in parallel. Indeed, ideally,

¹ Earlier evidence to the Committee identified the range of economic modelling of the Scottish economy being undertaken within the ESRC’s Future of Scotland and the UK pre and post referendum initiative, including our own CGE modelling.
models used by the Scottish Government would be available to external groups of researchers to use to assess the potential impact of alternative policies, for example. Alternatively, the Commission should at least have the ability to request the Scottish Government to conduct sensitivity analyses around its core projections (see below).

As others have emphasised to the Committee the independence and neutrality of the Commission is crucial here, as is the transparency of the Government’s and/or its own forecasting process.

Having this ability would also, again in principle, provide the Commission with the capacity to explore the implications of alternative policies, so that the Scottish Government’s chosen position can be better assessed. We suspect that it is unlikely that the Commission’s remit will be modified to the extent of considering alternative fiscal policy stances, in which case there is an even greater need for additional independent external scrutiny, although we believe that such scrutiny will be valuable, regardless of the scope of the Commission’s activities (see our concluding paragraph).

There are of course, real resource costs to providing forecasting capacity, and risks to the Commission’s credibility if forecast performance proves to be poor. If there were sufficiently detailed independent forecasts already produced for Scotland the Commission could perhaps use/adapt these. (Certainly it could and should use whatever external forecasts are available to assist its judgements, and it intends to do so.) However, currently available forecasts are unlikely to provide sufficient fiscal detail for the Commission’s purposes.

It may be reasonably argued that the capacity of the Commission should reflect the extent of the fiscal powers that the Scottish Parliament possesses. Given that, following the Smith Commission, the Scottish Government is shortly to enjoy significantly greater fiscal autonomy in addition to that already in the pipeline as the Scotland Act 2012 is fully implemented in April 2016, the case for a wider remit of the Commission is enhanced. In our view this is so even if the restriction on borrowing powers effectively rules out the “deficit bias” that has motivated the establishment of most fiscal councils. It is likely, in any case, that there will be continuing pressure for yet further fiscal autonomy even after the Bill currently being considered at Westminster is passed and its provisions implemented.

**Should the Commission have the capacity and resources to make its own forecasts even if its role is to assess the official forecasts?**

The current limitation on the Commission’s functions does reduce the potential benefits to independent forecasting activity (by, for example, precluding consideration of alternative policy stances), but again in the absence of other sources of sufficiently detailed forecasts/projections, it probably remains desirable against the background of increasing fiscal autonomy. Even if the Commission’s role is initially restricted to assessing the official forecasts, its own forecasting ability, or
the ability to require sensitivity analysis (see below) that it specifies around the Government’s core projections, would enhance its ability to subject official estimates to rigorous scrutiny.

**Should the Scottish Government’s forecasts be subject to sensitivity analysis by the Commission?**

We interpret “sensitivity analysis” here as potentially encompassing a wide range of possible activities, although, of course, the Bill will define the scope of such analysis (if the function of the Commission is extended in this direction at all).

Ideally, the Commission should be in a position to provide, or require others to provide, sensitivity analysis. One form of sensitivity, that could be delivered automatically, would provide probability bands to projections. However, a second type of sensitivity would seek to explore the consequences of possible deviations from key assumptions embodied in the Government’s forecasts, relating to, for example, net migration flows. This would allow a more thorough *ex ante* evaluation of the SG’s own projections. This would represent a considerable extension to the proposed remit of the Commission, and one that we think would be desirable.

If there was a shift in this direction there would clearly be a question regarding how wide the Commission’s activities should range (and there is, as previous evidence to the Committee has noted, a wide variety apparent among extant fiscal councils). The key issue here is that the focus of the Commission is currently fairly narrow (in common with many other fiscal councils). While the Scottish Government has a core purpose of increasing sustainable economic growth, this of course, encompasses a range of (potentially conflicting) policy objectives, among which the overall fiscal policy stance (as typically reflected in e.g. fiscal deficits and debt levels) – and the sustainability of fiscal policy - is only one. Clearly, a number of objectives may be impacted by fiscal policy, including economic growth, employment, equity and carbon emissions. It seems unlikely that the remit of the Commission will range that widely, but the issues are very important in any attempt to provide an overall assessment of fiscal (and other) policies. However, the Commission could be required to report on these wider, and longer term, issues in a more informal way, simply to raise possible policy issues/ conflicts if they believe that they might arise.

Even if further devolution were to continue to impose strict borrowing limits, to the point where any Scottish “deficit bias” is effectively precluded, many major fiscal policy issues remain (even given the common currency and UK-determined monetary policy). In particular, balanced budget fiscal changes allow considerable choice about the type of economy and society that we wish to establish. For example, the Scandinavian economies are often held up as an example that Scotland may wish to emulate (at least in terms of government expenditure levels), but even the Scotland Act 2012 (fully implemented from April 2016), would allow the Scottish Government actually to raise average income tax levels to Scandinavian
levels, and to use the increased tax revenues significantly to expand government expenditure. Of course, no political party in Scotland is currently proposing such a radical strategy, but it would be useful to explore the likely impact of such a change; or indeed of a movement in the opposite direction towards the low tax, low public spending Baltic economies.\(^2\) An explicitly interregional modelling approach can also be used to explore the complexity of implementing any “no detriment” condition given the presence of complex demand- and, in general, supply-side spillovers.\(^3\) While there has been considerable discussion around further fiscal autonomy, there has so far been little discussion as to how precisely these new powers might be used, and what the consequences of such choices are likely to be.

