



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

# FINANCE COMMITTEE

Wednesday 18 November 2015

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**Wednesday 18 November 2015**

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**FINANCE COMMITTEE**  
**29<sup>th</sup> Meeting 2015, Session 4**

**CONVENER**

\*Kenneth Gibson (Cunninghame North) (SNP)

**DEPUTY CONVENER**

\*John Mason (Glasgow Shettleston) (SNP)

**COMMITTEE MEMBERS**

\*Jackie Baillie (Dumbarton) (Lab)

\*Richard Baker (North East Scotland) (Lab)

\*Gavin Brown (Lothian) (Con)

\*Mark McDonald (Aberdeen Donside) (SNP)

\*Jean Urquhart (Highlands and Islands) (Ind)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Dr Angus Armstrong (National Institute of Economic and Social Research)

Charlotte Barbour (Institute of Chartered Accountants of Scotland)

Alan Bermingham (Chartered Institute of Public Finance and Accountancy)

Robert Buchan (Revenue Scotland)

John Cullinane (Chartered Institute of Taxation)

Eleanor Emberson (Revenue Scotland)

Professor Peter McGregor (University of Strathclyde)

Keith Nicholson (Revenue Scotland)

Professor Jeremy Peat (Royal Society of Edinburgh)

Chris Stewart (Scottish Property Federation)

**LOCATION**

The Sir Alexander Fleming Room (CR3)



## Scottish Parliament

### Finance Committee

Wednesday 18 November 2015

*[The Convener opened the meeting at 09:30]*

### Decision on Taking Business in Private

**The Convener (Kenneth Gibson):** Good morning and welcome to the 29th meeting of the Scottish Parliament Finance Committee in 2015. I remind everyone present to turn off any mobile phones or other electronic devices.

Our first item of business is to decide whether to take items 5 and 6 in private. Do members agree to take those items in private?

**Members** *indicated agreement.*

## Scottish Fiscal Commission Bill

09:30

**The Convener:** Our second item of business is for John Mason and Jean Urquhart to report back from their recent fact-finding visit to Dublin. Members have received copies of a short written report that sets out their key findings.

**John Mason (Glasgow Shettleston) (SNP):** Jean Urquhart and I feel that we had an extremely useful time. I thank Alison Wilson for writing the report and for looking after us.

There are many parallels. Obviously, Ireland is an independent country, so that makes it slightly different.

**The Convener:** Slightly?

**John Mason:** It is slightly different, but there are many parallels and points that we could learn from, especially given that Ireland is a small country and, like us, does not want to waste resources.

The Government does the forecasting, but I think that the Irish Fiscal Advisory Council has gradually changed its position and is doing a little bit more. Rather than it being a black-and-white situation, the Irish seem to have seen it as a gradation, which we can perhaps learn from.

IFAC has to endorse the forecasts. At first, there was confusion as to whether it was endorsing the whole budget or just the forecasts. I suspect that we might need to consider that issue as well. It seemed to be difficult for it not to endorse the budget, but it can make various comments and caveats along the way.

We spent a fair bit of time talking to people about the independence of the council. That is partly about what is in the legislation and the rules, but it is also partly about the reputation that is built up. We have noticed that in Scotland. We did not pick up from anyone any questions about independence.

There are five people on the council, and they all have Irish backgrounds, but not all of them are based in Ireland. We think that that is useful, because it gives the perspective of being outside the country and looking at the issues more internationally. Because Ireland is a small country and the Irish feel that the number of people who could be appointed to the council is limited, they are allowed two terms of office, which is positive.

The act that established the council does not give it a statutory right to information. The council has been challenged about that through a peer review and it is unusual in Europe. That point is being considered.

The final point that the members of the council made concerned how much time they have to spend on governance. Because the council is a statutory body, it has to consider its human resources policy and audits, for instance. Even though the council is small, that is almost as time consuming as it is for a large organisation. The council had not expected that and we wonder whether the members of our Scottish Fiscal Commission realise that they might have to spend quite a lot of time on that as well.

**The Convener:** Thank you very much, John.

Jean, would you like to add anything to John's comments?

**Jean Urquhart (Highlands and Islands) (Ind):** I have only a couple of things to add. First, it is interesting that the staff who are employed by the council are all seconded, some from the central bank.

Secondly, the council was at pains to talk about how it recorded everything for freedom of information purposes. There is an extraordinary amount of clarity on everything, whether it is conversations or emails. Rather than spend time being challenged on anything after the event, the council records everything so that the material can be ready for any freedom of information request.

I agree with everything that John Mason said. I, too, thank Alison Wilson, because it was sometimes not an easy job to follow our conversations.

**The Convener:** It is an excellent report. It seems clear and detailed. I thank you both for that and I also thank Alison Wilson for the work that she has done to put together such an excellent report.

I have a couple of points to raise. In relation to forecasting, paragraph 7 of the report says:

"We heard that it soon became clear to the Council that in order to be able to assess the DoF's forecasts thoroughly it would need to also produce its own to use as a benchmark."

**John Mason:** My understanding is that the council does not do the full thing from the grass roots up. I am sure that we will come on to that issue later this morning. I think that the council does some forecasting, but not the whole thing from scratch—I do not know whether that was the impression that Alison Wilson and Jean Urquhart gained. That is what I meant when I said that there are grey areas concerning who does the forecasting.

**The Convener:** Paragraph 26 says:

"Under the 2012 Act it was established that the Council has a complete guarantee over its budget; Ministers are unable to remove or reduce its funding. Any increase in functions would lead to an increase in funding."

Is that an automatic financial increase or does the council have to negotiate that? It obviously helps the robustness of the independence of the organisation if it does not have to worry about the funding ever being cut.

**John Mason:** Yes. From memory, I think that the budget is €800,000, which makes ours look quite generous. That limit goes up by the rate of inflation every year. In the first two years, the council did not use it all because it was just getting going, but by the third year it was pretty close to using the full budget.

**The Convener:** Paragraph 11 of the report says:

"the fiscal policy and tax unit has 8 staff and a budget of 2¾ to 2 million euros."

**John Mason:** That is the Government.

**The Convener:** It is the Government's unit. I thought that the macroeconomic unit was in the Department of Finance and that the fiscal policy and tax unit was part of the Fiscal Advisory Council. I apologise—thanks for that clarification.

**Jean Urquhart:** It seemed that quite a bit of the council's budget is spent on flying the four members who live abroad to Dublin, where the council meets 12 times a year. I do not know whether we would have an equivalent to that.

**The Convener:** I do not know whether that would amount to quite a bit out of €800,000, to be honest.

**Gavin Brown (Lothian) (Con):** I was interested in the point about appointments for two terms. What is the duration of a term?

**John Mason:** It is either four or five years, I think.

**The Convener:** It is four years. Quite a number of the witnesses who we will hear from later today have suggested that there should be two four-year or five-year terms.

**Richard Baker (North East Scotland) (Lab):** John Mason said that over time the Irish council has taken on a greater forecasting role, to whatever degree that is. Has that required it to increase its budget, which seems fairly limited if it includes a forecasting role?

**John Mason:** No. The budget is fixed—there was no negotiation over that.

**Richard Baker:** That is interesting.

**The Convener:** Thank you very much for that and for the report.

09:38

*Meeting suspended.*

## Scottish Fiscal Commission Bill: Stage 1

09:38

*On resuming—*

**The Convener:** Our third item of business forms part of our on-going scrutiny of the Scottish Fiscal Commission Bill. We will hear from two panels of witnesses today. First, we will take evidence from Charlotte Barbour of the Institute of Chartered Accountants of Scotland, John Cullinane of the Chartered Institute of Taxation, and Alan Bermingham of the Chartered Institute of Public Finance and Accountancy. I welcome them to the meeting.

Members have received papers from each of the witnesses, so we will go straight to questions from the committee. As you will be aware, I usually ask some opening questions and then we move to colleagues round the table. When I ask questions, each of you should feel free to answer them, but you do not have to answer. You do not all have to answer every question, so please do not feel that you have to.

We might as well start at the very beginning. ICAS has said:

“From reading the Bill ... it is not clear exactly what the Scottish Fiscal Commission ... is to do.”

That is an interesting start. There seems to be an issue about being

“precise and clear regarding the scrutiny function”,

but ICAS thinks that

“the SFC should provide external oversight and scrutiny but without having to re-do the forecasting.”

It agrees with the policy memorandum, which says:

“it is critical to the effectiveness and credibility of the Commission that it is independent of government and seen to be so.”

Will Charlotte Barbour give us some comments on her thinking on that?

**Charlotte Barbour (Institute of Chartered Accountants of Scotland):** Thank you for inviting us to give evidence.

The functions in section 2 of the bill are very high level and principled. The commission has the responsibility to write reports on various things. That allows a lot of room for deciding what will be done thereafter, but I was not completely sure from reading the bill and from some of the questions that were raised in earlier discussions exactly what the commission is being asked to do and whether it is being asked to oversee assumptions and methodology, which would be really useful and would offer a bit of challenge—it would be like a risk committee—or whether it would check all the forecasting. If the commission

really wants to check forecasting properly, it will maybe have to go back and do some of it. That seems to me to be a bit of duplication of work, which is perhaps not value for money. We would veer towards an oversight role and something that is more like a risk or audit committee function.

**The Convener:** It is interesting that you consider that the bill is not clear enough. If people are not sure what the bill is trying to achieve, despite the fact that that should be explained in the policy memorandum, that is obviously an issue of concern and we will raise the issue in our report.

Paragraph 12 of your submission states:

“ICAS does not consider that there is a need for the SFC to prepare independent forecasts as this would create duplication of work”.

You have just said that. The Scottish Property Federation is not giving evidence to us today, but it and others, such as Dr Armstrong, who will give evidence today, have said that that is important. The Scottish Property Federation said:

“The Committee has previously noted that it is important that the SFC is perceived to be independent of the Scottish Government. This could be difficult to achieve without a means of producing and publishing its own independent forecasts.”

Obviously, you have caveats about the duplication of work. Do you take the view that there is no concern about that and that duplication is more of an issue than the perception that the forecasts would not be independent?

**Charlotte Barbour:** That is one of the areas in which there is perhaps a lack of clarity. If we want a completely and totally independent institution that does completely separate forecasts, we will move off towards something that is closer to the Institute for Fiscal Studies south of the border. It would be completely separate. If we want a mechanism that is a check and balance on forecasting, the forecasts do not need to be completely redone. That would be duplication.

**John Cullinane (Chartered Institute of Taxation):** With the benefit of hindsight, almost any forecast that was produced by anybody before the credit crunch was insanely optimistic. It is not so much a matter of one forecast being better than another, as they will all be wrong to some degree; it is a matter of the key assumptions, varying the assumptions slightly and getting a very different result, and what happens that is different and unexpected and is so bad that we have to think about how we might cater for it anyway. It is more about having the ability to challenge than about investing in an alternative analysis, which might take up a lot of time and reduce the effective scrutiny of the official forecasts.

**The Convener:** Paragraph 2.2 of the Chartered Institute of Taxation submission says:

“At this stage, we do not think it would be a realistic demand in terms of capacity and resources for the Scottish Fiscal Commission to prepare its own forecasts.”

**John Cullinane:** I agree. I think that that would just divert it from the job of challenge, which could be very productive.

**Charlotte Barbour:** Yes.

**The Convener:** Sticking with Mr Cullinane, I note that paragraph 3.1 of the Chartered Institute of Taxation’s submission states:

“If the Commission exerts significant influence over the Scottish Government forecasts, in the sense that it is involved in their preparation and has a vested interest, this will harm both actual and perceived independence.”

You are saying that the commission should have a hands-off approach.

**John Cullinane:** There is a balance. When the commission is doing its detailed work, it should be independent. However, we would expect the Government to take on board the constructive criticisms that the commission makes over the years. We would expect some influence over the long term but not a lot of working together at the initial stage.

09:45

**The Convener:** Mr Bermingham, your submission is different from the other submissions that we have had in that it puts a focus on the issue of borrowing. It says:

“Firstly, in relation to borrowing, we would advocate that the statutory powers here should be expanded from projections of borrowing requirements to assessments of the sustainability, affordability and prudence of the Scottish Government’s Borrowing.”

Could you talk us through your thinking on that?

**Alan Bermingham (Chartered Institute of Public Finance and Accountancy):** CIPFA is leaning towards the view that, once we have a fiscal framework and are perhaps setting out fiscal rules, the scrutiny should be at the level of the whole public sector, to include the Scottish Government and local government, which has its own borrowing powers. The fiscal rules should be geared towards ensuring that there is not an intergenerational indebtedness that is unaffordable. That sort of fiscal sustainability needs to be examined at the level of the whole of the public sector. At the moment, we view the approach that is being taken as restricting the examination to the Scottish Government and the rules and borrowing levels that are in the Scotland Bill as opposed to considering the issues in totality. That is where the fiscal rules should be



applied, in CIPFA's view. The borrowing question becomes important in that context.

On whether the commission should make its own forecasts and so on, CIPFA probably agrees with the other witnesses that it should not and that, in terms of the budget, there should be scrutiny and assessment of the reasonableness of the forecasts. However, the commission should be able to do sensitivity analysis and say whether the fiscal rules and the fiscal framework are financially sustainable and are in keeping with the wider United Kingdom fiscal rules—Smith and others have suggested that the fiscal framework should be consistent with that.

That is the role of the Scottish Fiscal Commission, in CIPFA's view. We recommend that the financial management aspects should be strengthened to look at the totality of the public sector rather than just focus on the borrowing of the Scottish Government alone.

**The Convener:** Mr Cullinane, on additional powers, your submission says:

"it might be appropriate to leave the Bill as it stands currently, with the proviso that functions should be added, by affirmative resolution".

