Finance Committee
The Scottish Fiscal Commission (Scotland) Bill
Submission from the Royal Society of Edinburgh November 2015

Summary

- In line with the Finance Committee’s recommendation, the RSE is firmly of the view that the Scottish Fiscal Commission (SFC) should be capable of producing its own independent fiscal forecasts in assessing the Scottish Government’s fiscal projections. In doing so, the SFC should have the freedom to develop its own framework of analysis, data sources and methodology. The SFC will need staff with expertise in data analysis, statistical modelling and econometrics.

- The rationale for the establishment of the SFC is to strengthen independent scrutiny of Scotland’s public finances. If the SFC is expected to provide an independent assessment of the reasonableness of the Government’s forecasts, it is essential that it has no role in their production. In order to secure its independence and ensure transparency of process, the SFC should carry out its assessment of the Government’s forecasts after their publication.

- The functions of the SFC should include assessing the performance of the Scottish Government against its fiscal targets and an assessment of the long-term sustainability of the public finances. To enable this, the Government should prepare and submit a medium-term budget framework at the same time as it submits its draft annual budget bill.

- The Government needs to improve the provision of fiscal data to ensure the SFC can fulfil its remit. The SFC Commissioners have stated that they do not have data to allow comparison between forecasts and actual outturn figures. This reinforces the need to develop in Scotland a framework for the collection and use of fiscal data.

- In undertaking its work we would expect the SFC to take due cognisance of the UK-wide forecasts produced by the UK’s Office for Budget Responsibility (OBR). The SFC does not currently have access to data from HM Revenue & Customs (HMRC). The UK and Scottish Governments will need to address this so that the SFC has direct access to HMRC data. The SFC should have Memoranda of
Understanding with both the OBR and the HMRC for the sharing of information to enable it to fulfil its functions.

- To minimise potential conflicts of interest and to enhance the SFC’s independence, the Bill would be strengthened by ensuring that a Commissioner may not at the same time serve as a member of the Scottish Government’s Council of Economic Advisers.

- To provide clarity and transparency, the terms of appointment to the SFC should be clearly set out in the legislation as opposed to being left to the discretion of the Scottish Ministers. This is in line with the principles of the Organisation for Economic Co-operation and Development (OECD). It would be pragmatic to make provision to allow for Commissioners to serve for a second term.

Introduction

1. The Royal Society of Edinburgh (RSE) welcomes the invitation to respond to the Scottish Parliament Finance Committee’s scrutiny of the Scottish Fiscal Commission (Scotland) Bill. The Committee will be aware that the RSE has made a longstanding contribution to the debate around the provision of independent fiscal forecasting and analysis in Scotland. Most recently, the RSE responded\(^1\) in June 2015 to the Scottish Government’s proposals for putting the Scottish Fiscal Commission (SFC) on a statutory footing.

2. We are pleased that a number of the suggestions we made for strengthening the Government’s legislative proposals have been adopted in the current Bill:

- We were concerned that the provision in the draft Bill that the SFC must prepare such reports as the Scottish Ministers may from time to time require would compromise the Scottish Government’s stated intention to safeguard the independence of the SFC. We are pleased that the Government has removed this proposed reporting requirement from the current Bill.

- We also responded by saying that the SFC should be required to prepare an annual report on its activities for laying before the Scottish Parliament. We note this provision has been introduced in section 8 of the Bill.

- We recommended that the Government should set out arrangements for external independent evaluation of the SFC. We therefore welcome the introduction of section 9 in the current Bill that the SFC’s performance must, at least once every five years, be externally reviewed.

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\(^1\) RSE submission to the Scottish Government’s consultation on the Scottish Fiscal Commission; June 2015
Forecasting tax revenues

3. Section 2 of the Bill makes clear that the primary function of the SFC is to scrutinise, assess the reasonableness of and report on the Scottish Government’s devolved tax revenue forecasts and on the economic determinants underpinning Scottish Government non-domestic rate income (NDRI) forecasts.

4. It is clear that the Scottish Government envisages a position where the SFC’s role is focussed on assessing and reporting on the forecasts prepared by the Government.

