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Financial Scrutiny Unit Briefing

Scottish Fiscal Commission Bill

23 October 2015

15/67

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This briefing summarises the background to the Scottish Fiscal Commission Bill and key elements of the Bill as introduced. It also contains likely issues and themes for parliamentary scrutiny of the legislation.



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The Scottish Parliament
Pàrlamaid na h-Alba

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EXECUTIVE SUMMARY

The Scottish Fiscal Commission Bill was introduced in the Scottish Parliament on 28 September 2015. The Bill proposes to put the Commission on a statutory footing from April 2017, with a remit 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.

Issues around the creation of an independent fiscal institution (IFI) in Scotland have been on the parliamentary radar for some time. There is broad political consensus that an independent fiscal commission should be created in Scotland.

The Scottish Fiscal Commission (SFC) has been established on a non-statutory basis since mid-2014, and the Bill before Parliament proposes putting it on a statutory footing from 1 April 2017.

Scotland Act 2012, which devolved two new taxes to Scotland, and the legislative process currently underway to implement the recommendations of the Smith Commission, have been key drivers of the process to create an SFC.

Parliamentary debate around the creation of the SFC has centred primarily on its remit, and the degree to which it will be independent of Government. The Finance Committee has undertaken extensive work already on the issue and is the lead Committee tasked with scrutinising the Bill. The Finance Committee has issued a call for evidence, garnering views on a range of themes that will frame its scrutiny.

The Bill as introduced in the Scottish Parliament contains some changes from the Draft Bill issued for consultation by the Scottish Government.

The Bill is accompanied by a Financial Memorandum (FM) setting out best estimates of the costs of the SFC delivering its functions. From the first year of operation (2017-18), annual costs are estimated to be £850,000, 54% of which will be to pay 6 full-time equivalent staff and members. The remaining 46% of the budget (£393,000) is proposed for non-staff costs like accommodation, commissioning research, corporate and IT infrastructure. However, the FM makes clear that "it will be for the Commission to determine how it utilises its resources to perform its statutory functions." The Irish Fiscal Advisory Council (IFAC) has an annual budget of approximately €800,000 (£580,000) and a staffing complement of 5 full time equivalents.

There has been a proliferation in independent fiscal institutions (IFIs) in recent years, particularly since the 2008 financial crisis. IFIs are deemed useful in providing an additional check on the operation of a jurisdiction's fiscal framework. The OECD has developed a number of minimum requirements or principles that are useful to all IFIs, but recognise that the remit and operation of an IFI should suit the local political culture and circumstances.

With the exception of the United States, where each state has a Legislative Budget Office (LBO), IFIs at sub-national level are rare. In Europe, they have almost all been created at a national level (often following the recent problems in the Eurozone). Within OECD countries, aside from the United States, only Ontario in Canada, Catalonia in Spain and now Scotland in the United Kingdom have established a sub-national IFI.

INTRODUCTION

In evidence to the Finance Committee on 1 May 2013, the Cabinet Secretary for Finance, Employment and Sustainable Growth, after raising questions around the efficacy of some of the Office for Budget Responsibility (OBR) forecasts for Landfill Tax and Stamp Duty Land Tax, stated that:

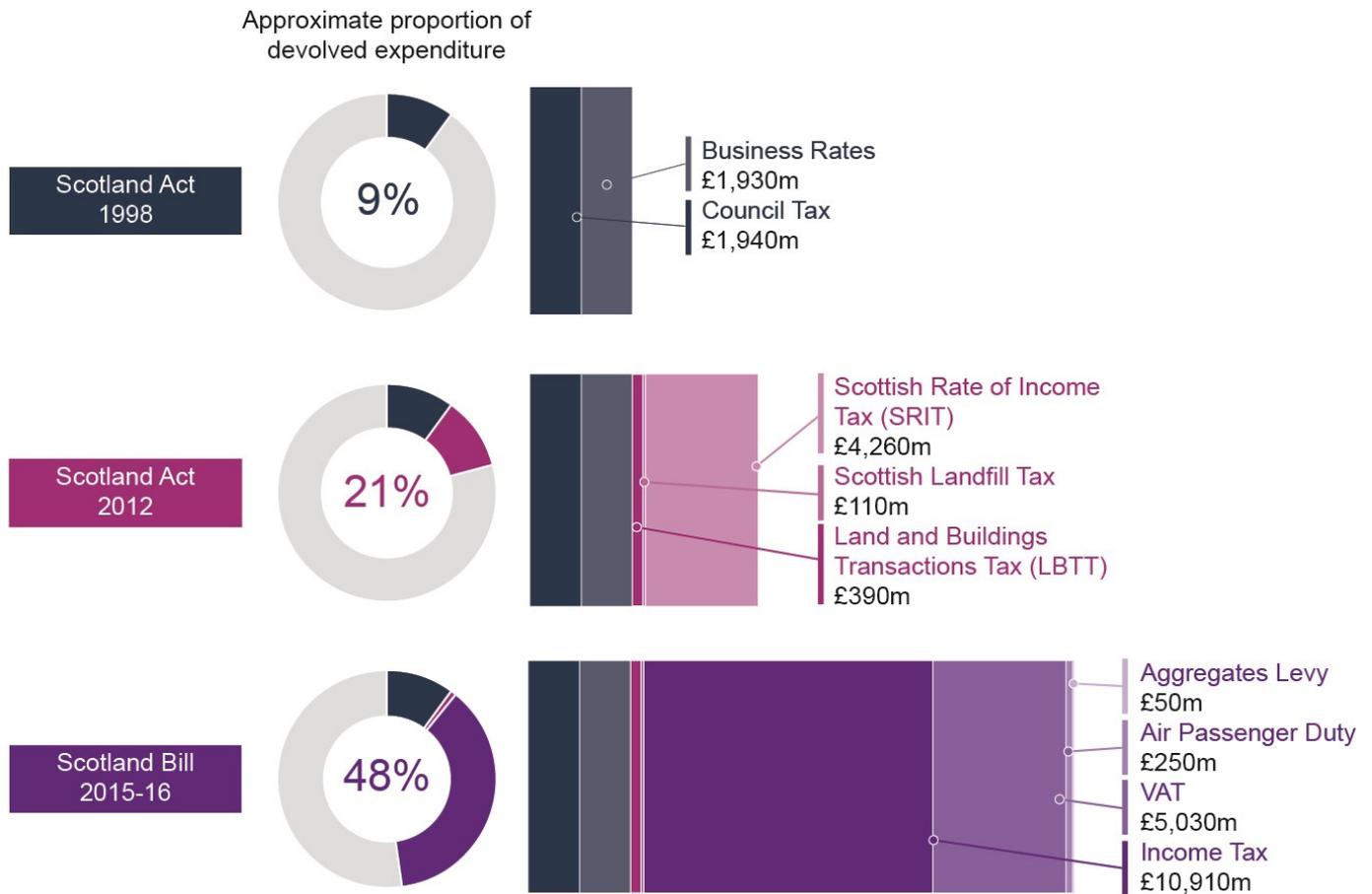
“The Parliament will be moving for the first time into a territory that we have not previously occupied in relation to the forecasting of revenues, with the exception that the Government, in concert with our local authority partners, makes an assessment of receipts from non-domestic rates income. As a consequence of the land and buildings transactions tax, the landfill tax and the Scottish rate of income tax, we will acquire a set of revenue-raising responsibilities. My view is that Scotland will require an independent forecasting body that can provide independent assessment to the Government and the Parliament of what might be generated as a consequence of those taxes. I am considering how that should be established” (Finance Committee, 1 May 2013, Col 2574)