However, it goes on to say:

"A further suggestion would be to consider whether the Commission should have the ability, where requested, to examine the results of consultations in relation to fiscal matters or to monitor the consultation process to ensure that due regard is given to the views of respondents where appropriate."

Is that not happening at the moment?

**John Cullinane:** I think that that passage is a recognition that we are in a kind of evolving situation in that there is a schedule for powers to increase and the model will develop as that happens. We do not know how the model will develop in the future. There is also the fact that, even within a statutory remit, the commission will have some autonomy with regard to how it develops its work. Some things will probably gel better than others, so it is reasonable to keep a degree of openness about how things might develop.

**The Convener:** Ms Barbour, paragraph 21 of the ICAS submission says:

"In clause 5 there is a power to confer, modify or remove the SFC's functions by regulations. ICAS does not support the use of secondary legislation to change primary legislation, particularly when this relates to the core functions of the SFC."

Do you have concerns that that might happen? What concerns do you have in that regard?

**Charlotte Barbour:** I suppose that, if it is not going to happen, there is no need for the provision

in the bill. However, that might not be the right answer to your question.

We have discussed this issue before in relation to some of the tax acts that have been passed. The view of ICAS is that, as a point of principle, any powers, duties or functions should be set out in primary legislation, because the state is giving out powers or imposing duties and it is not appropriate to do that in secondary legislation, which is much more to do with how powers are exercised.

**The Convener:** I am going to open up the session in a wee minute to colleagues around the table. On the bill's provisions on the staffing and funding of the fiscal commission, CIPFA's submission states:

"CIPFA considers that appropriate funding and staffing arrangements are proposed. These include the recognition of potential for increased resources as the devolved fiscal arrangements for Scotland increase."

You were sitting in the gallery when we were discussing the report back from Dublin, which said that the Government in Ireland cannot reduce funding of its version of the Fiscal Commission so that it can remain independent, and if additional powers are given to it, resources must go with that, which gives it a guarantee that it will not have its staff and budget cut. Would that be appropriate for Scotland?

**Alan Bermingham:** The research on the Irish Fiscal Advisory Council as a comparison seems to indicate that the Fiscal Commission will be quite well resourced. However, my view is that, similar to the funding of the National Audit Office, Audit Scotland and so on, there should be an element of direct allocation from Parliament as opposed to the commission having to go through a normal estimates process or something like that, so that it would sit a little outside the funding of regular directories, departments and so on.

I am not sure that the commission should be totally immune from any squeeze on resources—I would not say that you should leave it completely alone. Resources should be allocated to it differently—for example, in the way in which resources are allocated to Audit Scotland—from the normal allocation of resources to directorates, and the commission should manage those resources completely independently and make its own decisions. However, I am not sure that the commission should be totally immune from the kind of cuts that any other public or quasi-public body is open to. Our view is that there should not be capping of resources.

**The Convener:** Do you have any comment to make on that, Charlotte?

**Charlotte Barbour:** I support that view.

**The Convener:** Thank you. I will open up the questioning to colleagues around the table.

**Mark McDonald (Aberdeen Donside) (SNP):** I want to focus first on appointments and term lengths. I note that there is a degree of disagreement in the submissions that we have had, in that CIPFA supports the process of appointment, ICAS raises some concerns in relation to the process and the Chartered Institute of Taxation also suggests that the appointments process should be looked at. Is CIPFA given comfort by the fact that parliamentary approval would be required for appointment?

**Alan Bermingham:** Yes, I think that we are given comfort by that. Our only concern about this aspect of the bill is about removal. We are not clear: would a minister be able, off his or her own bat, to remove a person from the commission if that person is deemed to be unfit or has not attended meetings, or would removal be suggested to the minister through the commission's governance arrangements? From where would the suggestion come? We are satisfied about appointments and so on and Parliamentary approval.

**Mark McDonald:** Does that need to be on the face of the bill rather than in guidelines?

**Alan Bermingham:** Yes. It appears from the bill that the minister will have the power to step up and remove somebody from the commission. To me, that would mean an element of control rather than independence. The decision to make that recommendation should remain with the commission's governance arrangements, although a minister might have the final sanction.

**Mark McDonald:** Is further clarification needed around that element?

**Alan Bermingham:** Yes.

**Mark McDonald:** ICAS's submission raises some concerns about the appointment process. What appointment process would ICAS prefer to what is in the bill?

**Charlotte Barbour:** There are two points to make. First, an absolute fixed term—full stop—cuts off the ability to have other people. The term ought to be specified in the bill and there ought to be scope for two terms, which you discussed earlier.

Secondly, on appointments, it is crucial that the commission is seen to be independent or impartial—whichever word we want to use. In absolutely technical terms, the right controls might be in place in that it will be answerable to Parliament and so on, but from cold reading of the bill, it looks as though ministers will perhaps have quite a bit of influence, if not absolute control: that the commission will be completely independent

does not stand out, to me. I would have thought that the commission would be appointed and that it would then be up to the commission to get rid of somebody or to appoint another person, if that were needed. The commission should have its budget and be left to get on with it.

**Mark McDonald:** There needs to be an appointments process. Are you suggesting that the commission should be responsible for appointments or should there be some other mechanism? Obviously, in the bill as drafted, ministers can recommend appointments but Parliament has to rubber-stamp and approve them—or, equally, not approve them.

**Charlotte Barbour:** Yes.

**Mark McDonald:** What is your preferred option?

**Charlotte Barbour:** Ministers being key to the process seems to have things the wrong way round because it does not suggest independence. Parliament, therefore, should make appointments, or the commission should make its own appointments.

**Mark McDonald:** If the commission were to make its own appointments, should they still require parliamentary approval?

**Charlotte Barbour:** Yes—you might want parliamentary approval because the commission would report to Parliament. They might also be approved through the normal public appointments processes. I do not see that ministers should be involved in it.

**Mark McDonald:** I wonder whether being responsible for appointments would add a resource demand to the commission.

You touched on term lengths, so let us look at that. You said that five years is your preferred option. There has been some discussion previously about the need to decouple the appointment term from the electoral cycle. Without prejudging the forthcoming election bill, I say that it looks as though Parliament is moving to five-year terms. Would five-year terms for the commission and Parliament mean that we would not have that required decoupling?

**Charlotte Barbour:** ICAS would be perfectly content to see decoupling whether the term is four years or five years. Our experience as an institution that runs rather a lot of committees—dare I say it?—is that finite periods will be necessary. The periods should be set from the outset so that there is no debate. Set periods make commission or committee management far more straightforward and less antagonistic.

I think that appointees need three years as an absolute minimum to know the job, so three years plus three years is quite a good time profile. Four

years is a fine time profile and five years has been suggested before. Any of those would do, but the term needs to be finite.

**Mark McDonald:** Paragraph 6.3 of the CIOT submission says that reappointment should be possible, but you also suggest different term lengths to ensure that the entire commission is not turned over at the same time. How do you envisage that working? You suggest that half the initial appointments could be for a longer period than the standard term. Would that mean appointing people for longer than an initial five-year term?

**John Cullinane:** Yes, it could mean that. The main thing that we have picked up on is that the term of office should be explicit in the legislation. Once the commission is up and running, there could be a standard term of office—perhaps of five years. The terms would have to be varied in order to get the initial staggering.

That view is largely a reflection of the fact that the Organisation for Economic Co-operation and Development has a set of recommendations that signal that such commissions and bodies should be independent. It seems to be fairly straightforward to reflect that in legislation. Departing from those OECD recommendations would be a bit of an odd signal to give out.

10:00

**Mark McDonald:** I am not expressing a view in asking this. Should the legislation specify, in addition to a maximum term length, a minimum term length, or would that create difficulty around the ability to remove members, should that be required?

**John Cullinane:** I admit that our submission did focus a great deal on the need to remove people exceptionally and I cannot say that the CIOT has, as a body, thought deeply about that. However, I agree with Charlotte Barbour's comment that a period is needed for a person to get into the role in order to make sure that they are doing the job properly and that they are perceived as having a bit of independence. I would not quarrel with a three-year term. In our submission, we said that the term could be five years—although, because we were thinking more about continuity, the period could be longer for initial appointments.

The most important point to the CIOT is that there should be a standard fixed term that should be staggered at the outset in order to avoid a situation in which everyone in the commission would change at the same time.

**Mark McDonald:** We will get different views on forecasting from the next panel. Is it this panel's opinion that the important element here is not so

much who does the forecasting but how robust the forecasting is and how it is assessed? Is your general view that that is what the commission's role should be?

**Charlotte Barbour:** That sums the matter up from the ICAS perspective.

**Mark McDonald:** Within that, should the commission undertake small-scale forecasting? Rather than carry out a full forecast, as the Government does, it could probe specific areas. Is that a fair assessment?

**Alan Bermingham:** Yes. If the commission is to be accountable to Parliament, that must be recognised. If Parliament were to scrutinise a topic and the Scottish Fiscal Commission said, "If this methodology or assumption is to be used in this tax modelling, we have some concern about X", the next logical question would be to ask what the impact would be. As far as I can see, the SFC doing small-scale forecasting or sensitivity analysis is provided for in the bill. That is welcome—it should be the commission's function. If we move to a more fully fiscally autonomous position, the role may change slightly—you might want complementary forecasting. Until that point, the provisions are adequate.

**Mark McDonald:** In your opinion—I am happy for the other witnesses also to express a view on this—if that requirement were to be added, would there be an impact on capacity and resource? If so, what would be the likely impact, or is that something on which you would not have a view?

**Alan Bermingham:** It is not a matter on which I can give a view now. Using the Irish Fiscal Advisory Council as a comparison, I say that it seems to be able to do an element of independent forecasting with the resources that it has. As I have said, the resources that are to be allocated to the Scottish Fiscal Commission seem to be appropriate—indeed, it seems that it will be reasonably well resourced. My only concern about the Scottish Fiscal Commission's ability to do its own forecasts is that it works at subnational level and some of the forecasts are geared to national level. There may be difficulty in establishing such forecasts in the first place. That is my only comment on the matter. I am not sure that it would not have enough resources already to do that, however.

**Mark McDonald:** Does Charlotte Barbour or John Cullinane have anything to add to that?

**Charlotte Barbour:** I have nothing to add to that.

**Mark McDonald:** Thank you.

**Gavin Brown:** I will start with Charlotte Barbour. In answer to the convener's question earlier, you spoke about points being in primary legislation and

said that, as a general proposition, you are not in favour of using secondary legislation to decide issues of importance. It is quite difficult to disagree with that in principle, so I am with you there.

Your submission refers specifically to section 5. Let us say that, a couple of years down the line, a small tax is devolved. Section 5 would allow changes to be made so that the commission could include reviews of that tax, as opposed to such provisions being made in new primary legislation. Should section 5 be ditched in its entirety, or should the wording be tightened up in some way?

**Charlotte Barbour:** If another tax—one such as air passenger duty, for example—was devolved, that would probably be covered by section 2. If Parliament took the opportunity to set a completely new tax—a tourist or hotel tax, for example—that would be completely different. I would think that you would want to bring that before the committee and it would—I hope—be addressed through primary legislation. I do not think that the modifying function should be in the bill, so you could probably get rid of section 5.

**Gavin Brown:** I just wanted to be clear on your position. That is pretty clear. Thank you.

I will stick with the ICAS paper, in which forecasting comes up—as it does in every one of the submissions. The ICAS position is that there would be a degree of duplication and so is not, on balance, in favour of forecasting. How strong is that view across ICAS?

**Charlotte Barbour:** Our submission has been considered in the main by our tax committee—the Scottish taxes subcommittee, to be precise. It is not a view that has been tested across the whole of ICAS, but the subcommittee has the authority to make submissions to Parliament, so that is where that comes from.

**Gavin Brown:** I asked because paragraph 6 of your submission asks a question that puts forward a cogent case for why forecasting might be important. I will read out the relevant bit of the paragraph, because it is worth putting on the record. You ask whether forecasting

“is ... to be conducted by simply checking Scottish Government figure work and assumptions or is the SFC to undertake its own forecasting from a zero-base to then truly have an independent comparison to use as a check of the reasonableness of the Scottish Government figures?”

That is an interesting question to ask, and in some ways it puts forward strongly, and articulates better than I have done in the past, why forecasting might be important. Can you explain how ICAS went from asking that question to concluding that, on balance, forecasting is not something that it favours?

**Charlotte Barbour:** We did not have extensive discussions about that. The response was drafted, and the subcommittee reviewed and agreed to it. The initial general comments—of which paragraph 6 is one—ask what it is that you want. That brings us back to an earlier point: I am not quite sure that it is clear—either in the bill or from the questions that the committee has asked—what is being asked of the commission.

The ICAS position is that you need to look at the scale of operation that is needed at present, at resource allocation and at how far you want to duplicate work. Re-doing forecasts or doing separate forecasts would involve duplication. That is what we discussed in ICAS, but there was not a huge amount of debate around how we got from one position to the other.

**Gavin Brown:** I have one last straightforward question on the ICAS paper. Is the ICAS view that the term length, whether it is four or five years or anything else, should be explicit in the primary legislation?

**Charlotte Barbour:** Yes—I think that it should.

**Gavin Brown:** Thank you.

I move on to the Chartered Institute of Taxation. My first question is the same as the one that I have just asked. Your view as an institution is also that the term length, whatever it is, should be stated clearly in primary legislation.

**John Cullinane:** Yes. We see no obvious reason that it should not be.

**Gavin Brown:** At paragraph 2.2 of your submission, you make an interesting point. You state that, if the commission is not going to do forecasting,

“it may be more appropriate to explore whether there are alternative forecasts, produced by other bodies, which the Scottish Fiscal Commission could use in its work.”

That is a perfectly reasonable question. From my investigations, however, I am not aware of any such alternative forecasts. Did you have any particular bodies in mind, or were you making the theoretical point that it would be good to examine such an approach?

