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The Scottish Fiscal Commission: some key issues

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IPPI POLICY BRIEF

Jeremy Peat is a Fellow of the Royal Society of Edinburgh and was a member of an RSE group which drafted evidence to the Scottish Parliament Finance Committee regarding their enquiries into a Scottish Fiscal Commission. He also gave evidence to that committee on behalf of the RSE.

However, this brief is written in a personal capacity and should not be seen as necessarily reflecting the views of the RSE, or the International Public Policy Institute (IPPI) at the University of Strathclyde, where he is a Visiting Professor.

The Scottish Fiscal Commission:
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Jeremy Peat[1]

As the extent of devolution to Scotland of fiscal matters increases, so too does the requirement for objective, informed, transparent and independent analysis of and commentary on the Scottish Government's fiscal analysis and plans. The breadth, and quite possibly the depth, of this input will be required to expand as fiscal devolution continues. Some of this commentary should come from independent 'think tank' bodies, along the lines of the Institute for Fiscal Studies in the UK. The further development of bodies of this type in Scotland is to be encouraged. However, some of the input should come from a more official body, established by, but necessarily at a lengthy arm's length from, the Scottish Government, namely the new, proposed Scottish Fiscal Commission.

1. Introduction

The UK has its Office for Budget Responsibility (OBR) with remarkable powers – even to the extent that the OBR produces the macro-economic and fiscal forecasts which the Chancellor of the Exchequer must use to underpin his Budgets[2]. Scotland requires and is in the process of formalising the establishment[3] of an equivalent body, to be called the Scottish Fiscal Commission (SFC), which should be suitable for Scotland's emerging needs as devolution evolves. Initially, this will involve forecasting specific revenue streams from devolved taxes, etc.; but over time this role should, and I believe inevitably will, be extended to include issues related to the accuracy of overall fiscal forecasting and the sustainability of the public finances.[4]

Over the past two or three years, the Scottish Government has been working to establish the SFC, initially on a non-statutory basis and now via legislation which is being prepared and a

[1]. I am grateful for comments on an earlier draft from Professors Peter McGregor and Kim Swales of Strathclyde University. They too provided a submission to the Finance Committee and Peter McGregor also gave oral evidence alongside me. I am also grateful to William Hardie, Policy Officer at the Royal Society of Edinburgh (RSE), for all the most valuable briefing provided on this topic and for his comments on an earlier draft.

[2] In fact, some fiscal bodies around the world have even greater powers – for example to consider and analyse alternative policies.

[3] The SFC has existed on a non-statutory basis since June 2014.

[4] A recent spate of commentary on prospective adjustments to the manner in which the block grant will be calculated following implementation of the Smith Commission proposals has indicated that such analysis could be critical to a devolved Scotland's economic prospects. See 'Adjusting Scotland's Block Grant for new Tax and Welfare Powers: Assessing the Options' by David Bell, David Eiser and David Phillips; an IFS paper.

draft of which was the subject of the latest Scottish Parliament Finance Committee consultation.[5]

The earlier proposals from the Scottish Government were subject to significant criticism on, *inter alia*, the grounds of:

1. Limited independence of the Commission
2. Inadequate resourcing of the Commission
3. Unduly constrained scope for the Commission's proposed activities

The draft legislation goes some way to responding to some of these criticisms. However, in my opinion, the enhancements made thus far are still not fully adequate and further significant changes are required if the SFC is to be fit for purpose, both in the immediate future and thereafter as the Smith Commission findings are implemented and fiscal devolution of substance continues to take place. In short, the SFC needs to be 'future-proofed'.

A strong and fiercely independent Commission is essential as part of an appropriate economic governance framework for a devolved Scotland. In this context the Finance Committee of the Scottish Parliament is to be praised for its continuing robust examination of the Government's proposals and willingness to seek and take full account of informed commentary.[6]

This IPPI Policy Brief considers the present state of play on these key aspects of independence, resourcing and scope of remit and suggests the appropriate way forward for the final legislation and the SFC to be formally instituted in 2016.