This kick started a process that has seen the Finance Committee and wider parliament take a keen interest on the issue of a Scottish Fiscal Commission (SFC) remit and operation. In its 2014 [Report on proposals for a Scottish Fiscal Commission](#), the Finance Committee endorsed the creation of the SFC on an interim basis. In June 2014, the Scottish Parliament endorsed by division the Scottish Government’s nominations for appointment to the SFC. The SFC published its first report in October 2014 in response to the Scottish Government’s initial forecasts of revenues accruing from the devolved taxes.

A debate about the powers of the Scottish Parliament has been prevalent in Scottish political life since devolution. Often this has centred on the extent to which a Parliament with significant public spending responsibilities should have revenue raising responsibilities. With the Scotland Act 2012 and now the legislative process underway to implement the Smith Commission powers, Scotland has, and will accrue further, revenue raising powers.

Figure 1 presents the evolution of tax revenues since Scotland Act 1998.

Figure 1: Taxation as a share of devolved expenditure



Note: Based on tax receipts from 2013-14 (Scottish Government 2015a)
 Scotland Bill 2015-16 includes the assignation of VAT which is not a devolved tax.

FINANCE COMMITTEE CONSIDERATION OF SCOTTISH FISCAL COMMISSION

As mentioned above, the Finance Committee has undertaken extensive work on the Scottish Fiscal Commission issue and is the lead Committee for the Bill. In response to introduction of the Bill, it issued a [call for evidence on 9 October 2015](#), with a closing date of 6 November 2015.

The Committee's interest in this issue goes back to 2013. In response to the Scottish Government signalling an intention to establish a Scottish Fiscal Commission in May 2013, the Finance Committee published a report on [proposals for a Scottish Fiscal Commission](#) in early 2014. Key recommendations in that report were as follows:

- The Committee recommends that it is essential that the SFC should be independent and seen to be so.
- The Scottish Government should consider the option of inviting the SFC to produce the official macro-economic and fiscal forecasts for Scotland
- However, if the remit is to provide a commentary on Scottish Government forecasts, it is essential that to ensure its independence, the SFC should have no role in producing the forecasts
- The remit should include the option to develop its own forecasting methods and analytical capacity in order to provide a benchmark set of projections
- The role and remit should be clearly set out in legislation with further details in relation to how these are fulfilled set out in a Charter

- The Committee recommends that the SFC should have a right of access (at any reasonable time) to all Scottish Government and Revenue Scotland information and analytical capacity which it may reasonably require for the performance of its duty. The right of access should be established on a statutory basis and the detail set out in a MoU.
- The Committee recommends that it is essential that any contact between the SFC and the Scottish Government and Revenue Scotland should be based on a transparent framework of co-operation. The basis of the working relationship should be set out in a MoU.
- The MoU should include the procedure and timings for the SFC to submit its views to the Scottish Government on its provisional forecasts (prior to publication) and the procedure and timings for dealing with any differences of opinion. It is expected that such views will be made publicly available.
- The Committee recommends that given the OBR will continue to carry out the UK wide forecasts a MoU is agreed between the OBR and the SFC.
- The Committee also recommends that if the SFC will have a role in forecasting SRIT revenues then it will require a similar right of access to all HMRC information and analytical capacity which it may reasonably require for the performance of its duty. This should be set out in a MoU between HMRC and the SFC.
- The Committee notes that there are currently no other organisations within Scotland providing independent fiscal and macro-economic forecasts and the Scottish Government may wish to consider allocating this role to the SFC.

The Scottish Government agreed with many of the recommendations in the Committee report. It took a different view to the Committee in terms of who should be responsible for producing economic and fiscal forecasts arguing that responsibility for this “should lie with the Scottish Government and that primary accountability should be of Ministers to the Parliament”.