**John Cullinane:** It was partly theoretical—we perhaps did not put that very well in the submission. The implication is that we are talking about a full-blown forecast, whereas obviously it would depend on the particular issue that you wanted to pick up on.

There will be some contexts in which UK-wide or even international experiences would be useful for challenging some aspect of the forecast. It is not necessary to have a full-blown forecast that exactly matches the scope of the Scottish

Government's forecast in order to mount a challenge.

**Gavin Brown:** With regard to potential tax forecasts, did you have any bodies in Scotland in mind?

**John Cullinane:** No.

**Gavin Brown:** The bill as it is drafted says that, when the Scottish Fiscal Commission produces a report, the Government must get a copy first, but it is not explicit on how much notice should be given and so on. There has been some debate around whether the Government should get advance notice, and if so how much.

You have addressed that issue. What is your formal position on the matter?

**John Cullinane:** On the whole, we think that the Government should get advance notice, but only a limited amount. A lot of these things will come down to how the initial experience goes and the kind of behaviour that is established and built up.

It is a question of trying to avoid any suggestion that the commission is being unduly leant on. We do not see the role of independents as deliberately trying to cause controversy and squalls. We are trying to make informed, reasonable criticisms, and we think that it is reasonable for ministers to know what is going to be said and to have some time to consider the implications for what they are putting forward and how to respond. As I said, there should be a limited amount of notice, because we want to avoid any suspicion that the commission is being leant on.

**Gavin Brown:** You do not need to give an exact definition, but did you have an idea in mind for what you meant by "limited" notice?

**John Cullinane:** A day or two.

**Gavin Brown:** I move on to the CIPFA submission, which refers to the additional things that the commission might do, including the potential production of a Scottish balance sheet. If that suggestion was to be followed up and taken forward, how do you envisage it working?

**Alan Bermingham:** That is ultimately linked to the fiscal framework, and what is included in that. It would provide transparency for the electorate so that they can understand the Scottish Government's finances. The balance sheet—as I may have mentioned earlier—would apply across the public sector rather than just to the Scottish Government, so it would include local government and other bodies within the public sector boundary.

That gives us an opportunity to understand exactly what we own, what we owe by way of borrowing, what our indebtedness is and what the

liabilities on future generations will be. Without that tool, we would see a more independent state as a little bit weak in its financial management. That tool, and that kind of methodology, links in closely with fiscal rules and other such aspects.

We agree that the Scottish Fiscal Commission does not need to do independent forecasts at this stage, but it needs the ability to do sensitivity analysis, which might lead to a limited internal kind of forecasting. However, if there is a fiscal framework, the commission will have a role in assessing its reasonableness and whether the measures that are being taken and the forecasts that are being made are in keeping with the fiscal rules and are designed to meet them. The balance sheet and other areas of strengthened financial reporting will underpin that, which is why we support that approach.

10:15

**Gavin Brown:** When you talk about looking at the borrowing that the Scottish Government undertakes, you make the point that it should not just be about the total amount and sustainability of that borrowing; you go further and say that we should look in the round at borrowing by the public sector as a whole, including local government.

**Alan Bermingham:** Yes. That comes back to points that we made about the Scotland Bill. The Smith commission advocated a prudential framework to support that, and we still believe that that should be the approach. Obviously, if there is a prudential framework, the onus is on the Government to set an affordable level of borrowing. That is why we believe that we need to look at the totality of borrowing across the public sector and we need a balance sheet to be able to do that and make that assessment. The Scottish Fiscal Commission would as part of its remit have a role in considering whether the affordable limit that is set is reasonable. That ties all that area together.

**Gavin Brown:** Thank you.

**John Mason:** I will continue on the issue of borrowing, because I am interested in that, too. Mr Bermingham, you specifically mention that local government borrowing should be included. That point has been raised in the past when we have discussed the subject. However, it seems to me that we are not clear about which borrowing would be included. The UK does not seem to be very clear about that. There are questions about housing associations, colleges and the non-profit-distributing programme. Will we ever get a clear balance sheet? Is it the balance sheet that is important? You also talk about commitments. Even if we are renting a road, that is a commitment for a long time, is it not?

**Alan Bermingham:** Yes, it is. Obviously, there are accounting rules that would be adhered to that would determine whether some of those things are included on the balance sheet. There are defined accounting rules that cover that. I am aware of the issue with housing associations.

**John Mason:** As an accountant, I know that those rules have changed quite a lot over the years.

**Alan Bermingham:** They have evolved, shall we say, but they are reasonably settled now. People have moved to the international financial reporting standards, and I do not envisage that those will change much in forthcoming years.

**John Mason:** Does that not put a big emphasis on Government trying to get round that by putting money off balance sheet?

**Alan Bermingham:** Yes, but the accountancy rules are developing and the accounting profession recognises that having things off balance sheet is not necessarily a good thing. Analysts and other investing institutions tend to make adjustments for that when they are looking at accounts. The accounting rules tend to deal more with the area of control and therefore more things are recognised on the balance sheet. Certainly, the new leasing standard, which is up for debate at the moment, is likely to lead to more things being on balance sheet. That is the general direction. The rules are certainly changing to make it tougher to put things off balance sheet.

**John Mason:** Most of the other issues that I wanted to raise have been touched on already. The question of the independence of the commission appears in one or two of the submissions and the committee has discussed it previously. There is a suggestion that there should be more in the bill about independence. Is it just inevitable that the commission will have to build up its reputation over time, as for example auditors do in their relationship with any organisation? The feeling that we got in Ireland was that the Irish Fiscal Advisory Council has fairly successfully built up its reputation, and part of the reason for that has been that it has challenged the Government every so often. How do we get a balance between what we put in the bill and the need to build up a reputation?

**John Cullinane:** I agree with your general observation that a large part of that is down to behaviour and, inevitably, behaviour in the early years and how the commission builds up a reputation. The problem cannot be totally solved by putting something in legislation. I go back to the point about the term of office. I do not want to exaggerate its importance, but that is a specific way in which the bill departs from the OECD recommendations on how to establish

independence. It is difficult to see exactly what the reason is for not including the term in the bill. However, I do not disagree with your general observation at all.

**John Mason:** Does ICAS have a view? Of course, it must be my ICAS background that is making me think like this.

**Charlotte Barbour:** I am in agreement with you, John.

**John Mason:** That is great.

There is probably broad agreement that the bill should say what the term is. There is also the question of whether it should be one or two terms. The Government has been strong on the idea that there is more independence if there is only one term, because then people can do anything that they want and not worry about being reappointed, whereas we have had quite a lot of evidence that having two terms is a good idea. How do you see that balance?

**Charlotte Barbour:** Speaking as someone who has been a secretary for many years at ICAS, I believe that an organisation can lose valuable members if only one term of office is allowed. However, it is not essential for people to serve two terms—it should be one plus one. There are usually quite robust procedures to appraise members and decide whether they fit in, and these are almost always two-way things. Someone either likes being part of a commission or committee or they do not. One term might be enough for some people, but if someone is bringing value, both sides will want two terms. It would be a mistake to lose the opportunity for that.

**John Mason:** Do the other witnesses feel the same way, broadly?

**John Cullinane:** Yes.

**Alan Bermingham:** Yes. I imagine that it will be quite hard to come by the right people with the right skill set for the commission. Therefore, it would be valuable to be able to provide some continuity of expertise, whether that means that an element of the members of the commission can stay on for one extra term or something else.

**John Mason:** I want to return to the issue of independence and ask about the commission's on-going involvement and contact with the Government, especially around the time of the budget, and how much the commission knows. Another interesting point that we picked up in Ireland was that the Parliament there is insistent that it should hear the details of the budget from the Government before the Fiscal Advisory Council hears that. The council sees the big broad forecasts but not the details of the budget. How do we get a balance so that information is passed backwards and forwards but there is enough

distance between the two to ensure that the commission is independent?

**Charlotte Barbour:** To return to your earlier point, the distance will come in large part through how people conduct themselves. Really, we are talking about independence of mind and people conducting themselves in an impartial fashion in which they bring challenge and, if necessary, positive criticism rather than absolute complete separation. If there is complete separation, the two will not really work together, but that is surely the point.

**John Mason:** So from that point of view, what is in the legislation is not so important; the more important thing is how we appoint and who we appoint to those positions.

**Charlotte Barbour:** These things usually come down to the people.

**Alan Bermingham:** The Scottish Government's research suggested that the commission could exert "significant influence"—I think that that was the wording that was used. My view is that the memorandum of understanding should have some underpinning principles on challenge, openness and honesty and what the behaviour should be—the kind of principles that there would be in a ministerial or civil service code. That would help. If the commission challenges the Government during the process of making the forecast, does that mean exerting significant influence or is it just about being able to say that there is a question about how risky some of the assumptions are and that the Government should look at them again? Is that exerting significant influence or is it being open and honest and sharing information, which is what the principles should be about?

If we say that the commission exerts significant influence, to me, that is almost saying that it is a quasi-pressure group that is inside Government exerting direct influence over financial policy. It is an unelected body, although it is accountable to Parliament, so that does not seem to be what it should do. It is important to have principles in the memorandum of understanding, or something along those lines, on how the commission will work with the Scottish Government in the forecast process.

**John Mason:** So you would put that in the memorandum of understanding rather than trying to put something in legislation.

**Alan Bermingham:** Yes.

**John Mason:** Fair enough.

A linked issue is the interesting comment from ICAS, in paragraph 19 of its written submission, about

"a clear delineation between the work of the SFC and any oversight role of the Finance Committee."

I do not think that anybody else has raised that issue with us. Is there a danger that we all do each other's work?

**Charlotte Barbour:** Perhaps not, but clearly you will have oversight from the Parliament's perspective of forecasts and budgets, because they all come here to be discussed. There is a question about exactly who is doing what in the operation. We should not have too much checking of checking.

**John Mason:** I will leave it at that. Thanks very much.

**The Convener:** That concludes questions from the committee. If the witnesses have no further points for the committee, I thank them for their evidence.

We will have a short suspension to allow for a natural break and to enable the changeover of witnesses.

10:26

*Meeting suspended.*

10:33

*On resuming—*

**The Convener:** We continue our consideration of the Scottish Fiscal Commission Bill by taking evidence from a second panel of witnesses. I warmly welcome some old hands to the committee: Professor Jeremy Peat, Dr Angus Armstrong, Chris Stewart and Professor Peter McGregor. Members have received our witnesses' submissions, so we will go straight to questions.

The first question is for Dr Armstrong, whose submissions are always nice and provocative; there is always lots of good stuff to chew over. I hope that your leg gets better soon—thank you for explaining during the suspension why you are wearing a leg brace. Your submission says:

"In our view the SFC's role in preparing reports with the assessment of reasonableness is too narrow. Our preferred arrangement would be for the SFC to prepare its own independent forecasts both from revenue and expenditure sides, using inputs from the Scottish Government and civil servants and evaluating the fiscal consequences of their policy proposals."

We will dig into that in a wee second. It is interesting that none of the witnesses on our previous panel who had made submissions thought that there should be independent forecasting, whereas all four of the current witnesses are of the view that there should be independent forecasting. Perhaps we should have

mixed and matched a wee bit. Will you talk us through that statement, Dr Armstrong?

**Dr Angus Armstrong (National Institute of Economic and Social Research):** Good morning. It is a pleasure to be back here. The submission was jointly authored by my colleague Dr Katerina Lisenkova, so it is shared work.

We think that it is important that the SFC has the capacity to make a forecast, for a number of reasons. I refer to the committee's excellent report "Scotland's Fiscal Framework", in which there is a substantial section on moral hazard, which is important. Moral hazard arises through a lack of equal information because of imperfect information, which is why having a separate forecast is so important.

Why is the forecast more important than a test of reasonableness? As someone who is involved in forecasting, I think that reasonableness is quite a low threshold, because there is a lot of uncertainty. To be unreasonable, you have to really push somebody but, year after year, quite substantial errors can build up. Therefore, it is better to say, "Have your own forecasts and we'll start from there," than to test the bounds of reasonableness. Our first point is that the threshold of reasonableness is inappropriate—it is too difficult to say that something is unreasonable, because that is quite a strong requirement.

Our second point is that the rigour of going through a forecast is important because, the more we look at the data, the more we realise where all the nooks and crannies are. Until we play with the data, it is hard to understand where a lot of the uncertainties lie. That is important as a discipline.

Thirdly, it is important for the overall framework of what is in the Smith commission's recommendations that the Scottish fiscal framework sits within the UK fiscal framework. All that we know about devolving fiscal powers to sub-central Government institutions is that moral hazard has tended to come up. To mitigate that and provide confidence, the more independence, scrutiny and transparency that can be given, the better. The best way of ensuring that is to enable the independent commission to make the forecast and do the policy costings.

**The Convener:** Thank you for those opening comments. My next question is for Jeremy Peat. At the start of your submission, in the summary, you say:

"In line with the Finance Committee's recommendation, the RSE is firmly of the view that the Scottish Fiscal Commission ... 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 does not currently have access to data from HM Revenue &

Customs ... The UK and Scottish Governments will need to address this so that the SFC has direct access to HMRC data."

Will you talk us through that?

**Professor Jeremy Peat (Royal Society of Edinburgh):** Good morning. I am speaking not as an individual but on behalf of the Royal Society of Edinburgh, as a representative of a group that worked on this topic.

I very much agree that, for the reasons that Angus Armstrong just set out, it is necessary for the Scottish Fiscal Commission to have the ability to undertake forecasting. Primary among those reasons is the fact that, until a body undertakes its own forecasting, it does not get a feel for how the data are working and for the key parameters that matter most in the forecast that is being derived. For example, as we note in paragraph 7 of our submission, it is suggested that the SFC will have the power to assess the impact on projected revenues of changing the value of the underlying assumptions, but it is difficult to see how that could be undertaken without its having its own forecasts that it could play with to test the sensitivity to variations. That ability is critical.