5. In its recent Report on Scotland’s Fiscal Framework\(^2\), recognising the strong level of support among expert witnesses, including an RSE representative, the Finance Committee recommended that the draft Bill should be amended to ensure that the SFC is able to undertake its own forecasts.

6. The RSE agrees with the Finance Committee. We are firmly of the view that the SFC should be able to originate its own independent forecasts of the future fiscal revenues and budgetary position in Scotland. The SFC should have the freedom to develop its own framework of analysis, data sources and methodology, in assessing the Scottish Government’s forecasts.

7. Indeed, to fulfil its functions the SFC will need to be able to produce independent forecasts. For example, we envisage that the Scottish Parliament would look to the SFC to provide clarification on the level of certainty underlying the Scottish Government’s projected revenues from the new devolved taxes. It is likely that these various tax revenue projections will lie within a range (e.g. within a set of upper and lower values). Paragraph 9 of the Bill’s Explanatory notes states, “The Commission may, however, consider the effect of alternative forecasting assumptions or methodologies on revenue forecasts.” This indicates that the SFC will have the power to assess the impact on these projected revenues of changing the value of the underlying assumptions. It is difficult to conceive how the SFC would be able to carry out this impact assessment without it re-forecasting the Government’s projections. Therefore, in order to provide a robust assessment of the Government’s projections, the SFC will need to be capable of producing its own fiscal forecasts independently of the Scottish Government. Without this empirical evidence, the SFC analysis and comment will be seriously undermined.

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\(^2\) Scotland’s Fiscal Framework; Scottish Parliament’s Finance Committee; June 2015
http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/fin15-12w.pdf
8. It is paramount that the SFC be independent of government influence, and be seen to be so. This is required to ensure the reputation, impartiality and credibility of the SFC. The Scottish Government has made clear its aim to safeguard the independence of the SFC. However, some of the Government’s statements made in relation to the SFC’s functions would appear to be in tension with this. For example, in 2014 the Scottish Government was clear that it “agrees that the SFC should have no role in producing the original forecasts.” However, paragraph 16 of the Bill’s policy memorandum states that, “the remit enables the Commission to exert significant influence over the forecasts which underpin the Scottish Draft Budget.”

9. The rationale for the establishment of the SFC is to strengthen independent scrutiny of Scotland’s public finances. It would be alarming if the SFC were to have a role in producing the same forecasts that it is tasked with assessing. We strongly agree with the Finance Committee that in order to preserve the SFC’s independence it is essential that it has no role in producing the Government’s forecasts if it is expected to provide an independent assessment of their reasonableness.

10. We therefore support the legislative intention to ensure that the SFC is directly accountable to the Scottish Parliament for the delivery of its functions; not through Scottish Ministers. However, there needs to be clear and robust governance structures between the Commission and the Parliament to ensure that while being properly accountable to Parliament, the Commission’s work is not compromised. This approach also recognises the importance of ensuring the Commission’s freedom from political pressure while balancing this with an appropriate mechanism of accountability to assure its effectiveness and democratic legitimacy.

11. In order to secure its independence and ensure transparency of process, the SFC should assess the Scottish Government forecasts after their publication. For the same reasons, we do not believe that the SFC should be required to send a copy of its report to the Government in advance of it being laid before the Scottish Parliament. Section 4 (3) of the Bill should therefore be removed.

12. As with the relationship between the OBR and HM Treasury, we would expect all correspondence, meeting agendas and minutes between the SFC and the Scottish Government to be published on the SFC website.

**Assessing the long-term sustainability of the public finances**

13. The RSE has frequently raised concerns that the focus on short term priorities drives the Scottish budgetary process, arguing that this can restrict analysis of the long term outlook for public spending and revenues. The RSE therefore
agrees with the Finance Committee recommendation that the functions of the SFC should include assessing the performance of the Scottish Government against its fiscal targets and an assessment of the long-term sustainability of the public finances. While an assessment of the longer-term outlook will be inherently uncertain, it can help draw the attention of policy makers to long-term challenges.