If the SFC is to have only a forecast assessment role, the Committee recommended that “the SFC should have no role in producing the forecasts”. The Scottish government agreed “that the SFC should have no role in producing the original forecasts.” The response continued:

It [the Scottish Government] intends to set this out in establishing the remit of the body, on a non-statutory basis for an interim period and on a statutory basis in due course.

Against that background the Scottish Government does not expect that the SFC would need to develop its own forecasting methods or to have its own analytical capacity in order to provide a benchmark set of projections.”

In the first SFC report on Draft Budget 2015-16, an impression could have been taken that the SFC were involved with Scottish Government officials in the production of forecasts, as well as also having the role of assessing the reasonableness of forecasts:

“The Commissioners have held a series of internal meetings and regularly met and corresponded with Scottish Government economists and forecasters. Their first step was to understand the models being used by the officials to predict potential tax revenues. They then moved to examine the Government’s quality of data and information, as well as the working assumptions being applied.

The Commission’s approach can best be described as one of enquiry and challenge, followed by response, followed by further enquiry and suggested improvements. It examined many issues, ranging from formal mathematical modelling, to the role of judgement in methods of forecasting, to the composition of landfill waste.”

The policy memorandum accompanying the Bill as introduced states in paragraph 16 that “the remit enables the Commission to exert significant influence over the forecasts which underpin the Scottish Draft Budget, as demonstrated by the 2015-16 Draft Budget”. This has prompted the Committee in its call for evidence on the Bill as introduced, to ask for views on whether as an independent body “the Commission should exert significant influence over the forecasts” at the same time as providing an assessment of their reasonableness.

On 2 October 2015, the Deputy First Minister (Scottish Government 2015d) wrote to the Finance Committee to announce the publication of a Framework Agreement between the Scottish Government and the SFC. Paragraph 13 seeks to address Committee concerns around a tension between “influencing” and “assessing reasonableness” of forecasts. It states:

“Communications between the Scottish Government and the Commission will not seek to influence the Commission’s judgements or methodology for producing its assessments and analysis, which are determined independently and free from ministerial involvement.

To inform scrutiny of the SFC legislation, the Finance Committee has also commissioned research by Ian Lienert (2015) to consider key success factors for Independent Fiscal Institutions (IFIs), look at case studies from around the world, before making suggestions for the development of the SFC. This research will be published shortly.

SCOTTISH GOVERNMENT CONSULTATION

The Scottish Government (2015b) launched a consultation on a draft Scottish Fiscal Commission Bill in March 2015. The consultation closed on 26 June 2015 and 8 responses were published alongside an analysis report on 11 September 2015 (Scottish Government 2015c). Views were sought on the status of the commission; statutory functions; membership; staff, administration and funding; and independence.

The main point of contention raised in the consultation responses related to the functions of the Commission and independence of the Commission. Four respondents (Finance Committee, CIPFA, the Royal Society of Edinburgh and Taxpayer Scotland) suggested that the SFC should have the function to provide its own devolved tax forecasts, whether in addition to or instead of the Scottish Government producing such forecasts. For example, [the Royal Society of Edinburgh](#) said that the Commission “should be able to originate its own forecasts and enquiries”.

On the other hand, the [Chartered Institute of Taxation](#) said:

“we note that a question might be raised as to whether the Commission should prepare its own forecasts, and a case could be made for this. However, we do not think this is necessary; in addition it would create a huge demand on the Commission and is perhaps not realistic in terms of capacity and resources.”

Other suggestions were made for a wider role for the SFC to consider the Scottish Budget and scrutinise Barnett consequentials and monitor the Scottish Government’s ability to meet fiscal rules. Others were critical of the absence of an SFC power to determine and initiate its own programme of work. These issues were considered by the Scottish Government and the draft Bill changed on introduction (more on this below).

A central concern in responses related to the issue of ensuring the SFC’s independence. In its response to the Scottish Government, ICAS state:

“It may be that a more accurate analysis of the SFC as currently proposed is one of impartiality within the Scottish Administration, rather than being an independent commission.....

For example, it is difficult to understand how a body can be independent of Scottish Ministers if it must prepare reports that Scottish Ministers require; must send a copy of any report to Scottish Ministers before laying it before the Scottish Parliament; and can have its functions added to, modified or removed by regulations.”

Audit Scotland’s submission stated that “it may increase the appearance of independence further if the members of the Commission were appointed by Parliament with the agreement of Ministers.” They also make the following point regarding how the SFC is funded:

“Given the importance of the independence and impartiality of the Commission this, would be enhanced if the Commission were funded through the Parliament’s budget rather than through the Government’s budget.”

BILL AS INTRODUCED

CHANGES FROM DRAFT BILL

The Scottish Fiscal Commission Bill was introduced in the Scottish Parliament on 28 September 2015. As a result of the consultation responses, the Bill as introduced contained some changes to the draft Bill in the consultation document.

The power of Scottish Ministers to require reports on other matters is **omitted** from the Bill as introduced – this section had drawn criticism in the Government’s consultation responses, with some respondents arguing that this was at odds with the stated policy intention of creating a Commission that is structurally and operationally independent of government.

This function is replaced with a broader function allowing the SFC to “prepare reports setting out its assessment of the reasonableness of such fiscal factors as it considers appropriate”. A “fiscal factor” is defined in section 2(4) as “any forecast, assumption or projection which the Scottish Ministers use to ascertain the amount of resources likely to be available for the purposes of section 1 to 3 of the Public Finance and Accountability (Scotland) Act 2000” (those sections make provision for the authorisation of the use of resources by the Scottish Administration and other bodies by the Budget Act for each financial year). Section 2(6) limits this power to areas that “have regard for Government policy, but may not consider what the effect of any alternative policy would be.”