In an ideal world, Scotland would have several independent forecasts that could be used, but we do not have that proliferation. I hope that we will have more of them going forward. I am delighted that the Scottish Government is doing work on that and that the University of Strathclyde, which Peter McGregor comes from and with which I have an association, is doing a forecast, but there are not enough independent forecasts to rely on. It therefore makes sense for the SFC to develop its own capability.

The point that was made about data is important. There are two elements. One is that it is necessary that MOUs be established with those who provide data at the UK level as well as those who provide data at the Scottish level. It is also necessary that a very close working relationship be established with the Office for Budget Responsibility.

A number of items of data might not be available in Scotland at the moment in the right form and at the right time. One role of the SFC should be to point out the limitations on data and to work with the Scottish Government on improving data sources, so that forecasting can be better embedded.

There are a number of reasons why independent forecasting makes sense. I was surprised to read the submissions from the panel members who the committee spoke with earlier. I note that they are all accountants rather than economists, which may have something—



**The Convener:** Do not rise to it, deputy convener.

**Professor Peat:** Maybe it could be argued that the economists are just looking to the self-interest of their profession, but I hope not. The ability to create independent forecasts is necessary, but the point about data is equally critical—we have to have the right data to do the job properly.

My last point is that no forecast is ever going to be right; every forecast is subject to error and uncertainties. Unless a body has its own model to play with, it cannot explore those issues and it will never get a good feeling for what really matters to make a forecast with the right balance.

**The Convener:** Professor McGregor, your submission says:

“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”.

You agree with the panel on that point, and in the following paragraph you talk about data limitations.

In paragraph 12 of its submission, ICAS says that it

“does not consider that there is a need for the SFC to prepare independent forecasts as this would create duplication of work and not provide value for taxpayers.”

I suppose that that is not necessarily the committee’s view, but it is the Scottish Government’s view. Will you discuss why you think that ICAS’s assessment is in error?

**Professor Peter McGregor (University of Strathclyde):** It would be foolish to deny that there are costs associated with providing independent forecasts. The costs should be proportionate to the sophistication that is used in generating the forecasts. There will clearly be a learning process. At this point, exactly what models the Scottish Government is going to use is not clear. We do not want to use a sledgehammer to crack a nut; we need something that is proportionate to the activity that is undertaken in the forecasting process.

However, there is no doubt in my mind—I agree with the other panellists and for the same reasons as they put forward—that the provision of the forecasts and the process of generating the forecasts are very important. I would expect those independent forecasts to draw liberally on the expertise that exists in the Scottish Government. We know that the Scottish Government has been seeking to develop its own expertise in economic modelling. I will not list all the possibilities now, but we know that it has been looking at macroeconomic modelling and computable general equilibrium modelling, that it has done some microsimulation modelling and that it has a range of energy models. All of that is good news.

We need it to be able to properly understand the potential impact of policy.

Equally, we need an external body to assess what is being done with the models and the quality of the analysis. The value added will vary and will depend on the extent of fiscal autonomy that the Government has. The greater the autonomy, the stronger is the case for analytical ability and independent forecasting ability. Given what we know now about the future extent of fiscal autonomy, that kind of analysis really is needed. For much lower levels of fiscal autonomy, I would have accepted that it was not required, but we are about to go into a situation in which that ability is essential.

10:45

As I have said, there are roles for others in the independent evaluation. I doubt that the independent Fiscal Commission will be given a broad-ranging remit that encompasses, for example, assessing contributions to the ultimate objectives of Government policy. Sustainable growth is an objective, but it contains a number of objectives that could conflict. We might want to understand the impact of the policies that we are pursuing on the range of goals. I doubt very much that the Fiscal Commission will be given such powers, although I would like it to have them. The fewer powers the commission has, the more important it will be that we have other external independent sources—including, of course, the academic institutions that are partially represented around the table today.

The approach depends on circumstances and on the degree of sophistication and fiscal autonomy. My judgment is that, given what is likely to happen here in the near future, independent forecasting is absolutely essential.

**The Convener:** Thank you for that passionate response.

At paragraph 6 of its submission, the Scottish Property Federation basically supports what has been said. However, you say at paragraph 3 that

“With powers being devolved on income tax it is important for the economic competitiveness of Scotland that effective tax and finance scrutiny of Scottish Ministers’ decisions is assured for the parliament and the wider public.”

Mr Stewart, you are in effect building on a lot of what Professor McGregor said. In line with what Dr Armstrong said, do you not agree that such scrutiny is assured merely by commenting on the reasonableness of Scottish Government forecasting? Will you expand on your thoughts?

**Chris Stewart (Scottish Property Federation):** Sure—thank you for the opportunity to speak. We represent the property industry in Scotland, which

relies heavily on international markets for our capital—that is one of the key issues behind our industry.

We deal with the word “reasonableness” all the time in our contractual responsibilities as property developers, and it does not necessarily have the teeth that one would expect. From a capital markets perspective, the need for independent assessment is critical, because benchmarking against Government policy is required. That needs to be there to assure the capital markets that policy is being made with benchmarking and stress testing and with a robust challenge in place. That is one of our critical points: the closer you get to the bond markets, the more ability you have to raise finance from those markets and the more they want to see stronger disciplines in place, so that is necessary.

**The Convener:** Professor Peat, you state in your submission under the heading “Assessing the long-term sustainability of the public finances” that

“The RSE has frequently raised concerns that the focus on short term priorities drives the Scottish budgetary process”

and that the RSE

“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.”

How crucial do you think that is?

**Professor Peat:** In my view, that is becoming increasingly important. Peter McGregor referred to the extent of fiscal devolution, which I think we can all accept is likely to increase rather than reduce over the years ahead. The more the fiscal devolution route is taken, the more important it is that the Scottish Government looks not just at the short-term perspectives but at the medium-term and longer-term perspectives.

That is why we very much agree with the committee that looking at performance against fiscal targets and critically assessing the long-term sustainability of the public finances should be a substantial element of the SFC’s role. That would be assisted if the Scottish Government prepared a medium-term budget framework alongside its annual budget bill. The SFC should look at that and at long-term sustainability and provide comments.

As we note in our submission, nothing is perfect in this world, but the SFC would at least be able to point out critical issues and identify matters that needed to be looked at from a policy or budgetary planning perspective. That element is extremely important. The more we go down the fiscal devolution route, the more that will be critical.

When we get to the stage of having fiscal rules that need to be adhered to at different times, it will be a valuable role for an independent—a truly independent—Fiscal Commission to look at adherence to fiscal rules by the Scottish Government and to assist in Scottish Government contacts with the UK Government.

**The Convener:** You say “truly independent” as if you suspect that the commission is not or might not be. Do you have concerns on that front?

**Professor Peat:** It is critical that everything possible is done to ensure that the commission is truly independent. Significant progress has been made over the past couple of years—a lot of it has been a result of what the committee has said and what others have said to the committee in evidence—but we cannot as yet be 100 per cent certain that the independence is entrenched and will necessarily be sustained throughout.

There are issues that need to be addressed. We need to ensure that as much as possible that relates to the commission’s role is in legislation and can therefore be relied on; we make that point further on in our submission. I was not casting doubts on the commission’s independence, but I underline the need for utter independence and the utter perception of full independence.

**The Convener:** Dr Armstrong, you say in your submission that the SFC

“should have a wider role in assessing the sustainability of Scotland’s public finances”.

You go on to state:

“To work out modalities, we recommend creation of a Forecast Liaison Group (as per the OBR MoU) headed by the SFC but involving the civil servants working on the forecast.”

**Dr Armstrong:** I concur with the view that the SFC should ideally prepare a long-term fiscal sustainability report—or whatever the name of it would be; that would be the idea—for three reasons.

First, a lot of the challenges that Governments face lie in the long term. In particular, the demographics challenge is a longer-term challenge that needs to be considered in shorter-term decision making, because that is where a number of the difficulties will come from.

Secondly, we are notoriously bad at discounting the future properly. The climate change work has involved a lot of discussion in that area. Our way of taking adequate account of possible future events when they are uncertain is notoriously poor. In other words, we do not put enough weight on what will happen in the future. That is not a criticism of Scottish policy making at all—the position is the same around the world. It is simply the way in which human beings tend to operate.

We could militate against that by assigning such a role to an independent body.

Finally, the task is a public good—if the SFC does not do it, who else is going to? I say with the greatest respect to academic colleagues that it is a public good that must be communicated to the public in ways that we can all understand. I do not understand half the papers that are written. Something needs to be made that is readily accepted by the public so that it can influence policy properly, which is why the function should reside with the SFC.

A fiscal liaison group has been successful in the OBR model. It is as much about having the powers as it is about using them, if that is clear. The fact that the OBR has powers to call on civil servants and other people to provide evidence, to give it information and to help it in its preparation—civil servants would have a responsibility to respond if the fiscal liaison group asked for information—puts the burden the other way round, so people have to co-operate with the OBR.

The model also gives the OBR access to a wide range of people. The independent report on the OBR pointed out that, at any one time, it might have 100 people working on various tasks, because it has a broad network of people who have such a responsibility.

Making the head of the SFC the chair of a liaison group that reported to this committee would be the most transparent and democratic way in which to set the process up. That is important as a modality for making the system work.

There are two separate answers: one on fiscal sustainability and one that relates to a liaison committee.

**The Convener:** I will switch the emphasis a wee bit. Professor McGregor, you refer in your submission to borrowing and “deficit bias”. Will you talk us through that a little? Could you also comment on a comment in CIPFA’s submission? It says:

“in relation to borrowing, we would advocate that the statutory powers here should be expanded from projections of borrowing requirements to assessments of the sustainability, affordability and prudence of the Scottish Government’s Borrowing.”

**Professor McGregor:** The term “deficit bias” refers to the notion that Governments might be tempted, for a variety of reasons, to spend in excess of their revenues. There is a range of possible sources of that. One would be overoptimistic forecasts of tax revenues and another might be based on the political cycle. Whatever the reason, there has been a tendency towards the creation of deficits that are often judged to be excessive.

Tackling that deficit bias and providing independent monitoring and checking of the policy position that has been adopted have been major motivations in the formation of fiscal councils round the world. That implies a need to be able to project forward for Government expenditure and tax revenues; to assess the difference between them, depending on the precise fiscal rules that are in place; and to monitor that and react if a problem is anticipated further down the line.

An important role of the Fiscal Commission is to try to anticipate what possible problems might develop. If the commission has the ability to do that or to require others to do that, that implies that it should take responsibility for monitoring progress on and adherence to fiscal rules. That responsibility might also involve advice on when it might be sensible to depart from those fiscal rules. If there were particular economic circumstances that suggest that there should be some deviation from the rules, it would be appropriate for the Fiscal Commission to comment on that and provide some assistance.

**The Convener:** I have one further question, which is for Mr Stewart, and I will then open the discussion to the rest of the committee.

One of the things that Mr Swinney says when he comes to the committee is that the SFC has had an influence on the Government in forcing it to make changes on non-domestic rates income. Last year, the SFC said that the Scottish projections were overoptimistic and the Scottish Government changed them.

The SPF suggests in paragraph 11 of its evidence to the committee that

“there is a significant role for the SFC to play in verifying Scottish Government forecasts that will be aligned to the forthcoming revaluation”.

It continues:

“We welcome strongly therefore the inclusion of this as a specific part of the Bill”.

It goes on to say:

“it is important that it forms a core part of the SFC’s considerations.”

Will Mr Stewart tell us more about the SPF’s views on that?

**Chris Stewart:** That is a general point about alignment with markets. In the principal towns and cities such as Edinburgh, Glasgow and Aberdeen, there have been fluctuations in valuation over the past eight or nine years. However, in some places, rents have halved. There are major divisions in how the market has moved in different areas.

Especially on non-domestic rates, the way in which forecasting happens is critical to understanding the impact on those markets and

ultimately the tax take from them. It is such a big part of property's contribution. We do not think that the nuances of those markets are reflected as they should be, and they need to be reflected by the new SFC. That theme of market alignment goes through the whole issue, because the impact on markets is critical.

**The Convener:** I will now open up to questions from the committee.

**Richard Baker:** My first question is for Professor McGregor. Certain witnesses have expressed concerns about the production of independent forecasts in relation to resources and how much it would cost the commission to do those forecasts, but your paper suggests that the commission should be able to access staff resources and modelling work that is already being done in the Scottish Government. Could the commission do that and so minimise additional cost while maintaining independence in its forecasting?

11:00

**Professor McGregor:** Clearly, that is a challenge and the commission would need to be very careful, but I do not really see why not. For example, the Scottish Government economists could be given a set of alternative assumptions that the commission would like to explore. One example that has been mentioned is what will happen to net migration, which is going to be key. That is not easy to judge. It would be perfectly reasonable for a number of groups to take different views of that future. It may be very important to understand the fiscal consequences of those alternative futures. That is a comparatively straightforward example of a variation in assumptions.

If we think of all the assumptions that have to go into the future revenue and costs projections, it is clear that such projections are challenging. Each of the individual components is difficult, but when we are talking about forecasting deficits it can be really challenging. It is inevitable that there will be alternative views about the likely futures. It would be great if the Fiscal Commission could do that or require others to do it.

Assuming that the commission was satisfied with the modelling and the methodology, we are talking about using the same models to do alternative simulations. That is a way of minimising the cost, although it does not eliminate it. I will not pretend that it is not costless, because part of the burden is then shifted to the Government economists, who will require the capacity to handle that.

**Professor Peat:** I agree with Peter McGregor that there is no problem with using models that

exist in the Scottish Government or elsewhere, provided that those who use them have a total understanding of the models and full access to them, so that they can use them as they wish. My preference would be not for the commission to ask the Scottish Government to test some sensitivities through its model, but for the commission to have the model in its hands and to have the skills, expertise and computing capability to use it and undertake its own calculations. That would work better than asking the Scottish Government officials to do it.

