

Independent Fiscal Institutions: International Experience and the Scottish Fiscal Commission

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Ian LIENERT

Independent Consultant in Public Financial Management

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Executive Summary

Scotland is one of the few devolved regions of Europe that has created an independent fiscal institution (IFI). The Scottish Fiscal Commission (SFC) that has been operating for over one year and in September 2015, the Scottish Government (SG) submitted a SFC bill to the Scottish Parliament with a view to placing the SFC on a statutory basis. This follows the SG's consultation during March-June 2015, which resulted in the SG taking action to strengthen the statutory SFC's provisions for its operational independence from the SG.

This report first examines international experience with IFIs, which are quite diverse. The statutory SFC is designed to be a stand-alone body, comparable to the Fiscal Councils set up in several European countries in recent years, except that the SFC has a narrow mandate.

The report notes that some non-Euro zone countries (e.g., Poland, New Zealand) have decided not to establish an IFI because existing fiscal institutions are adequate and/or macro-fiscal forecasts are not systematically biased. Also, since 2013, all Euro-zone countries must establish an IFI, even though the need is not pressing in countries with low fiscal deficits and debt (e.g., Estonia, Luxembourg).

Four case studies draw lessons for Scotland, to the extent that this is possible given Scotland's constitutional arrangements within the UK. The report also identifies nine key factors for a successful IFI. These are based mainly on OECD's 22 sound principles for IFIs.

This executive summary is confined to the report's key suggestions concerning the SFC's:

- Mandate, including the SFC's role in assessing forecasts and the fiscal framework.
- Operational independence, including access to information
- Governance arrangements
- Accountability to Parliament and legal basis.

Clarifying the SFC's core mandate as envisaged by the Scottish Government

Core mandate and obligatory tasks. The SG's proposals for the SFC's obligatory and specific tasks are clear in the SFC bill. It would be clearer, in the SFC bill, to first identify the SFC's core mandate. This report suggests that the SFC's core mandate is to assess the realism (or "reasonableness") of the SG's macroeconomic and fiscal forecasts. This is a somewhat wider mandate for the SFC than that proposed by the SG, as it includes assessing the SG's macroeconomic forecasts and expenditure estimates in annual budgets. The report calls for a clarification of the SFC's core mandate in the SFC bill. In addition, it would be useful to state explicitly in the SFC bill that the SFC *must perform its duties objectively, transparently and impartially*.

"Voluntary" tasks. The SFC bill appropriately provides the SFC with the option of performing non-obligatory functions that the SFC chooses to include in its annual work programme. For example, the SFC could comment twice a year on the OBR's Scottish tax forecasts, in line with the Finance Committee's recommendation in its 2014 report on the SFC.

Prohibition. While this report considers that it would not be prudent to allow the SFC to recommend fiscal policy changes, it is difficult to justify the SFC's prohibition from examining the impact of alternative fiscal policies. A change in sub-section 2 6 (b) is recommended.

Deciding on the SFC's role in forecasting

It is appropriate for the statutory SFC to assess the realism of the SG's macroeconomic and fiscal forecasts. This is a key task for many IFIs. The IFIs in Euro-zone countries are required to endorse the government's macroeconomic forecasts, but not the fiscal forecasts. This report does not recommend that the SFC should endorse the SG's forecasts. However, in the SFC bill, it may be useful to add that the SFC:

- *Will state publicly the reasons why the SG's forecasts are realistic or unrealistic.*
- *May examine the impact of alternative fiscal policies, provided it does not make a recommendation on any preferred fiscal policy. If judged necessary, also add that the SFC may also consider the effect of alternative forecasting assumptions or methodologies on the budgetary forecasts of Scottish Ministers.*

For its forecast assessment activities, it would be helpful for the SFC to build up in-house macroeconomic and fiscal forecasting expertise. The SFC's forecasts would be for the purpose of benchmarking the SG's forecasts. Unlike some national IFIs that, for benchmarking purposes, *compare* the official forecast with those of another forecaster (e.g., those of the EU, IMF, OECD, the Central Bank or a research institute), this option is not open in Scotland. The SFC's forecasts could be published at SFC discretion.

The SFC bill is silent – as in most countries' IFI laws -- as to whether the SFC can or must prepare alternative macroeconomic and fiscal forecasts. Thus, the SFC bill is not inconsistent with the Finance Committee's 2015 recommendation that *the SFC should carry out its own forecasts*. Whether or not this should be stated in the SFC Act is optional. It is rare for an IFI to be obligated by legislation to prepare alternative fiscal forecasts (Table 1).

The SG's devolved tax forecasts have been prepared for only a few years. As a result, it is too early to assess if there is statistical evidence that the SG's forecasts are biased. This contrasts with the systematically biased macro-fiscal projections prepared in the UK Government prior to 2010, which led to the establishment of the OBR with a mandate to prepare the official UK forecasts (see Annex 2). There are very few other IFIs that prepare official fiscal forecasts. Largely for these reasons, this report does not recommend that the SFC should prepare the official macroeconomic and fiscal forecasts for Scotland.