The Bill as introduced also now makes provision for the SFC to prepare and publish an annual report (section 8) setting out its activities during the year.

In line with the OECD best practise and in response to some of the Government’s consultation responses, the Bill as introduced makes a statutory provision for external evaluation of the SFC at least once every 5-year period (section 9).

Section 21 allows the SFC to create committees (this provision was not in draft bill) and appoint members of these committees. Members of a committee may be non-members of the Commission, however there must be at least one Commission member on a Committee. The SFC may, with approval of Ministers, pay committee members.

Also an addition to the draft is section 26 entitled “ancillary provisions” which empowers Scottish Ministers to make ancillary provision by way of regulations and subject to affirmative procedure if they modify an Act.

OTHER BILL PROVISIONS

Section 4 of the Bill provides that the SFC must lay its report on the reasonableness of devolved tax forecasts, etc (under section 2(1)) on the same day as the Draft Budget is presented. Other reports must be laid before Parliament as soon as practicable, but before this happens the SFC “must send a copy of it to the Scottish Ministers” – although no timeframe is given for when the copy must be sent. The requirement to send a copy of any report to Ministers prior to the Parliament was raised as an issue impinging on the SFC’s independence during the Scottish Government’s consultation (ICAS quote above).

Section 5 of the Bill provides regulation-making power to the Scottish Government, subject to the affirmative procedure and following consultation with the Commission, to confer new functions on the SFC or to modify or remove existing ones. This enables the SFC’s remit to be adjusted in future without the need for further primary legislation, but subject to parliamentary scrutiny via the [affirmative procedure](#). This regulation making power does not allow Ministers to remove the SFC’s core functions.

The Scottish Government view is that because this legislation is being written with the Scotland Act 2012 powers in mind, section 5 allows for a more flexible expansion of the functions of the Commission in line with any future increase in financial powers held by the Scottish Parliament. Section 2 by specifically referring to “devolved taxes” appears to allow for an expansion of the number of taxes being assessed by the SFC when proposed Smith powers are conferred (although not income tax, which is not likely to be fully devolved). It is not clear whether it is the intention of the Scottish Government to use section 5 to expand the remit beyond being a “forecasting” body, or for example, to cover something like adherence to fiscal rules.

It could be argued that a more future-proofed mandate could be written into the face of the Bill during its current passage. For example, the Finance Committee has recommended that the Bill is amended to extend the functions of the SFC to include assessing the performance of the Scottish Government in adhering to its fiscal rules (Scottish Parliament Finance Committee 2015a).

Section 6 is designed to safeguard SFC operational independence. It states that in performing its functions, the SFC cannot be directed or controlled by any member of the Scottish Government.

Section 7 provides the SFC a right of access to information held by the Scottish Government, Revenue Scotland, Registers of Scotland and the Scottish Environment Protection Agency (SEPA). It also contains a regulation-making power, subject to the affirmative procedure, to grant access to information held by other bodies where necessary in future under an expanded SFC remit.

Members of the SFC are to be appointed by Ministers subject to parliamentary approval (section 11) for a period of time chosen by Ministers (section 13). It is the intention that appointments will be staggered to avoid a situation where several members leave office at the same time.

Section 17 makes provision for the Commission, with the approval of Scottish Ministers, to determine the remuneration of SFC members, and for reimbursement of expenses. Further

information on proposed remuneration rates are contained in the Financial Memorandum (discussed below).

The SFC is free to appoint its own staff (section 18), but must appoint a Chief of Staff to act as statutory accountable officer for the SFC.

THE SFC REMIT: WHAT THE SFC CAN AND CANNOT DO

All IFIs have at least one of the following three main remits:

- **Assessing and/or preparing macroeconomic and fiscal forecasts.** This can involve: (1) *assessing* (and, possibly, formally *endorsing*) macroeconomic and fiscal forecasts of the government, or (2) to *prepare the official projections* of the economy and fiscal outlook. Such forecasts can be one-year ahead or, most frequently, over a medium-term period (3-5 years). In many cases, the IFI is also charged with (3) *assessing long-term fiscal sustainability*. Most IFIs assess the official economic and fiscal forecasts prepared by the Government’s “ministry of finance” (MoF) (see figure 2 below).
- **Assessing the fiscal stance and fiscal outcomes:** *monitoring* and *evaluating* the forecast fiscal stance and actual fiscal outcome. The IFI may also be charged with making *recommendations* for correcting fiscal policies – changing revenue and/or expenditure policies – in order to achieve the officially approved fiscal targets.
- **Costing of proposed policy measures** including those of alternative policies. This involves costing new expenditure policies and/or new tax and non-tax measures. In some countries, costing is limited mainly to government proposals. In other countries (e.g., Australia) the costing extends to the costing of political parties’ election manifestos. Since detailed costing work require considerable resources, less than half of the IFIs in the world undertake this work.

The following infographic presents what the SFC (under the Bill as introduced) can and cannot do under the terms of the Bill as introduced.

Function	
Assessing Fiscal Forecasts	✓
Preparing official Fiscal Forecasts	✗
Considering effect of alternative forecasting assumptions or methodologies on revenue forecasts	✓
Assessing long-term fiscal sustainability	✗
Assessing the fiscal stance and fiscal outcomes	✗
Costing of proposed policy measures	✗
Commissioning research and appointing Committees to consider relevant issues	✓

The proposed remit in the Bill gives the SFC flexibility to pro-actively look at the reasonableness of forecasts for resources/revenue streams available (all taxes, charges, income streams,

borrowing). However, it does not allow them to look at the affordability or sustainability of policies (for example, affordability of health care for older people over next 5-10 years) as that includes spending projections not just the “amount of resources” available. As such they cannot, for example produce the equivalent of the OBR’s fiscal sustainability report, public finance forecasts, or its new role in regularly reporting on fiscal risks (including contingent liabilities).