A proliferation of models will be required to forecast the different elements. Peter McGregor and Angus Armstrong are much more practitioners than I am, but I think that it will be difficult, and therefore making use of good modelling, wherever it exists, makes every sense. However, the person using the model must know how it works and be satisfied that it works well and be happy with the data. It is preferable for people to do the work themselves so that they can be satisfied that the results are ones in which they can place credence.

**Richard Baker:** The commission is not starting from scratch in this work, which is a key point in relation to resources. Are you saying that models will exist but that the commission will use them in a different way with its expertise and views, and so will come up with an independent forecast without the necessity of creating a whole infrastructure?

**Professor Peat:** Yes, that is right. Let us be grateful that, rather than a budget of £20,000 a year, we are talking about £850,000. The budget of £20,000 a year was an absolute nonsense. Now, we are talking about what looks to be a reasonable level of resourcing, at least for the initial stages of the commission. It is true that the commission must be cost efficient in its use of resources and make use of what exists elsewhere, where that is of the quality and independence that is required.

**Professor McGregor:** I agree with Jeremy Peat. The point about transparency is crucial and should characterise all aspects of the behaviour of the Fiscal Commission. My personal preference—the Scottish Government economists seem to tend to this view—is for the models to be in the public domain. They ought to be accessible not just by the Fiscal Commission but by others who have an interest in independent analysis.

I also agree that, ideally, all of the work would be done within the commission, but I do not see a fundamental objection to part of the work being done according to the request of the Fiscal Commission but by the modellers themselves.

**Richard Baker:** What reasons have been given for the models not being in the public domain already? Perhaps Dr Armstrong can comment.

**Dr Armstrong:** At the beginning of your first question you mentioned resources. That is why having a fiscal liaison group that has the right to the information and to an explanation is important. When people know that they really have the power in their back pocket to call on, that makes the communication and dialogue much easier. That has been the experience with the OBR.

On the models, I add a note of caution. We have wonderful macro models but, when it comes to forecasting fiscal revenue, they are pretty crude spreadsheets. I would love to have a really fancy model that is nicely coded up, but we do not. We have big 60 or 70-page Excel spreadsheets that are a nightmare to get through. They are full of data, some of which just happens to be market-sensitive and unpublished HMRC data. I do not see how that can be made public, but that is exactly why the SFC needs to have such data sheets.

I do not see how it is possible to make a judgment on reasonableness without starting from the base of going through the numbers. It is not possible for someone to do that until they have looked at them and thought, "What are those elasticities and why are they that number? What happens if I put a different number in? Oh my word, look at all of that!" It would take a very competent user a couple of weeks just to figure their way round some of the models.

**Richard Baker:** That is interesting, because it indicates that there may be problems with the public accessing the data. However, everyone has stated how important it is that the commission has access to the data that it needs. Do you foresee any problems for the commission in getting data from other agencies, particularly UK departments, or are you confident that it will be possible to put in place robust memorandums of understanding to enable that to happen? Do you have a view, Professor Peat? Perhaps from your previous experience of Government you will know how open and transparent some of the agencies are.

**Professor Peat:** There is a parallel in my experience in the Competition Commission and then the Competition and Markets Authority. With that hat on, we run what we call data rooms in which data is put into a room and people who have signed confidentiality agreements can access it, run their own models and work with it. That means that they can make full use of it but they cannot take the full data away; they can take the results and the evidence. Members of the independent Fiscal Commission or their staff could be allowed to use particularly sensitive data such as the kind that Angus Armstrong referred to within that confidential context and then make use of the results without disclosing the highly

confidential information to a wide spectrum of people. It can be done.

**Richard Baker:** Professor McGregor, do you want to comment?

**Professor McGregor:** No, I agree with that.

**Richard Baker:** It is certainly doable, anyway. That is the key issue.

My final question is about ensuring that the SFC's independence is guaranteed by legislation. Professor Peat answered very carefully the earlier question on that issue. My understanding is that, at the moment, civil servants consult the Fiscal Commission in producing Government forecasts. In your submission, Professor Peat, you said:

"It would be alarming if the SFC were to have a role in producing the same forecasts that it is tasked with assessing."

Does that suggest that its role needs to evolve quickly? Are you satisfied that its independence is fully guaranteed in the bill or does the bill have to go further or change in any way to ensure that the commission is as independent as it should be?

**Professor Peat:** On the second part of your question, we say in our submission that one area in which the bill could be enhanced is that the terms of appointment should be clearly set out in legislation as opposed to being left to the discretion of the Scottish ministers. That would make it easier for independence to be assured.

I am trying to recall what the first point was.

**Richard Baker:** It was about the practice that I understand currently exists whereby Scottish Government officials consult the commission about their forecasts. You said in your submission that you would not encourage that.

**Professor Peat:** I apologise for missing that. What we have said is absolutely the case. If the SFC gave comments throughout the forecasting process and was alongside the Scottish Government as the forecasts were produced, it would be difficult for it to stand back once they were published and say where it disagreed with them. There is no harm in it being involved in technical aspects of how the forecasting is undertaken through the fiscal liaison group that Angus Armstrong referred to or another means. However, the Scottish Government alone should undertake the actual forecasting—the making of assumptions and working through the process—and the Fiscal Commission, with its own forecasts and with a good understanding of how the Government forecasts were derived, should then be in a position to make informed and objective comments that can be put into the public domain.

If the commission was in the camp as the forecasts were made, it would be really strange for

it to come out and make severe criticisms afterwards. The only way that it works is if it is separate.

**Richard Baker:** Thank you.

**John Mason:** The opening paragraph of Professor Peat's submission states:

"the SFC should have the freedom to develop its own framework of analysis"

and

"data sources".

How would that work in practice? How could it develop its own data sources? I presume that HMRC has to be the data source for income tax, for example.

**Professor Peat:** It would not be a data collection agency. It would identify which elements of data were inadequate or lacking and work with the UK and Scottish agencies that were actual or potential providers of the data to ensure that the data were enhanced and improved over a relatively short period so that the commission's work would be better founded. The commission would not go out and collect data; it would work with the other agencies through MOUs to ensure that the data that are required for the process are all available.

**John Mason:** Do we need more about the availability of data in the MOUs or in the bill?

**Professor Peat:** That is a good question. There should be something in the bill to say that it is part of the SFC's role to work to ensure the availability of adequate data for the forecasting role. That would give it a locus. Preferably, MOUs should be established as soon as possible and it should be clear in the bill that they are anticipated. However, if the SFC's role is set out in the bill, it can develop it in the short term thereafter.

**John Mason:** Is it totally black and white that the Scottish Fiscal Commission either produces forecasts or does not, or is there any grey area in the middle where it plays with the model or, as one of our previous witnesses said, does some of the forecasting? Is there a halfway house or does it really have to be all or nothing?

**Professor Peat:** There is no halfway house as to what the SFC is empowered to do. It must be empowered to do as much of the forecasting as it sees fit. What it chooses to do and how it does it is fine, following what Peter McGregor said. However, it must have the full power to do as much of the forecasting as is possible now and as devolution is extended. I would like the bill to be future proofed to allow for extensions as devolution is extended.

**Dr Armstrong:** I completely endorse what Jeremy Peat just said. It is a bit like being half pregnant—the SFC is either independent or it is not. Either the commission stands with total responsibility for the forecast that it has made or it is not the commission's.

**John Mason:** However, although we would give it the power to do the forecasting, it would not necessarily need to do every step itself, because it would be comfortable with bits of it. Is that correct?

**Dr Armstrong:** No, it would sign off on the forecast. If it does that, that implies that it is signing off on every step and has taken part in that. It is fully entitled to use part of the forecast that the Government civil service or the Scottish Government has given to it on its request, but it does that accepting full responsibility. That gets to Jeremy Peat's point. The commission has to have capacity to have full control over the forecast. How it would like to use that power in practice is its judgment alone. If it wants to do all the minutiae, it can do it. However, the chances are that it will largely accept what HMRC provides it with, although it might tweak it. The processes will evolve in time through the experience of using them. However, if it does not accept the data or analysis that is provided by somebody else, it needs to have the capacity and the right to call for more data or to do it itself. It has to have that capacity in order for the forecast to be its forecast.

11:15

**John Mason:** Is there a danger that we end up with a position whereby the Government produces a forecast, the SFC produces a forecast and they both dig in and defend their forecasts, and there is nobody neutral to comment?

**Dr Armstrong:** That is a good point. Our suggestion is that the SFC should provide a forecast, which the Government then uses. We do not think that there should be a beauty contest between two agencies. The problem with forecasting is that, if you make a forecast next week, the whole world could change the week after for a reason that is completely unforeseeable, and it might make one of the forecasts that was not reasonable become exactly accurate by default. That kind of situation gives a false impression of forecasting and makes it ambiguous and difficult to decide who is doing a better job.

From our point of view, the first best model would be to have only the SFC doing a forecast that the Government would be obliged to use in setting its overall budget.

**John Mason:** That would be more like the OBR model.

**Dr Armstrong:** Absolutely. That is our first best model. Assuming that that is not going to happen, we strongly support the committee's view in its fiscal framework paper that the SFC has to have full power to do its own independent forecast, although that would result in an unfortunate beauty contest between two agencies. However, we would go for that option, as our first best option does not seem to be available.

I endorse Jeremy Peat's point that that means the SFC having full capacity to do all the forecasts, if it needs to. It is important that the fiscal liaison group can request an explanation from HMRC or Government forecasters about work that they have done. That should be part of the MOU. The MOU that works for the OBR and the British Government is very important to the understanding and co-operation between them—co-operation is vital in this area. The MOU is an important part of the framework and I believe that it should be referred to in the bill.

**John Mason:** Would the absolute ideal be that the Government produces a forecast and somebody else—for example, the University of Strathclyde—produces a forecast, and the SFC stands back and comments on them?

**Dr Armstrong:** No. I see the OBR model being perfect for what is required. The SFC would do the forecast, which would become part of the Government's overall budget—that is the first best option. I do not think that the forecasting is a job to put on to academics who, with the best will in the world, are paid by the Government. That would be a mistake. We should stop putting things on to other people.

In the setting of the whole framework, if we believe in avoiding moral hazard, we need transparency, and that requires that whoever makes the assessments can do it completely independently and can be seen to be independent. I am not casting aspersions on people and saying that they would not be independent, but they have to be seen to be independent.

Chris Stewart is right about the situation when the Scottish Government eventually goes to credit markets to start borrowing. I assume that the Government will have to do that eventually; my view is that that will be necessary because of the amount of power that the Government will have. For the credit markets, the issue is not just whether someone is independent; it is whether they are seen to be independent—that is absolutely crucial. That is why I am slightly hardline on the need for the SFC to be not only independent but to have the full powers of explanation from other agencies.

**John Mason:** My next point is on independence, but does anybody else want to come in just now?

**Chris Stewart:** I just want to make the point that it is central to the organisation's credibility that it is independent. Perception will be everything in that regard, especially the capital markets' perception. If the SFC is not truly independent and just analyses or uses reasonableness, that will not be good enough—it must have complete independence. The SFC's responsibilities will clearly grow, so its credibility needs to be strong.

**John Mason:** To be slightly cynical, can you ever have complete independence? When we were over in Ireland, where all the key people know one another, we heard that one of the people on the council was checking on somebody with whom he was pretty friendly.

**Chris Stewart:** It is perception, and the organisation will have to do everything that it can about that. This is a small place, clearly, but I do not think that that is an excuse.

**Dr Armstrong:** Jeremy Peat made an important point about the terms of appointment. I take the point about whether you can ever prove independence—you cannot. However, if you make the terms of appointment sufficiently clear and open to public scrutiny, you can minimise the risk of having something that people view with some doubt. It is more about minimising that; that will be crucial in the terms of appointment.

**John Mason:** Professor Peat very much emphasised having independence in the legislation. How much can we force that into legislation and ensure that the right people are appointed—people who will be independently minded, who will stand up to John Swinney and so on?

**Professor Peat:** It is a mixture of both, as ever. I agree that you cannot provide a 100 per cent guarantee of independence, but you can avoid obvious pitfalls. For example, you should not appoint people to the commission who are members of the Council of Economic Advisers. That would clearly be inconsistent with setting up an independent body and it has been removed. That is not to cast any aspersions on the individuals concerned; it was just the wrong way to go.

**John Mason:** Is that the only body with which you would not allow an overlap?

**Professor Peat:** I would be very careful about other agencies. I suspect that the council is probably the one that matters most. However, one would have to be very careful about appointing people from any other body that gave advice to the Scottish Government on matters that are

related to the fiscal situation. That could come out in the appointment process. One could have a note in the terms of appointment to say that, like knowledge and understanding, absolute objectivity is critical. It is a matter of touching it and seeing whether it works, rather than absolutely prescribing who can or cannot be on the commission. It is so important that one gets this right that the more that one can build that approach into legislation, the better.

I note in passing that the RSE agrees with Angus Armstrong that the first best solution would be for the commission to undertake forecasts and for those to be used. I suppose that my hope is that, over time, as we get experience of the IFS, as it proves its worth and gets comfortable in its working relationship with Government and peers, and as fiscal devolution extends, the Government will feel comfortable, within a relatively short period, to say that it will move to an OBR-type model and allow the IFS to produce forecasts that are then used in the Government's budget.

**John Mason:** So the Government would not produce forecasts—

**Professor Peat:** I hope that the Government would become comfortable with that. The IFS has come a long way over the past couple of years in terms of enhancing its independence and resources. It may be that, at this stage, giving it the right to produce the forecasts that are then used in budget is a step too far. However, I hope that, in time, that might be achievable.