Considering a widening of the SFC's mandate

The SFC bill proposes that the mandate of the SFC in the future could be widened incrementally using Scottish Statutory Instruments proposed by the SG, over which the Scottish Parliament would have veto rights. An alternative approach would be to widen drastically the statutory SFC's mandate now, to include assessments relating to the wider fiscal framework. In particular, the present SFC bill could require SFC assessments of: (1) Scotland's fiscal stance and adherence to SG fiscal rules or medium-term fiscal targets; and (2) Scotland's fiscal sustainability.

The report discusses this possibility in the context of the Finance Committee's 2015 recommendation that *there should be a legislative requirement for the SG to prepare a Charter for Fiscal Responsibility* in Scotland. Pre-requisites for a wider SFC mandate include:

- Addressing the weaknesses in intergovernmental relations (IGR) between the UK and Scottish governments (and those in Wales and N. Ireland) that were identified in the Smith Commission (2014) report. Formal institutional arrangements are

needed to negotiate appropriate fiscal targets with the subnational governments in the UK. Scotland's fiscal targets would need to be broadly consistent with the UK's medium-term budget framework (MTBF) and fiscal targets until 2019/20.

- The need for the Scottish Government to prepare and publish a medium-term fiscal strategy that includes a quantified MTBF (Figure 5 shows the conceptual framework), preferably with a comprehensive analysis of fiscal risks in Scotland. Presently, the SG does not systematically provide such documents to the Scottish Parliament when it submits its annual draft budget.
- The need for the SG to resolve data quality issues (highlighted by Audit Scotland and in the SFC's first report), which affect the base year for the SG's fiscal forecasts.
- Formal adoption of fiscal rules by the SG. Presently, the SG has a golden rule – a balanced budget for current transactions, with a self-imposed constraint on borrowing for infrastructure projects. There is no (net) debt rule, although the Finance Committee in 2015 recommended *the SG should agree on a debt rule with the UK Government consistent with the UK fiscal framework*.

Until these constraints are overcome, the SFC's assessment role is likely to remain limited. In present circumstances, the SFC cannot assess medium-term projections against fiscal targets or fiscal rules. In view of the groundwork needed to develop a coherent fiscal framework for Scotland, this report suggests that the Finance Committee could:

- Urge the SG to use its influence to help address institutional UK-wide weaknesses.
- Consider whether it is appropriate to add provisions to the present SFC bill relating to the wider fiscal framework, such as requiring the SG to provide a MTBF with its annual budget submission to the Scottish Parliament and/or to establish fiscal targets that are broadly consistent with the UK fiscal framework.
- Reiterate the FC's previous recommendation that the SG adopts two fiscal rules: a "balanced budget" rule consistent with the agreed level of borrowing, and a limit on net debt, and require, in the SFC bill, the SFC to assess compliance with the SG's fiscal rules.
- Note that the SG is not yet in a position to prepare its own fiscal sustainability analyses which, in the longer-term, the SFC could also assess.
- Consider the risks of delaying the adoption of the SFC Act, should a broader Scottish "Fiscal Responsibility Act" (SFC bill plus new fiscal framework provisions) be proposed during the current legislative session.

Ensuring SFC independence prior to publication of its main assessment report

The SFC bill requires the SFC's main annual report – its assessment of the SG's forecasts -- to be submitted to the Scottish Parliament on the same day as the presentation of the SG's budget to Parliament. There would be some advantages to eliminating the "same-day" SFC reporting requirement from the SFC bill, while requiring the SFC to report "as soon as practicable" after budget day.

The report takes a strong view on the need to eliminate from the SFC bill the requirement that the SFC submits a copy of its report to the Scottish Government prior to the report's submission to the Scottish Parliament. Such an obligation could thwart SFC independence.

To reduce further the risk of SG interference in the SFC assessment work, the report identifies eight safeguards. These include: (1) drawing up a publicly available Memorandum of Understanding (MoU) that specifies the forecast-related information to be shared between the SFC and the SG on particular days before and after budget day; (2) avoiding too frequent SFC/SG contacts; (3) preparation by the SFC of its own independent fiscal forecasts, prior to sharing them with the SG; (4) nurturing strong relationships between the SFC and other institutions in Scotland or the UK that provide a view helpful for the SFC's assessment activities, as well with the media.

The focus of attention should be on whether the SG's forecasts are reasonable, not on any differences in the SG's official forecasts and the SFC's benchmark alternative forecasts. If the SFC's independent forecasts are substantially different from those of the SG, the SFC would provide reasons why the SG's forecasts are not reasonable. The SFC bill could require this.

Enhancing other specific aspects of the SFC's operational independence

The SFC bill contains several useful provisions relating to the SFC's independence. The bill could nonetheless be further strengthened to enhance the SFC's operational independence. Three specific suggestions are:

- Consider amending the SFC bill's sub-section 6 (1) to indicate that, in performing its functions, the SFC acts independently, not only of the Scottish Government, but also of the Scottish Parliament and any other public or private entity.
- Consider expanding section 4 to indicate that the SFC may, on its own initiative, publish any research and other papers related to its statutory functions.
- Eliminate section 26 (on "Ancillary Provisions") that confers wide-ranging powers on Scottish Ministers to regulate the SFC.