They could, in theory, look at the sensitivity of tax revenues to changes in the economy, but not the level of revenue that might be generated at different tax rates – which would mean they could not produce outputs like the Financial Scrutiny Unit’s (FSU) [tax calculators](#).

The removal of the “power of Scottish Ministers to require reports on other matters” means that in principle, the SFC could reject a request from Ministers (and indeed the Scottish Parliament) to produce a report. This provides the SFC the ultimate decision making power as to which, if any, additional statutory reports it produces (subject to the scope defined in the remainder of section 2).

THEMES FOR SCRUTINY

The Finance Committee launched a consultation on the SFC Bill on 9 October 2015. This set out a series of questions which will frame the Committee deliberations on the Bill.

FORECASTING TAX REVENUES

As already mentioned, a key element of the Finance Committee’s work on the SFC thus far has related to whether or not the SFC is able to produce revenue forecasts. The Scottish Government has argued that official forecasts should be the responsibility of Scottish Ministers “who should be directly accountable to the Scottish Parliament for these forecasts”. The Bill as introduced does not propose that the SFC should prepare its own forecasts, however there is nothing to stop them preparing or commissioning alternative forecasts should it wish to. Given this, the Committee in its call for evidence has sought views on whether:

- there is a need for independent forecasts in addition to the Scottish Government official forecasts?
- the Commission should have the capacity and resources to make its own forecasts even if its role is to assess the official forecasts?
- the Scottish Government forecasts should be subject to sensitivity analysis carried out by the Commission?
- the Commission should be able to develop its own forecasting methods and analytical capacity in order to provide a benchmark set of projections?

ROLE OF SFC PRIOR TO THE PUBLICATION OF THE SCOTTISH GOVERNMENT FORECAST

Section 4(1) of the Bill as introduced requires the Commission to publish its report on the assessment of the reasonableness of the forecasts for the devolved taxes on the same day as the draft budget is published. Section 4(3) requires the Commission to provide a copy of the report to Ministers in advance of publication, but as mentioned above does not specify when. This means that the Commission will be required to carry out its assessment of the Government’s forecasts prior to publication.

The Commission states on its [website](#) that throughout “the year the Commission scrutinises the Scottish Government’s work in developing models and methodologies to produce its forecasts. Its interaction with the Scottish Government informs the Commission’s understanding of the reasonableness or otherwise of their forecasts and its scrutiny improves the methods used by the Scottish Government and thereby the eventual forecasts.”

The Committee has previously recommended that, if the SFC is to have only a forecast assessment role, in order to ensure the Commission’s independence it is essential that it has no role in producing the forecasts (Scottish Parliament Finance Committee, 2014). The Scottish Government responded that it “agrees that the SFC should have no role in producing the original forecasts” and “intends to set this out in establishing the remit of the body, on a non-statutory basis for an interim period and on a statutory basis in due course.”

The policy memorandum states that the Commission is able to “exert significant influence over the forecasts which underpin the Scottish Draft Budget.”

The Committee consultation has sought views on whether:

- the Commission should exert significant influence over the forecasts at the same time as providing an assessment of their reasonableness?
- the Commission should have a role throughout the year in scrutinising the Scottish Government’s work in developing models and methodologies to produce its forecasts?
- the Commission should carry out its assessment of the Scottish Government forecasts either *before* or *after* publication?
- the Commission should be required to send a copy of its report on its assessment of the forecasts to Ministers prior to publication and, if so, how far in advance?

ADDITIONAL FUNCTIONS

The Bill has been drafted with Scotland Act 2012 powers in mind, but leaves scope for expanding the remit of the SFC via secondary legislation at some point in the future. Given this, the Committee in its consultation has called for views on whether:

- the Commission should 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 now to reflect this?
- the Bill should be amended to include assessment of mechanisms for adjusting the block grant?
- there should be a legislative requirement for the Scottish Government to prepare a charter for budget responsibility and the Commission should have a role in assessing adherence to the charter?

RIGHT OF ACCESS TO INFORMATION

Section 7 of the Bill provides the SFC with a right of access at reasonable times to any relevant information from the Scottish Government, Revenue Scotland, SEPA and the Registers of Scotland. The Committee has previously recommended that the right of access should be established on a statutory basis and the detail set out in a Memorandum of Understanding (MoU). The Committee also recommended that it is essential that any contact between the

Commission and these bodies should be based on a transparent framework of co-operation and that the basis of the working relationship should be set out in a MoU. The Scottish Government agreed with these recommendations.

The Committee has sought views on:

- is the right of access in the Bill robust enough?
- is there a need to include a requirement for a MoU on the face of the Bill?
- what principles should underpin the working arrangements between the Commission and the Scottish Government and other relevant public bodies?
- the process and timings for the Commission's engagement with the Scottish Government and how this should be set out in the MoU?
- the process and timings for the Commission's engagement with HMRC and the OBR and how this should be set out in the MOU?

APPOINTMENTS OF MEMBERS AND STAFF

The Bill provides for Members of the Commission to be appointed by Ministers but only if the Scottish Parliament has approved the appointments. The current Members will form the first statutory Commission, serving to the conclusion of their current appointment terms.

All subsequent appointments to the Commission will be subject to the Public Appointments and Public Bodies etc. (Scotland) Act 2003. Members (including the Chair) can only be appointed for one fixed term. The period of appointment is to be determined by Ministers who may also remove a member from office under specified conditions¹ but only with the approval of the Parliament. The Commission will determine its own staffing arrangements, with the terms and conditions of employment to be agreed firstly with Ministers.