14. We are of the view that in enhancing its autonomy and expanding its current functions, consideration should be given to tasking the Commission with:

- a) reviewing the fiscal outlook for the government and the public;
- b) forecasting the future revenues likely to be available;
- c) estimating current structural imbalances; and
- d) estimating the likely consequences of current spending and taxation plans.

15. This would be consistent with the Smith Commission recommendation that the Scottish Parliament should seek to expand and strengthen the independent scrutiny of public finances in Scotland in recognition of the additional variability and uncertainty that further tax and spending devolution will introduce into the budgeting process. However, the responsibility for the choice, design and execution of fiscal policy would remain firmly with the Scottish Government.

16. In order to enable the SFC to undertake an assessment of the Scottish Government’s medium-term fiscal strategy, the Scottish Government should prepare and submit a medium-term budget framework at the same time as it submits its draft annual budget bill.3

17. Given the need to ensure the impartiality of the SFC in any statements it makes on the ongoing sustainability of Scotland’s public finances, the Finance Committee might wish to consider whether the SFC should produce something akin to the OBR’s annual fiscal sustainability report.

Fiscal rules

18. As part of its remit the OBR has responsibility for monitoring compliance with the UK Government’s fiscal rules. It would therefore seem reasonable to accept that there is the need for an equivalent independent body (the SFC) to adopt a similar role in respect of monitoring adherence to the Scottish Government fiscal rules. This role is likely to be important to the Scottish Government and Scottish

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3 Independent Fiscal Institutions: International Experience and the Scottish Fiscal Commission; Report prepared for the Scottish Parliament’s Finance Committee; Ian Lienert; October 2015
Parliament in relation to agreeing adjustments in the Barnett formula, seeking borrowing capacity and/or the further devolution of taxes.

**Right of access to information and data-related considerations**

19. In giving evidence to the Finance Committee in April, the SFC Commissioners made clear that currently they do not have data to allow comparison between forecasts and actual output figures. Similarly, at the Finance Committee’s evidence session on 20 May, economists and public policy experts stated that to ensure that the SFC can fulfil its remit, the Scottish Government needs to improve the provision of fiscal data. We note that Audit Scotland has made similar comments.

20. This reinforces the importance of developing a better understanding of data requirements and the need to sustain data collection over the long-term in order to derive trends from it. A framework for data provision will require to be appropriately resourced. Inevitably, as more powers are devolved to the Scottish Parliament, the more important it becomes to develop in Scotland a framework for the collection and use of fiscal data.

21. Section 7 of the Bill states that the SFC should have a right of access at reasonable times to any relevant information that it may reasonably require for the purpose of performing its functions. We fully agree that the SFC should have full and unfettered access to Scottish Government data and to any related analysis or evaluations made elsewhere.

22. The Scottish Government, Revenue Scotland, the Keeper of the Registers of Scotland and the Scottish Environment Protection Agency are listed on in the Bill as sources of relevant information for the SFC. We agree that the framework governing the working relationship between the SFC and these bodies be set out in Memoranda of Understanding (MoU). The MoU’s should be published.

23. However, we note there are a number of notable bodies that are not listed on the face of the Bill. We would expect the SFC to take due cognisance of the UK-wide forecasts produced by the OBR. In addition, we note that the SFC Commissioners have stated that they do not currently have access to data from HM Revenue & Customs (HMRC). Given that the Scottish Parliament will have devolved responsibility for the Scottish rate of income tax from April 2016, with further responsibility for income tax expected to be delivered through the Scotland Bill, it will be necessary for the Scottish and UK Governments to address this so that the SFC has direct access to HMRC data. We would expect

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4 Scottish Parliament Finance Committee; Official Report; 1 April 2015
the SFC to have Memoranda of Understanding with both the OBR and the HMRC for the sharing of information to enable the SFC to fulfil its duties.

Appointment of Members

24. In order to provide flexibility and recognising that the Commission’s functions are expected to expand over time, we are content with the proposition that the Commission should comprise of a chairing member and between two and four other members.