2. Independence

One non-negotiable requirement for any fiscal commission is that it must be wholly independent from the Government whose analysis and forecasts it is examining and critiquing. One concern about the SFC as initially constituted, i.e. in advance of the current planned legislation, was that two of its original three members were also members of the Scottish First Minister's Council of Economic Advisers. The risk of conflict of interest here should have been plain to all. In the event, the two individuals (appropriately) stood down from the Council, but this instance

[5] Finance Committee consideration of the Scottish Fiscal Commission (Scotland) Bill http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/93009.aspx

[6] Two commentaries meriting attention are by Ian Lienart, an independent consultant, and SPICE, the Information centre at the Scottish Parliament. The Lienart report, published on October 25th 2015, was specifically commissioned by the Finance Committee to consider evidence on fiscal commissions from around the world and draw out implications for Scotland. The SPICE report by Ross Burnside is shorter and more accessible but containing most valuable and pertinent briefing.

exemplifies the need both for independence and the perception of independence from all quarters.

In the original legislative proposals the SFC was charged, *inter alia*, with undertaking such further work as the Government may 'from time to time require'. Again, that was clearly inappropriate. The Commission must not be constrained to areas of work decreed by *Government* but should have the right to undertake, within the confines of its remit, such work as *it* deems appropriate. The Government should have no power of veto. Of course we should expect close working relations at a technical level[7][i]; so that both SFC and Government should understand and generally agree where further work is required. But the final decision has to be for the Commission. It is encouraging that the proposed requirement to prepare additional reports only as required by Ministers has now been dropped.

One further welcome change is that the SFC is to be charged with preparing annual reports to lay before Parliament. That is the correct reporting line and the concept of annual reports, as proposed in earlier commentary by, for example, the Royal Society of Edinburgh (RSE), is important to underscore both independence and transparency. The only limitation on transparency should relate to any truly confidential data. I would add that for true transparency, such reports, indeed all SFC output, should be not only published but accessible and comprehensible. Their work has to be of the highest technical standard, but that should not mean that their findings are not accessible to all interested readers.

However, further changes to safeguard independence are still required. For example the terms of appointments of members should be included in legislation rather than being left to Ministerial discretion. Further, it should be stated that individuals may not be, at one and the same time, members of the Council of Economic Advisers and the SFC. The appointment process should be transparent, with the Parliament's Finance Committee's approval of appointments being required.

One final point of relevance to independence also relates to the activities of the SFC. It has been proposed in the draft legislation that the SFC should comment on the forecasting work of the Scottish Government, providing comments as these forecasts are being prepared. As stated in the draft Bill's policy memorandum: - "the remit enables the Commission to exert significant influence over the forecasts which underpin the Scottish draft Budget".

[7] For example I welcome the suggestion by Dr Angus Armstrong and Dr Katerina Lisenkova of the NIESR, in their submission to the Finance Committee for a group to be established akin to the Fiscal Liaison Group involving the OBR and HM treasury at the UK level.

This influence should not come via close involvement internally with the Government's actual forecasting. Such engagement could easily pose problems, as it would be difficult for a Commission that has worked closely with Government on the latter's forecasts to then feel open to criticise the forecasts as and when these are finalised. I discuss below the view that the SFC should have the right to prepare its own forecasts and hence be well placed to criticise Government's forecasts post publication.

3. Resourcing

As originally established, the annual budget of the Commission was to be £20,000. This was wholly inadequate. Under the draft legislation the annual budget rises to £860,000. Taking account of the Lienart Report (see footnote 5), this sum should be sufficient to permit the appointment, at an appropriate rate of pay, of a close to full time chair and two further part time members, also to be paid, with suitable support staff. The combination of Commissioners and support staff should have the required skill sets to undertake the analytical and other work of the Commission. It is not essential that all should be from Scotland and certainly some external experience would be of value to the Commission's work. And the use of secondees may make sense, especially initially.

At times, external inputs for particular pieces of work may need to be bought in, from the Commission's budget. To date, premises have been provided by the University of Glasgow, but funding should be sufficient to permit the Commission to acquire other premises if it so determined was appropriate.