The Committee has sought views on whether:

- the proposed appointment and removal procedures are adequate for ensuring the independence of Commission Members?
- Ministers should determine the period of office of each Member or should it be specified in the Bill?
- appointments should be for one fixed term or should there be an option for a further term?
- should the Commission determine its own staffing arrangements on the basis of terms and conditions of employment agreed firstly with Ministers?

COMPARING FISCAL COMMISSIONS

A key message from the literature on fiscal bodies is that it is very much a case of creating an organisation and remit that suits the political culture of the jurisdiction – the OECD (2014, 2015) literature refers to the importance of “national” as well as “local ownership” and “broad political consensus” for an IFI to be enduring.

¹ If a member has not attended meetings for more than three months (without permission for absence), if a members is unable to perform their functions or if Ministers deem them to be unfit for the role.

However, the OECD has developed a number of minimum requirements or principles that are deemed suitable for “travel” regardless of local circumstances. These are discussed in the Finance Committee (2014) report, OECD (2014, 2015), Lienert (2015) and in the Policy Memorandum accompanying the Bill, and summarised below. In the Scottish context, many of the OECD principles are addressed by the legislation before Parliament. However, comment is made below on some issues that might usefully be raised during the Parliamentary scrutiny of the Bill *and is placed in italics*.

PRINCIPLES FOR EFFECTIVE INDEPENDENT FISCAL INSTITUTIONS

A clear mandate

The OECD state that the mandate of IFIs should be clearly defined in “higher-level legislation” or “clearly stated in primary law”. *This principle is met by the SFC Bill’s proposals for the SFC in year 1, but may not be met if the SFC’s remit is expanded via regulations subject to affirmative procedure in the future.*

Independence and non-partisanship

There are different elements of independence which should be achieved by an IFI.

Political independence – the IFI should serve the interests of all political parties represented in Parliament, without discrimination.

Independent leadership – leadership of an IFI should be selected on basis of merit and technical competence, without reference to political affiliation

Independent recruitment and management – the IFI must be free to recruit and dismiss staff. *This issue was also raised by the Council for Economic Advisers (CEA, 2013) in its report on Fiscal Rules and Fiscal Commissions, who said that*

“an important aspect is to avoid institutional capture whereby those working in an independent fiscal commission are formally – or informally - part of the government (e.g. secondments).”

This idea of “institutional capture” has been raised as a concern in the Scottish Government’s consultation responses – for example, by ICAS who talked of the current Bill proposals as creating an SFC of “impartiality within the Scottish Administration”. It might also be an issue for the SFC to consider during the transition period and beyond when recruiting staff. For example, the SFC currently has a staff member seconded from the Scottish Government.

Operational independence – the IFI should have the “autonomy to determine its own work programme within the bounds of their mandate”.

Financial Independence – resources allocated must be commensurate with the IFI mandate in order to fulfil it in a credible manner. *This may have been an issue with the initial £20,000 SFC budget, however this is addressed in the Bill as introduced.* The Financial Memorandum to the Bill was produced in conjunction with the SFC.

The literature also suggests that multi-annual funding commitments further enhance an IFI’s independence and provides additional protection from political pressure.

Access to information – it is important for an IFI to have access to all the information and official documentation required to carry out its functions.

Transparency

Governance structures should be clear and laid out in primary law.

There should be transparency in all reports and analysis produced with clear statements of methodology and assumptions published. All reports should be freely available, and media coverage of IFI work should be encouraged.

Accountability and oversight

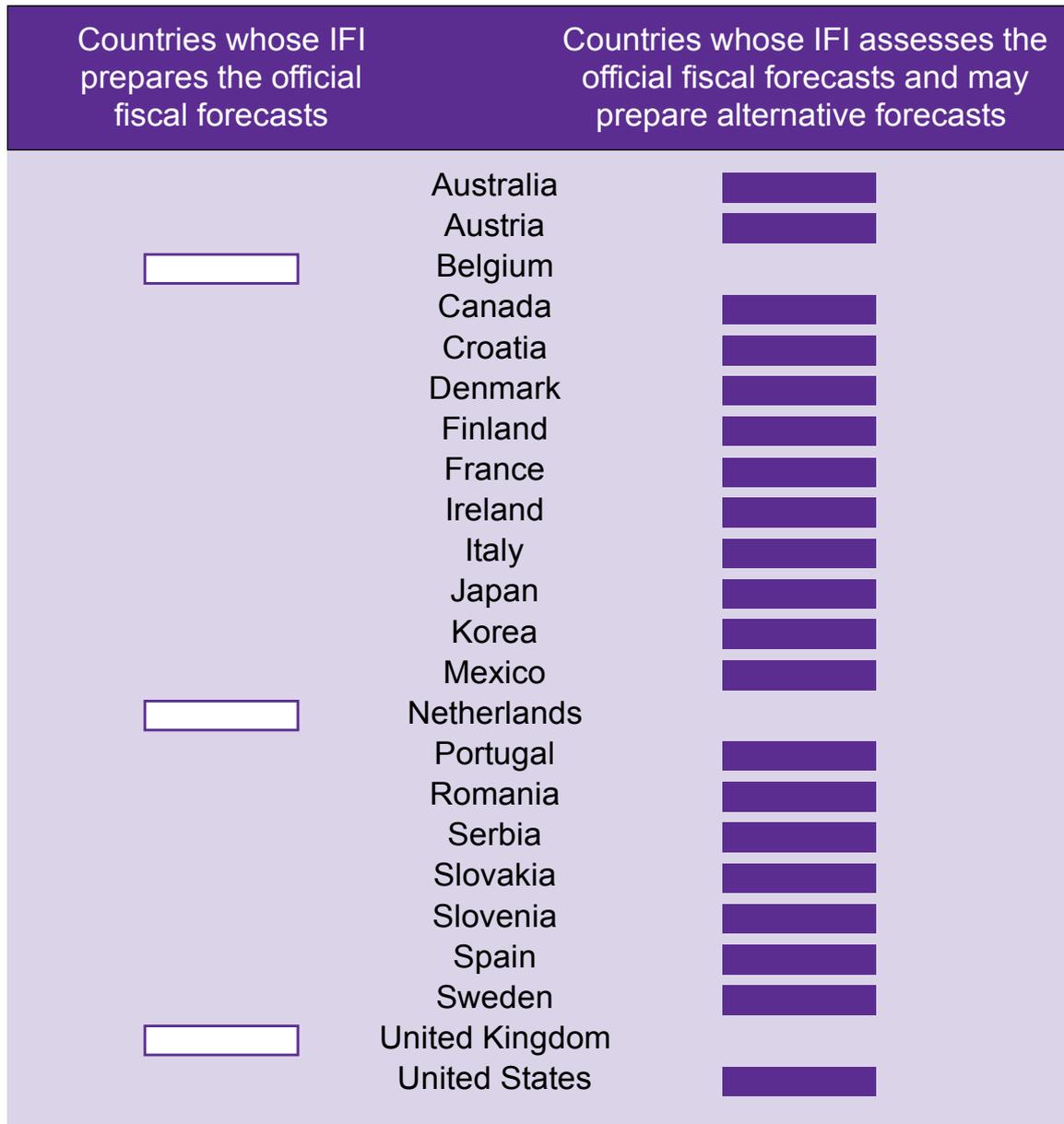
The IFI should be accountable to the Parliament's finance committee, other committees and individual members of Parliament. Outputs should be timed to assist in scrutiny of the annual budget.

