

Finance Committee

Scottish Fiscal Commission Bill

Submission from Professor Ronald MacDonald

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My written evidence to the committee is a response to the questions raised by the Committee in:

http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Call_for_evidence_SFC_NOV2015.pdf

The committee's questions are in bold below.

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

It is an important principle that the Fiscal Commission (FC) is able to produce an independent set of forecasts for the new devolution powers embodied in Smith (2015) and it may be that an evolutionary approach will prove an optimal way forward on this. For example, in the initial phase of the FC's work, it may prove optimal for it to act as an independent scrutineer of SG forecasts. Moving forward the FC could then move to a system where they produce their own forecasting model and forecasts. I say this because if it is assumed that the model used by Scottish Government is based on best current practice, and assuming the model is relatively tractable which it is likely to be given current data limitations, the model that the FC produced would likely be very similar to that used by SG. If this is the case it would therefore seem more efficient, at least initially, to allow the FC to run their own counterfactuals based on the SG model. (This would also have the advantage that it would give those appointed by the FC to undertake their own modeling/ forecasting to set up a model and refine it so that it could produce accurate forecasts). As the role of the FC evolves it would be best for it to take on the forecasting role,

perhaps exclusively so, as is the case of the OBR. So in the longer run the SG role in forecasting could be tapered out and left to the FC.

Given my response to the first point, the FC should indeed have the potential capacity and potential resources to make independent forecasts, although I do not think that the resources required would be large given that a full blown macro-econometric model would not be needed or, indeed, could initially be produced given data limitations. The FC would of course need to have access to all relevant data sources.

Following on from this, a sensitivity analysis would be crucially important given that small changes in assumptions can often have a big impact on forecasts and the potential to create a large forecasting error (which of course could have costly implications for public services).

Yes, the Commission should have the capacity to develop its own forecasting methods/ analytical to provide benchmarks although as noted above this may be part of an evolutionary approach.

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

I think the influence and assessment of reasonableness should be kept separate. It is one thing for the Commission to give its comments to SG, and more widely to the public, but another to force the SG forecasting team into making changes to their forecasts if the latter group are convinced that they are correct. To address this issue, and if the FC are to use the SG model for its own forecasts at least initially, it should be allowed to ask the SG forecasting team to run other counterfactuals based on alternative assumptions (provided by the FC). These functions should be kept separate.

If a small team were to be funded for the FC's independent scrutiny of the SG's forecasts, and if the modeling framework used by the SG was approved of by the FC, then it would make sense for the Commission to have an ongoing role throughout the year in scrutinizing the SG's work on developing

the underlying model and methodology, this particularly so if the two stage strategy mentioned above were to be adopted.

Given the importance of forecasts for future planning I think the FC should carry out its assessment of SG forecasts at the same time. Clearly if the FC's assessment / alternative forecasting were to be done ex post there would always be a danger that differences between its assessment / forecasting were a function of timing.

I would support sending a report to Ministers as courtesy prior to publication, perhaps when the SG forecasts are in Press, which perhaps would be a week before publication.

- ☐ **the Commission should have a wider role in assessing the sustainability of Scotland's public finances such as adherence to fiscal rules and, if so, should the Bill be amended now to reflect this?**
- ☐ **the Bill should be amended to include assessment of mechanisms for adjusting the block grant?**
- ☐ **there should be a legislative requirement for the Scottish Government to prepare a charter for budget responsibility and the Commission should have a role in assessing adherence to the charter?**

It would make sense for an independent body to assess the sustainability of Scotland's public finances and adherence to any fiscal rules devised, especially with the on going further devolution of fiscal powers and a revised and beefed up fiscal Commission would seem ideally suited to take on this role. So, yes, I believe the Bill should be amended to take on board such a change.

A bloc grant element is going to be essential for any form of fiscal devolution short of full fiscal autonomy, the latter in my view only being consistent with political independence. I also believe we should move away from the Barnett bloc grant element which is not transparent and to many seems unfair, to a new bloc grant system perhaps based on a new needs assessment. Since there would need to be mechanisms, such as some form of indexation (which the committee has previously noted may well be controversial) in place to adjust the grant in moving forward it would make sense that the Bill was amended to include assessment of such mechanisms and how they work in practice.

Having a Charter for budget responsibility would seem to make sense especially since that is now set out explicitly for the UK as a whole and there have been issues raised about how devolved policies in Scotland may differ from those in the UK as a whole.

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

Overall the right of access in the bill does seem robust enough although I suppose a quibble could be raised over the use of the term 'reasonableness'. What happens if a request is deemed 'unreasonable'? There doesn't appear to be any arbitration mechanism in the current legislation if a dispute about what is reasonable were to arise. As is noted elsewhere, the production of a solid and comprehensive data-base for the Scottish economy is still work in progress (Paras 175-177 of http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/fir15-12w.pdf). It is not clear to me that the current right of access would allow the FC to access such preliminary data, some of which may not be published. I think the FC should have the right of access to such data and of course any other data produced by civil servants.

Given the potential importance of the FC work for Scotland's public finances, I think it is important that there is a written understanding of the agreement between the SG and the FC. I would therefore support the inclusion of a MoU on the face of the Bill.

I would give priority to independence, transparency and openness in the working relationship between the FC, SG and other public bodies. A spirit of cooperation would also I think be important by which I mean a real willingness to cooperate for the benefit of the greater public good rather than cooperation based on an overly legalistic and formulaic framework. In that regard the FC should be seen as a group that is designed to enhance the decision making process and be a positive benefit to SG rather than as a body that offers criticism for criticisms sake.

One of the key issues that have been identified as a problem with current interactions between the two governments is that they are ad hoc and relatively informal, leading to a lack of transparency and accountability and clearly this has to be avoided in setting up new arrangements. There should be a set calendar for each year for meetings, both between FC and SG and the FC and other bodies, such as the OBR. Most likely the timing of these

meetings would coincide with the SGs production of forecasts although if the FC does have a further enhanced role with respect to fiscal rules, meetings for these would have to be factored in as well.

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

Overall the proposed appointment and removal procedures are adequate, although I think there should perhaps be a clause ruling out members transferring from a body such as the Council of Economic advisors straight to the FC without any lag in service. Without such a lag, and irrespective of how independent such members turn out to be, such a move will always raise a question in the public eye of how independent they actually are.

I would support having the period of office specified in the Bill and I see nothing that should preclude someone serving for two terms in office particularly if they are deemed to have made an especially helpful contribution in their first term in office (as I understand it other similar bodies such as the Bank of England Monetary Committee and OBR allow for the option of a further term of office). The cycle of period of office should differ from the political cycle.

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

For stability and other reasons it is important that funding is in place for a fixed period, which I believe the Cabinet Secretary has indicated will be the case, and this will not coincide with the political cycle. The overall cost set out in the FM, and the number of staff and remuneration / time commitment, seem to me reasonable for the initial tasks of the FC, but are clearly going to be inadequate for the extended potential roles for the Commission in both the direction of producing their own forecasts and as overseers of any fiscal rules introduced. I think it would be beneficial to attract someone on secondment

from a UK or European forecasting unit in the initial stages of the modeling to oversee the development of the forecasting model and the cost of such a person, who would likely be relatively senior in position, would have to be factored into the costing.