Generally the funding appears to be both fully 'guaranteed' for the medium-term and not subject to the whim of Government. It also appears adequate to permit it to perform the required tasks, at least in the early years.[8]

The SFC should also be permitted full access to all data and other information required, whether this comes from UK or Scottish sources. This should mean Memoranda of Understanding with a number of agencies and this necessity should be included in the legislation. Data availability is effectively a part of the required resourcing of any Fiscal Commission. Again, as pointed out by the RSE and other commentators, there may be a need for Scottish economic and financial data to be enhanced to permit SFC and others to perform their functions effectively. The SFC would be well placed to advise on required data improvements and additions.

[8] This is also the conclusion of Ian Lienart in his report for the Finance Committee referred to above.

4. Scope of activities

At the end of section 2 above, I referred to the view that the SFC should have the right to develop its own forecasts. This view is shared by most professional economists (including Professor McGregor and Dr Armstrong who were on a panel with me being questioned by the Finance Committee) but to date this has not been the view of the Scottish Government. To quote from the RSE submission: - “In line with the Finance Committee’s recommendation, the RSE is firmly of the view that the SFC should be capable of producing its own independent fiscal forecasts in assessing the Scottish Government’s fiscal projections.” As noted during the evidence session, it is during ‘hands on’ forecasting work that a strong understanding of the key factors to which forecasts are sensitive becomes apparent.

To many the ultimate preference is that, as with the OBR, the SFC should produce the forecasts which are then required to be used by the Government in their budgetary work. This does not appear to be likely to be agreed *at this stage*. However, as confidence in the ability and objectivity of the SFC is established it may well be feasible to take this further step towards enhancing the role of the SFC and hence the credibility of the Government’s fiscal plans, etc.

I also agree with the conclusion from the RSE and others that the SFC should be tasked with: “…. assessing the performance of the Scottish Government against its fiscal targets and an assessment of the long-term sustainability of the public finances.” This would require the Government to develop medium-term budgetary analysis and encourage a move away from excessive emphasis on the short-term. The SFC could also add value by examining the consequences of alternative fiscal stances.

At the evidence session with the Finance Committee, two other interesting points were raised. A member of the Committee noted that the SFC was not, as matters stood, charged with forecasting revenues from either Business Rates or Council Tax. At first blush, this appears to be an anomaly and inclusion of these items should be seriously considered. Then Dr Armstrong noted that the SFC could also assess the cost-efficiency of different means by which Government could, in due course, raise funds from external sources. Again, I agree and accept that Scottish Government borrowing is likely to be extended as devolution progresses.

Finally on this topic, the role of the SFC should be, so far as feasible, ‘future-proofed’ by allowing for extension of its role as elements of the Smith Commission recommendations are implemented and when further fiscal devolution is considered and potentially implemented. The requirement for a strong SFC will grow over time and the SFC should be encouraged, under initial legislation, to grow in line with that requirement to internationally recognised levels of expertise, independence and transparency (as noted above).

5. Some conclusions

My firm expectation is that the Holyrood Finance Committee will continue to comment fully and rigorously on the proposals for a Scottish Fiscal Commission and will focus on its independence (*primus inter pares*), resourcing and scope of remit. It is important that objective and informed commentators also continue to watch developments and to press for an appropriate legal basis for the SFC and then for the new body to be established in sound shape.

At the same time, I very much hope that the capacity for independent analysis on the Scottish fiscal front can also be increased, to sit alongside the SFC and to work towards being as professional and as influential as the Institute for Fiscal Studies – but in a form suited to Scotland.[9]

Scottish economic and financial devolution can prove to be greatly to the advantage of our economy and economic welfare. However, checks and balances are essential within the governance framework and a strong SFC should be top of the list of essentials.

[9] : Perhaps I should stress that the body or bodies I am encouraging should be Scotland-based rather than offshoots of a UK institution.

About the author:

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He has a distinguished career as an economist and economic commentator and was Group Chief Economist at the Royal Bank of Scotland (1993-2005). He is currently is a member of the Board of Scottish Enterprise and Chair of the Royal Zoological Society of Scotland and was a long-standing Director of the David Hume Institute (2004-14). He is a fellow of the Royal Society of Edinburgh, of the Chartered Institute of Bankers and the Royal Society of Arts.

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