IFIs should develop mechanisms for external evaluation of their work to be conducted by local or international experts.

TYPES OF INDEPENDENT FISCAL INSTITUTIONS

It is usually the "Ministry of Finance" (MoF) that produces official fiscal forecasts, while other publicly funded agencies, including IFIs, prepare alternative fiscal forecasts. Some countries with IFIs have arrangements with non-MoF agencies for preparing alternative macroeconomic and fiscal forecasts (for example Ireland, Slovenia and Sweden).

Figure 2: OECD based IFIs and forecast role



Source: Debrun and Kinda (2014) and OECD (2015)

Figure 2 shows that there are only three IFIs in the OECD who produce official forecasts themselves (the UK's OBR, Belgium and the Netherlands). However, it is common in independent fiscal institutions (IFIs) for there to be other economic and fiscal forecasts to draw on. In responses to the Finance Committee and PQs, the Scottish Government has cited the examples of Sweden and Ireland where the IFI does not produce official forecasts. However, both the Irish and Swedish fiscal bodies have access to alternative forecasts and do not rely solely on Government forecasts. For example, in Sweden, as the Committee has made clear in its Fiscal Framework report, the Swedish Fiscal Policy Council (SFPC) relies heavily on the forecasts of other public bodies in Sweden and, in particular, the forecasts of the National Institute of Economic Research (NIER). The two bodies are located in the same building and collaborate closely. In its 2014 report, the SFPC concluded that

“The Government has a considerably more positive view than NIER and other forecasters of how much the economy can grow before equilibrium capacity utilisation is reached. The Government also has a more optimistic view of how rapidly the public finances will improve the capacity utilisation increases.”

This highlights a point made by Ian Lienert (personal communication) that “whether an IFI has the role of *assessing official forecasts* or of *preparing the official forecasts* the IFI needs tools for preparing its own “benchmark” forecast.”

This is because fiscal and other forecasts may be adjusted judgementally. Some studies for European countries² indicate that, for fiscal forecasts, official projections – especially for economic growth and government revenues – are biased optimistically, and there is a more than a 50% chance of being too high. To counter systematic and politically motivated forecasting biases, Jonung and Larch (2006) argue that forecasts prepared by an independent agency would be superior to in-house MoF forecasts.³ The same reasoning applied in the UK prior to the creation of the OBR in 2010, which is independent of HM Treasury, the previous official forecaster.

However it is also possible to systematically produce pessimistic macro-fiscal forecasts. After the debt crisis of the early 1990s, Canada deliberately prepared pessimistic official forecasts for economic growth and budget revenues.⁴ The argument for this was it was preferable to have pleasant surprises (actual revenues higher than forecast revenues) than unpleasant surprises (revenues lower than forecast, with pressure to cut expenditure in the following year’s budget). Canada wished to avoid another debt crisis and to begin running fiscal surpluses. Since actual federal revenues were higher than those projected, Canada was able to exit its high indebtedness more quickly than it would have if its projections had been unbiased or, worse, too optimistic, as in several European countries.

National level IFIs are the norm

IFIs at subnational level are rare. The United States is a major exception with Legislative Budget Offices (LBOs) in all 50 states. In Europe, IFIs have been established at national level. Lienert (2015) identifies three other countries where subnational IFIs have been established – Ontario in Canada, Catalonia in Spain and now Scotland in the UK.

FINANCIAL MEMORANDUM

As mentioned above, the Bill is drafted with Scotland Act 2012 powers in mind. As such, the financial costs associated with the SFC’s creation and contained in the Financial Memorandum (FM) do not relate to the additional powers currently being considered in the UK and Scottish Parliaments. Given this situation, the scope of the functions of the SFC may change and hence the costs of the SFC may change in the future with the accrual of further powers (and changes to functions via secondary legislation).

The Bill assumes that the SFC will be operational on a statutory basis from 1 April 2017. The FM estimates that costs arising from the Bill will total £850,000 per annum from 2017-18. This compares with the Irish Fiscal Advisory Council (IFAC) which has an annual budget of not more than €800,000 (approximately £580,000), set out in the legislation for IFAC, adjusted for inflation – in 2015, IFAC’s budget ceiling was set at €823,360 (approximately £600,000) (IFAC, 2015b).