25. We are of the view that in minimising potential conflicts of interest and in order to enhance the SFC’s independence, the Bill would be strengthened by ensuring that a Commissioner may not at the same time serve as a member of the Scottish Government’s Council of Economic Advisers.

26. The Scottish Government’s consultation proposed that members of the SFC would be entitled to a fee. The RSE agreed that Commissioners should receive a daily fee reflecting the public service nature of the work. We are content with the proposal that Commissioners are remunerated in line with the Public Sector Pay Policy for Senior Appointments.

27. The Financial Memorandum assumes a time commitment of 1.5 days per week for each Commissioner. However, if the SFC is to have a role in assessing the performance of the Scottish Government against its fiscal targets and providing an assessment of the long-term sustainability of the public finances, as we believe it should, then it is highly likely that it will require Commissioners to dedicate more time to the SFC. Similarly, with the anticipated devolution of further powers to Scotland, it can be assumed that the Commission’s workload will expand.

28. In this context we note that in its Principles for Independent Fiscal Institutions (IFI), the Organisation for Economic Co-operation and Development (OECD) recommends\(^5\) that the position of head of the IFI should be a remunerated and preferably full-time position. In his commissioned analysis for the Finance Committee, Ian Lienert\(^6\) indicates that given their oversight and public relations responsibilities, the SFC chairperson should be at least 50% full-time equivalent.

29. The OECD principles are also instructive in relation to terms of appointment, where principle 2.3 makes clear that term lengths and the number of terms that IFI members may serve should be clearly specified in legislation. However, section 13 of the Bill states that the Scottish Ministers will determine lengths of

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\(^6\) Ibid. 3
membership. To provide clarity and transparency, we believe that the terms of appointment should be clearly set out in the legislation as opposed to being left to the discretion of the Scottish Ministers. We are also of the view that it would be sensible to make provision to allow for Commissioners to serve for a second term.

**Staffing and Resources**

30. In evidence\(^7\) to the Finance Committee, the OECD emphasised that the resources allocated to the SFC must be sufficient and sustainable to allow it to fulfil its remit in a credible manner.

31. In order that it can undertake its own fiscal forecasts, staff with expertise in data analysis, statistical modelling and econometrics will be needed.

32. We understand that in its first year of operation in 2014-15, the SFC was allocated a budget of £20,000. In response to the Scottish Government consultation we commented that this would have to increase significantly if Commissioners are to be remunerated and to enable the SFC to employ even a minimal level of staff support. The Financial Memorandum states that the Scottish Government’s estimated recurring costs for the operation of the SFC are £850,000 per annum from 2017-18.

33. We note from Lienert’s analysis of international IFIs, that the proposed annual budget for the SFC should allow for reasonable flexibility in the way it structures its operations and staffing. The operation of the SFC will of course need to be kept under review by the Parliament and changes to its functions and scope of activities may need to be reflected in subsequent budgetary allocations.

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\(^7\) Report on proposals for a Scottish Fiscal Commission; Scottish Parliament Finance Committee; 7 February 2014
http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/72938.aspx
Additional Information

This Advice Paper has been signed off by the RSE General Secretary.

In preparing this Advice Paper we would like to draw attention to the following RSE responses which are relevant to this subject:

- The Royal Society of Edinburgh’s response to the Scottish Government’s Consultation on the Scottish Fiscal Commission (June 2015)
- The Royal Society of Edinburgh’s response to the House of Commons Constitution and Political Reform Committee on Scotland in the United Kingdom: An Enduring Settlement – Draft Scotland Clauses 2015 (February 2015)
- The Royal Society of Edinburgh’s response to the House of Commons Constitution and Political Reform Committee on Scotland in the United Kingdom: An Enduring Settlement – Draft Scotland Clauses 2015 (February 2015)
- The Royal Society of Edinburgh’s response to the Scottish Parliament’s Finance Committee on proposals for an independent fiscal institution in Scotland (September 2013)

Any enquiries about this Advice Paper should be addressed to Mr William Hardie (email: evidenceadvice@royalsoced.org.uk).

Responses are published on the RSE website (www.royalsoced.org.uk).

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