**The Convener:** I take it that when you say the IFS you mean the SFC.

**Professor Peat:** I apologise. Yes, I mean the SFC.

**The Convener:** It was just for clarification.

**Professor Peat:** Let us keep the IFS out of this.

**John Mason:** I have a couple more points. Dr Armstrong, towards the end of your submission you said:

"we believe that SFC should take the OBR forecast as given."

Will you unpack that a bit? Do you mean for whole UK things or for Scotland? Our understanding is that the OBR does pretty rough and ready stuff for Scotland. It just says "8 per cent" and that is it, whereas we expect the SFC to dig in a bit more.

**Dr Armstrong:** Forgive me. I was not specific enough. I was dealing with the macroeconomic forecasts that the OBR produces. When the OBR says that it expects UK growth next year to be 2.5 per cent or whatever, that 2.5 per cent should be given as a UK macroeconomic forecast. That presents an interesting problem. Let us suppose that the SFC was to say, "We think Scotland will

grow by 10 per cent", which would imply that the rest of the UK would grow by 1 point something per cent. That could become tricky, because there could be a clash with what the OBR has been saying about the rest of the UK. That is a remote possibility. Because of the size of those economies—one is 10 times bigger than the other—there must be a big divergence to make it statistically meaningful and identifiable. However, the OBR's 2.5 per cent UK forecast should be taken as a given and any Scottish gross domestic product should operate within that.

It would be ideal if the OBR in conjunction with the SFC came up with an indicative Scottish macro forecast. It would have to be indicative because we do not currently have the data to be certain about it.

The weakest part of the data is the external accounts for Scotland. How could we have a current account for Scotland with regard to the rest of the UK? That is really messy. We would have to work out who owns what companies north and south of the border, and being able to do that properly opens up a whole can of worms. That is why the neatest approach is just to take the OBR headline macro number as a given until such time as we have the right Scottish data to be able to say, "Let's have a rethink about whether this is the best way to go about it."

**Professor McGregor:** I agree with that up to a point. However, it is very important that we appreciate the degree of interdependence between the Scottish and rest-of-UK economies and the extent to which spillovers are likely to occur, depending on policy initiatives in either region. We have done preliminary work that looks at that and at the scale of those spillovers, which, in fact, can be quite surprising and substantial. Given the existing data on interregional trade—this is an important qualification—it looks as if, when an expansion is conducted in Scotland, for example by stimulating exports, and assuming that that expansion is successfully achieved, the impact on the rest of the UK is almost on the same scale as the impact on Scotland. That is because of the trade data that exist. We really need to understand the extent of the interdependence of the economies if we are to appropriately understand the impacts of policies and if we are ever to aspire to any kind of no-detriment principle on a wider scale.

I basically agree that this begins to raise questions about the nature of the interregional trade data, but they are fundamental to understanding the extent of policy spillovers between Scotland and the rest of the UK. I would use that as a reason for suggesting that, not only in the short term, but in the medium to longer term,



we ought to be trying to correct that data problem and to look at the matter in detail.

**Professor Peat:** The solution in the short term is that, as part of the arrangement with the OBR, the OBR and the SFC should liaise as the OBR is finalising its forecasts, and any input that the SFC can make as it sees how the OBR is moving to take account of particular issues that pertain in Scotland and may be relevant to the macro forecasts at the UK level—and vice versa—is taken into account. Therefore, as part of the process of the OBR producing its forecasts, it would talk to the SFC and take account of its expertise as it reaches its final decisions at the UK level.

**John Mason:** There is a whole area that we could go into there, but we will leave it just now.

My final point is for Mr Stewart, in case he feels left out.

**Chris Stewart:** I am listening intently.

**John Mason:** Towards the end of its submission, the Scottish Property Federation talks about land and buildings transaction tax. That is interesting, as it is already happening, albeit that it is early days. The submission says:

“an independent forecast of the consequences of higher rates on pricing, transactions and consequent revenue would have helped with current LBTT forecasts”.

The following paragraph makes the point that it appears, at the moment at least, that residential revenue is below what was expected, although we have to put in some caveats—it is the first year, and the first half of the first year, for example. Let us assume that the forecast was wrong and that an independent forecaster would have given us a lower forecast of incoming taxes. That would have encouraged the Government to raise the tax level. Would you have been happy with that?

**Chris Stewart:** It is more about the behavioural analysis behind the forecast and looking at the stress tests. Ultimately, a segment of the market—its top end—has really stopped moving. That can be completely attributed to the change in LBTT rates.

11:30

That has several implications. It means that the market is not functioning as well as it should: some people want to move up and some people want to move down, and if part of the market is sticking, the whole market is affected. Our comment in relation to the decision that was made really goes to how much analysis was done of the banding to understand the behaviour that has occurred since the change was made.

If the SFC did its own forecasting and stress testing, and if that could be analysed, that could help to inform the decision. I do not think that it is because it is the first year; I think that it has just stopped dead a part of the market. Other parts of the market are performing well, and that is why there is a clear differentiator.

**John Mason:** Is it perhaps just that some things, especially new things, are almost impossible to forecast?

**Chris Stewart:** I would have thought that the whole point of the SFC and an independent forecast is that you can use that data to be more informed about the thresholds. This is about getting it as accurate as you possibly can, I think. From a market perspective, what has happened to the market has been pretty blunt at that top end and is affecting other parts of the market. I am sure that that was not the intention when the changes were decided on. There must be a better way to do that, and clearly the SFC and an independent forecast would assist that process.

**John Mason:** I take your point. My own feeling is that it is still early days but we will see what happens.

**The Convener:** Mark McDonald has a brief supplementary to John Mason’s question.

**Mark McDonald:** I want to explore this a little bit further. The OBR has been held up as a standard that we should perhaps be looking at with regard to the SFC. However, the OBR also did forecasting around LBTT, and its forecast was that the income from LBTT would be even higher than the income that was forecast by the Scottish Government. There are no guarantees that if an alternative forecast is produced to the one from the Scottish Government, it will necessarily be accurate, based on what the OBR predicted in relation to LBTT—if what you are saying about the income that is derived from LBTT transpires to be the case.

**Chris Stewart:** I will not comment on the OBR. My comment is about what has happened to the market and how we can better inform the decision making so that that behavioural analysis happens. The top rate of LBTT is now pretty overwhelming, and it is stopping transactional activity. Whether that is about the introduction of different banding or whether it is perhaps more interim or whatever, my point is that it is really just about having better information at the point of decision making. I am sure that that is what we are looking for from an independent SFC forecast.

**Mark McDonald:** I am interested in the point because I know that the Scottish Government forecast is for all transactions to bring in £381 million. In March 2015, the OBR made an estimate of £431 million, which it then revised in July 2015

to £540 million—it lifted the estimate after LBTT had been introduced.

**Chris Stewart:** Again, my comment is not about the OBR and its forecasting; it is about asking how you collect the appropriate amount of tax from the real estate market and how you make sure that your forecasting delivers the take that you predict. With the residential market, a lot of it is about behavioural analysis, and it should be easier to try to make that prediction, whatever the level.

It seems that perhaps that ability to predict was not there in the case of LBTT, and it very clearly caused part of the market to stall. That is a different question—it is about the amount that you recover. LBTT is making the market not work as it should, which is not good for the market as a whole.

**Mark McDonald:** I am aware that we have an evidence session with Revenue Scotland coming up—the issue might leach into that session.

**Jackie Baillie (Dumbarton) (Lab):** I suspect that most of my questions have been asked and answered already, but I want to tease out a couple of things. I think that it was Professor McGregor's submission that referred to scrutiny of the block grant mechanism. We are all clear about testing Scottish Government assumptions, but he was also clear about testing a UK Government assumption—the block grant mechanism. I ask him to expand on that, and the rest of the panel whether they agree.

**Professor McGregor:** I do not think that the commission could be charged with coming up with an alternative block grant mechanism. I was suggesting that there should be an exploration of the consequences of the mechanism that is eventually agreed and, perhaps, an exploration of the possible consequences of alternative mechanisms.

There has been a lot of discussion in the committee and elsewhere about the precise nature of that adjustment mechanism, which can be very important in determining the revenue that is available to the Scottish Government. For that reason, some independent analysis of it would be very welcome. If the Scottish Fiscal Commission was in a position to require others to do that, I think that that would be helpful and useful.

In the longer term, I think that it would be useful to monitor the behaviour of that mechanism and, if necessary, to think about whether there are grounds for renegotiating it if it is believed to be prejudicial in some way, appealing to the no-detriment principal—if we are still doing that. I do not know whether that would work, but I certainly think that we should be informed about the consequences, given their potential importance.

**Jackie Baillie:** Do the other members of the panel agree?

**Dr Armstrong:** I have a view on that. I think that the matter is extremely political. The formula and any adjustment is not just a Scotland issue—it is an issue for all parts of the UK and for the UK Parliament overall. That is the place for it to be discussed.

I think that it would be bad—in fact, it would be negative—to give it to the SFC because it is such a political question; we would be throwing that body into the politics of the situation straight away. The SFC will need to co-operate closely with the Government and we cannot legislate on every item. There will need to be confidence between the two sides. Including something so overtly political would make that difficult, and I would not do it.

The Finance Committee's report makes the very good point that intergovernmental relations need to be put on a better standing; they are weak, informal and ad hoc. That is not the right way to look at the application of the formula and to decide what expenditure is what. There will be a rule—the Barnett formula and its design. Once that has been decided by Westminster, its application, which is in itself quite an opaque process, will need to be scrutinised by a body such as the joint exchequer committee. That would bring all the constituent parts of the UK together to discuss its application—it could be much more wisely put there for scrutiny.

If an independent assessor needed to be on that committee, I do not see why that would be a problem. I would like to think that the constituent parts of the UK, in a public committee that was open to public scrutiny, could make a reasonable judgment about how to apply the formula. I do not think that that should be an SFC issue—it is too political.

**Professor Peat:** It is a complicated matter, as members have just heard from those different views. In our submission, we suggest that, if the SFC is monitoring adherence to the Scottish Government's fiscal rules, it could have a role in assisting the Scottish Government and the Scottish Parliament in considering the implications for those fiscal rules and the overall fiscal position of prospective adjustments to the Barnett formula and/or further devolution of taxes.

The SFC should certainly not become engaged in the politics of what should take place, but—if sensitively handled—it could be valuable to give it a role in analysing potential or proposed changes and in helping the Parliament, in particular, to understand what those might mean.

**Jackie Baillie:** Thank you. Mr Stewart, do you have any observations to make?

**Chris Stewart:** No.

**Jackie Baillie:** The second thing that I am picking up from you all is that, in an ideal scenario, the SFC would do the forecasting; and, in a less than ideal scenario, the Scottish Government would do the forecasting and the SFC would comment on those forecasts. How can we ensure that there are Chinese walls in both scenarios? I suspect that it would come down to the timing and choreography of some of the different inputs. For example, we understand that the Scottish Government would require to see the published SFC forecast in advance of producing its own forecast and budget. There is the Audit Scotland model whereby the Government would see the forecast a couple of weeks in advance and would be able to amend some of it by discussion and agreement. There is also a suggestion that providing the forecast 24 hours in advance would be much more effective and would ensure independence. How would you arrange the choreography? Should the Government see the forecast before or during the budget proposals or afterwards?

**Dr Armstrong:** You are talking about the SFC producing a forecast, and there are three scenarios. First, the SFC could produce the forecast that is used by the Scottish Government. In that case, there would need to be an iteration on an informal, co-operative basis. I do not think that you could legislate for that, and the confidence and respect of both parties would be important in making that work. I would expect that, at least a month before the budget, there would already be informal discussions—by “informal” I mean not that they would not be serious but that both sides would sit down in private and set out their questions and the things that they thought were difficulties. The number of meetings that would take place would be governed by what the Government’s policy proposals were and the difficulty of the forecast—some are easier than others.

I do not think that you could legislate beforehand for anything like that. To make the process work would require co-operation and confidence on both sides, which it would be much easier to have—this is the really important experience from the OBR—if, in advance, when it was created with statutory elements and so on, the SFC were given more independence than it would ever have to use. The point is that it would never have to use half its powers, but it would have them if it needed them. That is the most important thing.

Our second-best scenario is competing forecasts, whereby the SFC would produce an independent forecast. It would be useful to have a number of meetings, but I do not think that one

should try to prescribe what they would address—that would depend on the issues involved. As long as the commission had the power to use its independent judgment, you could be confident that both sides of the discussion would work in the best interests, knowing what their parameters were. Therefore, sorting out those parameters at the outset would be very important. Quite a few meetings take place between the OBR and the Government. That is not spilling any secrets.

**Professor Peat:** I agree that the model of how the OBR works with the UK Government is a valuable precedent, because it seems to have settled down very well. Professor Lienert’s report is valuable because it looks at alternatives, although there are not many examples of an independent commission providing the forecasts. Nevertheless, we have that evidence, and I bow to Angus Armstrong’s experience of how that works in practice.

I think that it would be dangerous for the Government to receive the report two weeks in advance. One day would give the Government plenty of time to react initially. If there has been the right informal contact and the Government understands the issues that matter and the scope for potential differences, without having been given absolute numbers, getting the numbers a day in advance should give it more than enough time. One would then be assured that the report that came from the SFC was its report and that the report that came from the Scottish Government was its report and had not been produced jointly with the SFC. That is critical. Twenty-four hours seems to be plenty of time.

**Gavin Brown:** Up until now certainly, the Scottish Government has not been enthusiastic about the SFC having forecasting powers or capabilities. When the bill team gave evidence a couple of weeks ago, they changed slightly to say that they would not do anything legally to prevent the SFC from forecasting, but that certainly did not sound like a ringing endorsement. With that in mind, do we need to have something about forecasting in the bill?