While the institutional context, including any fiscal rules and the Commission itself, of course, imposes constraints on Scottish fiscal policy, very significant choices will remain, and might be usefully informed by wider economic analysis. How much of this analysis is (at least initially) undertaken by the Commission will be determined of course by the legislation. It seems certain, however, that the Commission’s function will not extend to attempting to provide wider evaluation of Scottish fiscal policy’s contribution to the Scottish Government goals.

**Should the Commission be able to develop its own forecasting methods and analytical capacity in order to provide a benchmark set of projections?**

Again, we would agree that this would assist the Commission’s assessment of Scottish Government projections, and many other fiscal councils have this capacity.

**Role of the SFC prior to the publication of the Scottish Government Forecasts**

We do not have strong views on the series of issues raised here. Our response would depend to a degree on the precise remit of the Commission, but we would generally be supportive of the Committee’s recommendations.

**Additional Functions**

**Should the Commission have a wider role in assessing the sustainability of Scotland’s public finances such as adherence to fiscal rules and, if so, should the Bill be amended to reflect this?**


While there is a variety of motivations for establishing fiscal councils, a key objective is to enhance the credibility of fiscal policy through provision of an independent monitoring function that reports, inter alia, on the sustainability of the current (and anticipated future) fiscal policy stance. Where fiscal rules are in place (so that the Commission itself is clearly not regarded as substituting for such rules), it would seem very strange indeed to have a Fiscal Commission that did not have such a role: it is a core function of most fiscal councils.

The difficulties involved in assessing the sustainability of Scotland’s public finances will of course depend on what precisely is agreed about the extent of borrowing powers. However, even if these are limited, the Commission could be required report, perhaps more informally, on the longer-term sustainability of public expenditure programmes as a consequence of, for example, anticipated population changes.

Importantly, the Commission should also provide independent guidance as to whether prevailing economic circumstances merit some deviation from the rules, and perhaps the extent of such deviation that it believes may be reasonable without prejudicing longer term fiscal sustainability.

Accordingly, our view is that the Commission should have the role of assessing the sustainability of public finances and the Bill should be amended to reflect this.

**Should the Bill be amended to include assessment of mechanisms for adjusting the block grant?**

In view of the potential importance of the precise mechanism for adjusting the block grant, it would certainly be very useful to have some independent assessment of the alternatives. If the Commission has its own forecasting/projection capacity, or was in a position to require others to provide appropriate analyses, it would be able to explore the consequences of acceptance of any particular adjustment mechanism as against potential alternatives. Once an agreed adjustment mechanism is in place, it would be helpful to monitor its impact.

**Should there be a legislative requirement for the SG to prepare a charter for budget responsibility and should the Commission have a role in assessing adherence to the Charter?**

This seems helpful given a general desire for transparency.

**Right of access to information**

Right of access is clearly central to the Commission being able to carry out its role effectively. Because of that it probably would be helpful to establish this on a statutory basis in a MoU. It may also be helpful, to facilitate transparency, that the basis of the working relationships be set out in a MoU.
Appointment of members of staff

Our view is that: the proposed appointment and removal procedures are fit for purpose; ideally the Bill would specify periods of office; one fixed term is typical (although the need for staggering to ensure some continuity has already been noted); the Commission should definitely determine its own staffing arrangements on the basis of terms and conditions of employment agreed firstly with Ministers.

Resources

Not surprisingly, given the differences in the breadth and depth of their responsibilities, the resources used by fiscal councils around the world vary dramatically - and not necessarily in line with the size of the country – reflecting the differences in the breadth and the depth of their responsibilities. Adding in-house forecasting capability will add to costs, but the extent of this will depend on precisely what the Commission is expected to deliver (and the Government’s, and its own, choice of model(s)). This extension should also allow assessment of the Scottish Government’s adherence to fiscal rules.

Wider policy assessment

It seems unlikely that the Fiscal Commission’s remit will be extended very substantially to encompass assessment of the contribution of fiscal policies to Government objectives. The more restrictive the role of the Commission, the more important it will be to have additional scrutiny provided by external, independent researchers.

There has never been a period in Scotland’s recent history where the need for independent analysis of Scottish economic policy has been more striking, and the scale of its likely impact on the Scottish people more important. The ESRC has funded considerable relevant research activity under its Future of Scotland and the Rest of the UK pre and post Referendum Initiative, but securing external funding to support continuing, and wide-ranging, policy scrutiny is challenging. The Fraser of Allander Institute (FAI) remains committed to providing a source of independent commentary and analysis - as it has done over the 40 years since its establishment - together with our academic colleagues in the Centre for Constitutional Change, and others such as SPICE. It is essential, against the background of substantially enhanced fiscal autonomy, that Scotland maintains a critical mass of independent economic analysis that can complement the work of the Commission.