² For an overview of fiscal forecasting experience in Europe, see Leal et al (2007).

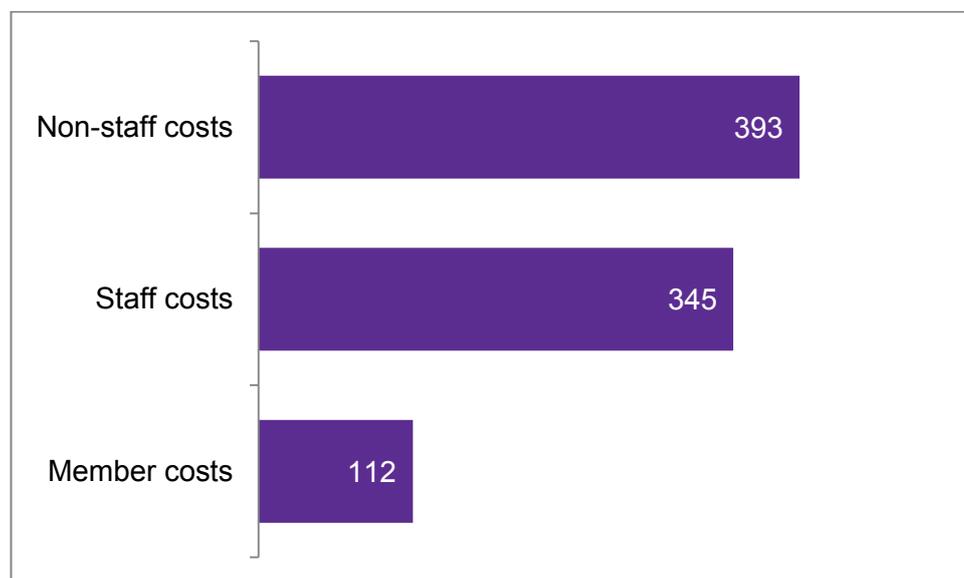
³ Hughes Hallet (2003) had earlier proposed creating a Sustainability Council (an independent panel of experts) for enforcing fiscal rule compliance in the euro area.

⁴ Canada’s “MoF” took the consensus forecasts for GDP and interest rates and, using a macro-fiscal model, adjusted these downwards and upwards respectively, to prepare a pessimistic scenario – especially for the revenue projections of the federal budget. For details, see Bayoumi et al (2007).

The FM also provides cost estimates for the SFC in the transition period from its current non-statutory status to statutory body from April 2017.

Of the costs envisaged in the first statutory year of operation, over half is to meet costs of staff and members (54%) with the remaining 46% being for non-staff costs.

Figure 3: Year 1 costs by category, £'000s



STAFF COSTS

Staff costs in year 1 are estimated at £345,000 and are based on there being 6 full-time equivalent staff (an average of £57,500 per person) providing “governance, strategic, operational and technical support to members in discharging the Commission’s functions”. By way of comparison, the staffing complement in IFAC is 5 full-time equivalents, comprising one administrator and four economists.

The FM contains the Government’s best estimate of the total staffing resource which the statutory SFC is likely to require, however, it will be for the Commission to decide its staffing structure in “due course”. Staff costs are based on the Scottish Government average staff cost for 2014-15, uprated for inflation and include employer pension contributions, and employer National Insurance contributions.

Staff costs are split as follows.

Table 1: Estimated staff costs £'000s

Posts	2017-18	Assumption
Chief of Staff	100	Presumably 1 post costing £100k (includes salary, pension, employer National Insurance contributions)
Analytical and Strategic support	165	Presumably 3 posts costing £55k per post (including pension, employer NICs)
Corporate and member support	80	Presumably 2 posts costing £40k per post (including pension, employer NICs)
Total	345	

MEMBER COSTS

Member costs are estimated at £112,000, which is split into £104,000 for member remuneration and £8,000 for expenses. The daily rate for the Chair of the Commission is assumed to be £465, with a daily rate of £331 for other members. Costs are not pensionable, and assume a time commitment of 1.5 days per week, and employers' national insurance.

NON-STAFF COSTS

The non-staff cost include provision for accommodation costs of £125,000 should the SFC opt to relocate from their current host, Glasgow University. The £125,000 figure includes commercial rents, rates and utilities, but does not include any payments that might be required to locate and secure the accommodation, for example advance rental and associated legal advice which are included in the transition costs for 2016-17.

£108,000 is provided for the provision of external research that the SFC may require to buy in. It is based on average daily rates being paid of £600, implying 180 days of work.

TRANSITION COSTS

Transition costs for the years prior to the SFC becoming a statutory body (2015-16 and 2016-17) are included. Costs cover estimates for pay and expenses of a team of 6 full-time equivalent staff tasked with delivering corporate services, including IT and accommodation, and the establishment of operating procedures, HR and governance. These costs total £180,000 in 2015-16 and £360,000 in 2016-17.

Non-staff transition costs are estimated at £15,000 in 2015-16 and £30,000 in 2016-17 and include estimates for costs associated with searching for property, and legal advice on subsequent property leases.

COMMITTEE CONSULTATION

The Committee has sought views on the following areas in its Bill consultation:

- the overall costs set out in the FM;
- the number of staff;
- the remuneration and assumed time commitment of Commission members;
- the likely costs of expanding the Commission's role to include an assessment of key aspects of Scotland's fiscal framework such as the Scottish Government's adherence to fiscal rules.

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Published by the Scottish Parliament Information Centre (SPICe), The Scottish Parliament, Edinburgh,
EH99 1SP

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