11:45

**Professor Peat:** My view is that, yes, it has to be clear in the legislation that the commission has the right to develop and undertake its own forecasts in such a way as it sees fit as it develops its role. That is important. I read the evidence from the bill team and others and I did see movement, which was excellent to see. Including that in the legislation will be important.

**Dr Armstrong:** Doing so would be helpful in achieving what we all agree needs to be achieved, which is that more power needs to be devolved to

the Scottish Parliament. With devolving power comes moral hazard, which we have observed in just about every other country that has devolved powers to sub-central Governments. It is difficult to see how you could have less independent scrutiny at sub-central Government level than at central Government level and make it work well. That is an invitation for moral hazard. The threshold should be that whatever independent scrutiny you have at central Government level is at least matched at sub-central Government level. Therefore independence for forecasting should be in the bill.

**Gavin Brown:** Do other panellists agree?

**Chris Stewart:** I agree.

**Professor McGregor:** I agree on the same grounds as Dr Armstrong.

**Gavin Brown:** Everything else has already come up, but I have one other thing to ask about. I do not think that it came up in any of the papers, so the panellists should feel free not to share their view at this stage and to reflect on it if they wish.

There is an anomaly in the current set-up and in the bill in that business rates are not treated like other taxes. Instead of judging the forecast of business rates, the SFC is to look at some of the buoyancy estimates that underpin the forecasts, which strikes me as a bit convoluted. Council tax is controlled directly by the Scottish Government at the council level and it affects overall public spending in Scotland. I cannot see why both of those are not explicitly included in the bill in the same way as for the OBR, which will give a forecast for council tax and business rates. If any of the panellists have thought about that, do they wish to share their view?

**Professor McGregor:** I had not thought about it until you mentioned it. Your position seems to be entirely reasonable, but I am not an expert on either of those things, so I do not know whether there are technical reasons for the situation. I cannot think of any. It seems to be entirely reasonable to treat them in the same way—symmetrically.

**Chris Stewart:** Yes, they need to be included. As I said earlier about non-domestic rates, there is volatility in what underpins them and I do not think that anyone completely understands the buoyancy model—I certainly do not. It is critical to get to the bottom of all that and they should be part of the legislation.

**Professor Peat:** I have no expertise in the area, but the logic of what you say rings true to me.

**The Convener:** There appear to be no further questions from the committee, but I have a couple of others to finish off with. The commission has endorsed the Scottish Government's initial

forecast for residential LBTT without any behavioural analysis. Is it reasonable to produce such a forecast without looking at that?

**Professor McGregor:** I assume that this is a first step and that we are engaging in a developing process. I also assume that there is no behavioural model available at the moment that can be used, so the commission is resorting to mechanistic methods of forecasting revenue on a pragmatic basis. To answer the question, it would be unsatisfactory to be relying on mechanistic methods in the long term. They might be okay on a short-term basis but they get things very wrong over the longer term. Also, we need to be sensitive to policy changes, which you cannot possibly capture with a mechanistic model, other than judgmentally. I would expect that, in the longer term, behavioural models will be developed for important sources of taxation.

**The Convener:** Is that the general view of the panel?

**Dr Armstrong:** It is my view, yes. Property-related taxes are notoriously difficult to work with, because of the length of cycles that are involved. To a certain extent, there is mean reversion in many of these series. It would be surprising if a well-thought-through forecast did not contain some sort of behavioural assumptions. I do not think that it would be easy to do a forecast purely mechanistically.

**Chris Stewart:** I am not an expert in this area but, clearly, I understand property. We know that the whole of the market needs to function as one. That is clear. If there is an overly weighted banding against one part of the market that has the effect of stopping it, that affects the whole market.

It is demonstrable in what has happened on the back of LBTT that some kind of understanding of how the market operates is critically important. The closer the forecasting can get to the market, the better. We have capable agencies throughout Scotland that are directly involved in the market and know day by day what is trading and what is not and how things are working. I do not know how you build in that connection, but it is critically important.

**Professor Peat:** If this issue was on my desk, the first thing that I would examine with great care was why the Scottish Government forecasts and, in particular, the OBR forecasts had gone so wrong. What were the assumptions that were incorrect? Were they due to a failure to bring in behavioural assumptions? Were the data poor and misleading? I would want to look at that in detail and think about whether the best way of improving forecasting would be to insert behavioural forecasts or some other changes to the data or

models that might lead to a greater probability of being closer to actuality.

**The Convener:** That is an important point. You are probably aware that the OBR forecasts for LBTT income varied enormously. The most recent forecasts are 20 per cent changed from the initial ones. Even on a biannual basis, there were quite dramatic changes. As Mark McDonald pointed out, initially, the OBR simply extrapolated Scottish figures from UK data, which were, obviously, skewed by London in particular.

**Chris Stewart:** One of the misconceptions about the property market is that it has recovered. It has not recovered; it is recovering. For example, when the market was buoyant, the commercial transactions that have been a big part of the commercial property transactions in Scotland happened in Aberdeen. That will stop now. There are fairly major shifts in the market because of its fragility. It can be severely affected by subtle changes in LBTT. If part of the market stops operating, as has happened in Aberdeen, that will have a consequence for the numbers overall, as can be seen in this quarter's numbers. That link to the market is critically important.

**The Convener:** To be fair, I do not think that LBTT is considered to be one of the major components of what is happening in the property market in Aberdeen at this time.

**Chris Stewart:** That is correct, but the key point is that, as a market, we are funded by international capital. I would say that 70 per cent of the funding in our market is not from domestic banks and domestic equity but is international. How our market operates is not consistent with how the market operates in the rest of the UK, where the funding for a lot of transactions is based in its own market. The frequency with which buyers come into the commercial property market, for example, and the consequence on LBTT, depends largely on which assets are for sale. It is not as though they are investing in the market as a whole and you can predict the market; rather, they are investing in what asset comes up. Atria Edinburgh, which is beside the Edinburgh international conference centre, is for sale. That is a good asset; it will attract attention. However, other secondary assets will not. The LBTT take will depend entirely on what comes up for sale in the year.

**The Convener:** Thanks. I have a final point. The commission has described its role as one of challenge and inquiry, with the aim of improving the Scottish Government's forecasting methods. What level of transparency should that work have?

**Professor McGregor:** Ideally, the work should be as transparent as possible, including on the model. Of course, as was mentioned, you cannot

release details of confidential data but, subject to that restriction, I do not see why there should not be complete transparency about that interaction and the responses to it. It would be great if the core models—if they did not have confidential data—were made widely available for others to use as well.

**Professor Peat:** I agree entirely that the work should be as transparent as possible. That should include evidence to this committee and wherever else is appropriate. It should also involve putting forecasts and comments into the public domain in an accessible manner. I am not talking about including complex econometric modelling or even Angus Armstrong's 50 pages of spreadsheets; rather, I am talking about including documentation that can be read by the interested public. They can then form a view of the issues that matter and make their own judgments. Accessibility, as well as transparency, is critical.

**Dr Armstrong:** The transparency of the SFC's findings and forecasts is critical. However, as we have discussed, some elements contain sensitive information and some of the models are just too cumbersome. Therefore, if there has to be opacity, what is important is that whoever is in charge has complete impartiality. We just have to accept that some things are confidential and that some information is sensitive—that is life. However, if we cannot have transparency, and that is the case to a certain extent in the models that the SFC uses, we need impartiality. Indeed, at that point impartiality becomes super-important, which is when some of the governance issues and the independence of the SFC become so important.

**The Convener:** Thank you very much for your evidence this morning. Does anyone want to make any final points to the committee before we wind up?

**Dr Armstrong:** I will make a final point. There is no discussion in a number of the submissions about how the Scottish Government will do its borrowing. I have given evidence a number of times that if we want to have responsibility, it has to come from independent parties—for example, external debt. An issue has just struck me: who is going to make an assessment of the cost efficiency of some of that debt finance and fundraising? That matter seems to have slipped through the net in the papers. That is just a comment, but perhaps the issue needs to be thought about in the overall framework.

**The Convener:** As no one else wants to make a comment, I thank everyone very much for their contributions. It has been an excellent session. To conclude, I just want to say to Angus Armstrong that the Sacha Distel look suits him. [*Laughter.*]

We will suspend briefly to allow a changeover of witnesses.

11:59

*Meeting suspended.*

12:04

*On resuming—*

## Revenue Scotland

**The Convener:** As we are all present and correct, we will resume the meeting. Our third item of business is evidence from Revenue Scotland as part of our draft budget scrutiny. I welcome to the meeting Keith Nicholson, Eleanor Emberson and Robert Buchan. Members have received copies of a written update from our witnesses. Keith Nicholson has a brief opening statement to make before we go to questions.

**Keith Nicholson (Revenue Scotland):** This is the first time that a representative of Revenue Scotland has appeared before the Finance Committee following our go-live date of 1 April. As such, I feel it appropriate that, as chair of Revenue Scotland, I address the committee and highlight some of the work that has brought us to this point, before Eleanor Emberson, as chief executive and accountable officer, takes the committee's questions.

Revenue Scotland has now been collecting and managing the two devolved taxes—the land and buildings transaction tax and Scottish landfill tax—for more than seven months. I want to reflect briefly on how we got to this point. It has been a historic journey from the passing of the Scotland Act 2012 and the three bills passed by the Scottish Parliament, through to the creation and establishment of the tax administration programme, the birth of Revenue Scotland and the collection of the first devolved taxes.

As the committee knows, an important theme throughout the journey has been collaboration and engagement with key partners, which is a key aspect of the Scottish approach to taxation. The Scottish Government consulted publicly on each of the three bills and on the subordinate legislation. The Government held workshops and meetings with interested parties, such as the Law Society and the Chartered Institute of Taxation, from a very early stage. It also established working groups to discuss the main policy issues.

The knowledge and expertise of the Scottish Environment Protection Agency and the Registers of Scotland, which carry out key functions delegated to them from Revenue Scotland, have been vital in the establishment of Revenue Scotland and its work since its launch on 1 April. Continued engagement is vital to our on-going success, and initiatives such as regular meetings of both LBTT and Scottish landfill tax forums, following from the devolved tax collaborative meetings, and a new programme of roadshows that will be rolled out in the new year, provide stakeholders with the opportunity to feed back and contribute to the efficient management of the devolved taxes.

Getting Revenue Scotland to this point has been a team effort. The Revenue Scotland board is now an important part of that team. We want to continue to build relationships with our key delivery partners to ensure that Revenue Scotland has a successful future. The team of staff who have set up and run Revenue Scotland deserve enormous credit for getting us to where we are now. I do not want to steal any of Eleanor Emberson's thunder, but it is worth reflecting on the fact that, in the first six months, we collected more than £220 million in tax revenues, with 97 per cent of revenues made online. Those achievements demonstrate the value of the collaborative work that has been done at every stage, and they show that Revenue Scotland can face any future challenges with confidence.

**The Convener:** Thank you for that opening statement. As usual, I will ask the initial questions before we go on to questions from others. I do not have many initial questions because the report is excellent and detailed; it has answered many of my questions already.

In paragraph 8 of the report you say:

"The total set-up cost for Revenue Scotland and collection of LBTT and SLT is £5.5m. This compares to my estimate of £6.3m in February 2015."

It is always good when such things come in under budget, rather than over budget. You have also given us a detailed breakdown of the costs in annex C. Can you talk us through that breakdown a wee bit?

**Eleanor Emberson (Revenue Scotland):** Certainly. Two main things changed, one of which was more significant than the other.

When I gave the committee the estimate in October 2014, and the update in February 2015, I had taken a fairly cautious view about the set-up costs that would run on into this year, knowing that staff would still have work to finish up on the set-up in this financial year and would then need to find other jobs. In fact we were very efficient in finishing off the extra work and staff found other jobs very readily, having had the experience of setting up Revenue Scotland. That meant that we underspent on the staff costs because people moved on more quickly than I had anticipated.

The other element that is slightly different is the information technology procurement cost. That is an accounting issue and is to do with how much of the cost is capitalised and how much is spread over the lifetime of the contract. We were working on the assumption of one treatment, but the final decision on the treatment is that the costs come in as part of the operating costs rather than the up-front procurement. That is what has driven the change in the IT cost.

**The Convener:** Does that mean that the costs for this year will be higher than anticipated?

**Eleanor Emberson:** We are absorbing that within our budget.

**The Convener:** Fine. At paragraph 12, you say:

"we remain very alert to the possibility of tax avoidance but, as yet, have not had to use the powers available under the General Anti-Avoidance Rule."

You say that you have not had to use anti-avoidance powers and you are obviously alert to the issue, but where are we with it? Is everyone who has submitted tax returns been doing everything in a hunky-dory way? Is the legislation proving robust?

I know that it was thought that there would be a wee gap between what was going to be collected and what should be, which would indicate some element of avoidance. Has that gap not happened? If you recall, we have had discussions about the size of the gap at previous committee sessions.

**Eleanor Emberson:** We cannot really estimate the gap. All I can tell you is that right now we are going after all the money that is due to be paid. Our job is to bring in the correct amount of tax, and we are using all the powers that the Parliament has given us to go after the correct amount of tax.

Right now, if I were aware of any unpaid tax, I would be using the powers that you have given us to go after it. The tax gaps that people talk about tend to be rather theoretical estimates. They tend to have been made retrospectively by looking at economic indicators and what that information might mean about the size of various markets compared to the amount of tax paid. They are generally done for past years and not for a current or a future year. It is notoriously difficult to estimate a tax gap with any accuracy.

Therefore, I would not read anything into the fact that we have not used the general anti-avoidance rule or think of that fact as having anything to do with tax gap. We have not used it yet because we have not had to. We are using all the other powers that you have given us, and we will use the GAAR if we have to. At the moment, we are entirely in the business of bringing in all the tax that is due. We may try to make retrospective estimates at some point, but it is really quite hard to do so accurately.

**The Convener:** You have not had to use the general anti-avoidance rule, but you say in paragraph 18:

"we may generate between £800k and £1.5m of compliance yield in total by the end of this financial year and £3m to £4.5m . . . if we are able to retain the specialist

compliance posts which were initially included in our staffing plans for one year”.

You do not have avoidance, but there are issues of compliance.

**Eleanor Emberson:** Yes, but that is what a tax authority does. We ask questions and we challenge things in the returns that people have submitted. If we need to, we open formal inquiries, which we have done in some cases. We do debt recovery work if people have declared and not paid. We do all the things that you would expect us to do to make sure that the money comes in.

**The Convener:** Before I open up the discussion to the committee, could you talk us through the application of penalties, which your submission touches on in paragraph 17?

**Eleanor Emberson:** Yes. We have given the taxes an initial period to bed in, to let people get used to new arrangements and the new taxes. The Revenue Scotland board took the decision that we would start imposing penalties and interest for transactions from 1 October. That is in place now, and returns associated with those transactions have been coming in.

We have issued quite a large number—I think more than 300—of what we call pre-penalty letters. We ask people what was going on and why the return was late. I suspect that we will get to the actual application of penalties quite soon.

**The Convener:** Thank you very much.

**Jackie Baillie:** Ms Emberson, I congratulate you on the work that you have done. It has been a smoother transition than I think anybody imagined, and I have no doubt that that is partly down to you and to the Revenue Scotland staff team as a whole.

I want to focus on residential transactions for LBTT for a moment. My maths is shaky but, judging from the amount raised and the amount that was anticipated to be raised, even if I was generous and doubled the figure that is there, we are looking at quite a substantial shortfall of potentially over £40 million.

I am curious to know two things on the back of that. First, I do not know whether you are party to it, but there have been discussions with the UK Government about forestalling. I do not know whether a figure has been agreed, but obviously forestalling had some effect at the very start of the implementation of LBTT. Do we have a figure for that?

Also, anecdotally, I would have thought that house sales in December, January and February are pretty small. Have you done any modelling or estimates on what is likely to be expected in that period?

12:15

**Eleanor Emberson:** We are not party to the discussions on forestalling between the Scottish Government and the UK Government, so I cannot give you an update.

There is a point other than the forestalling issue that I should draw to the committee’s attention that is important in comparing our numbers to the forecast. In effect, our numbers are cash flow: they represent the tax declared and paid within a given month. Forecasts are on an accruals basis: they are transactions within a year.

Within the first year of a new tax, that effect comes into play far more strongly than it will in subsequent years because, during April and to some extent May, HMRC still collected some stamp duty land tax relating to transactions in March. We were collecting LBTT for transactions in April, but some will not have come in until May, because people have 30 days after the date of the transaction to submit the return and make the payment. There is a cash flow effect, as well as the other effects that people are trying to model.

We have looked at seasonality. Obviously, we do not have any seasonal pattern to go by on a brand new tax such as LBTT, but we have looked at SDLT. There is a seasonal pattern, with more sales in the summer months and a drop-off in the winter before sales pick up again. We are not forecasting: we have noted that there is such a pattern and we will see whether it is repeated for LBTT. It will take two or three years to build up a really good seasonal model for LBTT.

**Jackie Baillie:** Do you have an order of magnitude for how much sales drop off, based on the SDLT information from last year?

**Eleanor Emberson:** I do not have a figure with me.

**Jackie Baillie:** But it exists.

**Eleanor Emberson:** We are not forecasting—

**Jackie Baillie:** I understand that, but there is an issue of planning. If there is a huge number of transactions, that has staffing implications; if there are far fewer, it is not something that you need to take additional measures to account for.

**Eleanor Emberson:** In fact, our workload is steadier than might be thought. Because we receive well over 97 per cent of our returns online, the flow of returns and of payments comes through fairly easily.

We manage our compliance work and the reactive work when people raise queries. That work is largely on the highly technical and complex transactions. It is driven by a whole range of factors but not by the volume of relatively straightforward residential transactions.



For work planning purposes, we do not estimate transaction numbers in quite the way that I can understand that you might think.

**Jackie Baillie:** So even though yield may typically go down in December, January and February, there are lots of other things going on that people turn their attention to. That is helpful to know.

In the figures that you provided to the committee, you included LBTT for the first quarter. Do you have the figures for the second quarter? It was suggested that those might be available on Friday 13 November.

**Eleanor Emberson:** That was the date by which returns were due. We are now looking at what has come in.

We publish the statistics a few weeks after the end of the quarter. We do not have figures ready to publish yet, but we will issue a release some time in December. I am happy to provide a copy to the committee when it is available.

**John Mason:** I realise that the papers we have been given were prepared in part by Ms Emberson and in part by committee clerks, perhaps drawing on other material.

When I compare the figures that we have received, on tax or anything else, with an estimate or forecast, it is good to have the figures on the same basis. I look to Ms Emberson, but the question may be for someone else. Having a full year on an accruals basis and six months on a cash basis makes the figures difficult to compare. I would like to see the figures on the same basis in the future.

For further clarification, I thought that house sales would be low in the summer as well as around Christmas, with spring and autumn as the peak times. Is that right, or is it not quite that way?

**Eleanor Emberson:** I am not the expert on this, but I think that we see a bit of a summer surge. The tax surge lags a little behind the housing market for the same reason that I explained previously. People have up to 30 days to submit the tax returns, so we might see the surge run about a month, or up to a month, behind the surge in house sales.

**John Mason:** The convener mentioned paragraph 8 of the report, but I do not think that it was mentioned that staff costs for 2015-16 are projected to be around £227,000 higher than you estimated. Can you give us a bit of explanation on that?

**Eleanor Emberson:** It is just the difference between the theoretical estimate and the actual costs when we have the members of staff in place. We have had one or two extra temporary people in

to help us out on a couple of things, but there is no particular thing that I could point to that would make the difference clear.

**John Mason:** In other words, it is a one-off.

**Eleanor Emberson:** They are mostly one-off costs.

**John Mason:** There is also the suggestion that staff costs are turning out to be higher than originally estimated. Presumably, that is because you are in a competitive market and you have to offer what people are willing to work for.

**Eleanor Emberson:** It has not proved difficult to recruit good staff.

**John Mason:** Right.

**Eleanor Emberson:** We have staff coming in and we are on standard Scottish Government terms and conditions. We pay the same rates as the Scottish Government would pay.

**John Mason:** So as things settle down we can expect staff costs to be closer to budget.

**Eleanor Emberson:** Yes. We should have more accurate forecasts.

**John Mason:** Paragraph 9 states that operating costs for 2015-16 are 0.76 per cent of the £498 million tax revenue forecast. That is an interesting figure, and I would be interested to know how it compares with the position in other countries. Do we have such information?

**Eleanor Emberson:** The OECD publishes figures on that. Its latest published figures were released a couple of years ago, so the information is all retrospective. As you would expect, there is quite a broad range in the percentage concerned, but I think that I can say that broadly comparable jurisdictions might have figures somewhere between 0.8 and 1.2 per cent. Obviously, that is for tax authorities that might have a very different mix of taxes, so we have to approach the comparison with a bit of care. However, our figure looks perfectly okay internationally compared with some of the other things that we have seen.

**John Mason:** Great.

**Mark McDonald:** A couple of the points that I was going to raise have been mentioned. However, I note that paragraph 13 of the report refers to applications to defer payment on LBTT. For what reason would people seek deferment? How many such requests have been received? If a deferment is granted, how long is it generally granted for?

**Eleanor Emberson:** Robert Buchan will say something on that.

**Robert Buchan (Revenue Scotland):** If the consideration for a transaction was contingent on

a certain event occurring, that would be one of the reasons why we would allow deferment until that contingency occurred in the future. We would take payment at the date that the contingency occurred rather than at the date of the transaction.

**Mark McDonald:** To contextualise that, what kind of circumstances are we talking about?

**Robert Buchan:** If I were to buy a property from you, and in the unlikely event of planning permission being granted on that property in 20 years' time for me to build a wind farm on it, my lawyer might advise me to put a contingency in the contract to say that, in that event, a significant additional sum would be payable. That event is unlikely and no money is actually being paid, so although it is part of the consideration technically, we would not seek tax on it at that date but would wait until the contingency occurred.

**Mark McDonald:** Have there been many requests for deferment on that basis since LBTT came into effect?

**Robert Buchan:** I think that there has been a total of 10.

**Mark McDonald:** How many of those requests have been granted?

**Robert Buchan:** I can check that.

**Eleanor Emberson:** Perhaps it would be better if we came back to you on that.

**Mark McDonald:** Yes. You could also come back on the length of the deferments. The example that you gave, regarding a 20-year period, was fictional. It would be interesting to know where deferments have been granted and for how long.

**Eleanor Emberson:** We will have to be careful about protecting taxpayer information, but we are applying the LBTT legislation as set out—or we are doing our level best to do so.

**Robert Buchan:** I am very happy to provide that information, although it may not always be possible to give you the exact length of time because we do not know when the contingency will occur.

**Mark McDonald:** I am aware of the difficulties that can arise when we are dealing with very small numbers—individuals can be identified and so on. We would like to receive that information if possible, but I understand that there may be difficulties. [*Interruption.*]

**The Convener:** We will stop for a minute.

12:25

*Meeting suspended.*

12:26

*On resuming—*

**The Convener:** We will reconvene.

**Gavin Brown:** Jackie Baillie asked about the tax that has been collected so far. On a really crude analysis, halfway through the year, we would appear to have collected more than half of the target for non-residential tax and less than half for residential tax.

You added an important caveat that it is done on a cash basis not on accruals. I accept that entirely. Since you submitted your report, you probably now have some idea of what happened in October. Can you give us an idea of the magnitude—how big is the difference between cash flow and accruals? If we were looking at the figures now, would a couple of million pounds be added, for example, or a couple of hundred grand?

**Eleanor Emberson:** We have not done the analysis that would answer your question. However, we have provided a lot of data to the Scottish Fiscal Commission so I imagine that it will look into that when it reports to the committee. I believe that it is due to do that shortly.

**Gavin Brown:** That is fair enough.

On the seasonality point, you are absolutely right to say that with LBTT we only have the figures for six months. Stamp duty was volatile and depended a lot on the economy, but if you went back five or 10 years would there not be some monthly patterns in the figures that we could draw conclusions from? Even in a bad year, I presume that more houses are sold in September than in December. Could some work be done on that to give us some idea of where we are?

I agree that if you look at the figures on a cash basis, the analysis is crude. Perhaps the second six months will naturally be better than the first six months. Has no analysis been done on that?

**Eleanor Emberson:** The issue is more that Revenue Scotland has not done it. We are trying not to confuse the landscape on forecasting. It probably would not help the committee, or anyone else, if there was a Revenue Scotland forecast and a Scottish Government forecast and so on. We are not trying to do that; we are concentrating on trying to ensure that the money comes in. We will provide the data to the Scottish Government and to the Fiscal Commission, which will look at the forecasting. I am sure that they have looked at SDLT seasonality as a model.

**Gavin Brown:** I think that you are saying that the question would be better put to ministers. You are operational—you report what has been collected and you are going out there trying to ensure that everything is collected.

**Eleanor Emberson:** Yes.

**Gavin Brown:** I have one further question—it is slightly random, but it is on a point that intrigues me. There may be a good explanation. Table 3, on page 9 of your report, shows under August 2015 that the total non-residential tax liabilities are £15.5 million; it gives the total collected as £15.8 million. You appear to have collected more than the tax liabilities amount. Is there an obvious explanation for that?

**Eleanor Emberson:** It is partly cash flow and partly that the legislation—as you may remember—allows taxpayers to amend their tax returns for up to a year afterwards. If tax returns are amended, the liabilities and the cash payments start to get slightly out of step. However, as you will see, we have repaid the money now.

**Gavin Brown:** Okay. Thank you.

12:30

**Jean Urquhart:** I remember various discussions that the committee has had over the past few years as you were working up to this. We discussed two things at length, the first of which was the new legislation that was closing loopholes, particularly around land transactions. There was great discussion about simplifying what was already fairly complicated legislation. The second thing was your being able to answer queries and deal with the public. A lot of that activity was going to be online. Can you give us a quick update on both those issues? Is the legislation as streamlined as it appears to be?

**Eleanor Emberson:** As you know, real efforts were made to streamline the legislation and I suspect that it is simpler. It has been aligned more with Scots law. However, to be honest, LBTT remains very technical and some property transactions are quite complex by their nature in the real world, so it is not always completely straightforward for anyone to arrive at the correct tax treatment for LBTT.

Sorry—what was the second half of your question on?

**Jean Urquhart:** We had quite a lot of discussion around public inquiries and your being able to supply relevant information on the changes that have been made to any taxpayer or property developer who got in touch with you.

**Eleanor Emberson:** We have given you some statistics on the volume of calls that we receive,

the correspondence that we receive and our response times. We look to respond to the more complex queries relating to particular transactions in a more secure way than through plain email. We are answering our phones and our correspondence.

In practice, most of our inquiries come from solicitors, landfill operators and those who are acting for landfill operators. We do not get a large number of inquiries from members of the general public, because most people use a solicitor when they are dealing with a property transaction and the solicitor makes the inquiries for them.

**Jean Urquhart:** Thank you.

**The Convener:** Thank you very much. That appears to have exhausted questions from the committee. Do you want to make any final points before we wind up this evidence session?

**Keith Nicholson:** I am grateful to have had the opportunity to speak to the committee. I felt that it was important for us to do that, as it is the first time that we have appeared before you since 1 April.

**The Convener:** Not at all. I am glad that everything is going smoothly, as Jackie Baillie said. I congratulate you on the excellent work that you are doing.

12:33

*Meeting continued in private until 12:39.*



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