Ensuring SFC access to needed information

The SFC bill provides considerable discretion to Scottish Ministers to decide what can "reasonably" be provided within "reasonable" time limits. The SFC Act should be unequivocal in this area. Although they do not need to be required by the SFC Act, MoUs should be drawn up with relevant Scottish and UK authorities. The MoUs would elaborate on the types of fiscal information needed, the delays in providing data, etc.

The SFC bill's provisions for the SFC's access to data could be enhanced by:

- Specifying sanctions on public bodies that do not provide the SFC with essential fiscal data and information in a timely manner (c.f., the extract from Portugal's "fiscal council" law – see Annex 6).
- Ensuring, by legislation, that the SFC has direct access to Scotland-specific fiscal data and information that is held by UK bodies such as HM Treasury, the OBR, HMRC and DWP. This may require the SG to take initiatives at UK level.

Reducing Scottish Government influence in SFC governance

Another important aspect of SFC independence concerns how the SFC members are selected, appointed, reappointed, and removed. Relevant sections of the SFC bill assign a preponderant role to Scottish Ministers. This report makes specific suggestions for amending the SFC bill with a view to including provisions for:

- Forming a special panel (that could include the SFC chair) for selecting a short-list of candidates for new SFC members. One option is for the Finance Committee of the Scottish Parliament to select one candidate from the short list, prior to formal appointment by Scottish Ministers. Another is to reverse the order of the selection and appointment (SG selects, Parliament appoints).
- Limiting the maximum number of SFC members to five, two of which could be non-executive members.
- Specifying the term lengths and the number of term renewals for SFC members, in line with OECD Principle 2.3. Two renewable four-year terms may be appropriate, given Scotland's 5-year parliamentary election cycle.
- Providing more details (see main text) for removing SFC members who are "otherwise unfit". The SFC Act should remove the possibility of abuse by future SGs who may wish to remove, without adequate justification, outspoken SFC members.
- Involving explicitly the Finance Committee (not just the Scottish Parliament) should there ever be a proposal by Scottish Ministers to remove a SFC member.

Providing the SFC with adequate resources and annual budget

In the SG's Financial Memorandum, the cost estimates for the SFC's annual budget as from 2017/18-- £850,000 per year – are munificent. The provision of six SFC staff, in addition to five SFC members may be over-generous, given the SFC's limited mandate. Some comparable fiscal councils (e.g., those in Ireland, Slovakia and Sweden), which have wider mandates, are functioning on more limited budgets (on a per person basis). A downward revision of the cost estimate may be appropriate.

The report makes several suggestions relative to enhancing the SFC bill's provisions for the SFC's budget, of which the most important are:

- Consider involving a special SFC remuneration panel (identical to the proposed appointment panel), instead of solely relying on Scottish Ministers, to determinate SFC members' remuneration or fees for expenses for time spent on SFC business.
- Remove the need for the SFC to seek prior approval of Scottish Ministers for setting the level of SFC staff remuneration and employment. In this context, re-formulate sub-section 18 (3) so as to ensure that SFC staff remuneration would be guided by the conditions applicable to Scottish civil servants.
- Insert a section that indicates that the revenues of the SFC's budget would be received from Scotland's Consolidated Fund and that the SFC's annual budget would be prepared by the SFC (within the constraints of law).
- Consider introducing a section in the SFC bill so as to ensure that the SFC's annual budget increases from the agreed initial base level (lower than £850,000), using transparent rules for adjusting the SFC's annual budget, e.g., by price indexation.

Although it does not need to be stated in the SFC Act, it is preferable that the position of the SFC chair be at least half time (see OECD Principle 2.4). Also, the SFC needs a Chief of Staff to begin expanding the SFC's capabilities to assess the SG's macroeconomic and fiscal forecasts.

Also outside the SFC bill, it would be useful for the Scottish Government and the SFC to reach a multi-year funding agreement and publish it as a formal document. Before finalization, the Finance Committee could review the funding agreement.

Finally, it would be useful for the SFC, as an independent body corporate, to receive a treatment in the annual Scottish budget and periodic Spending Reviews that is similar to that of other independent bodies, notably the Scottish Parliament and Audit Scotland.

Ensuring accountability and oversight of the SFC

The SFC has made a good start in respecting OECD principles relating to IFI transparency. The SFC should continue to publish all of its reports and major correspondence, and to seize available opportunities to make its messages known in the Scottish Parliament, the media and elsewhere. This will strengthen the SFC's credibility.

The SFC bill could be further strengthened in areas concerning the SFC's accountability to the Scottish Parliament. The following omissions could be included in the SFC Act:

- Require SFC appearances before the Finance Committee of the Scottish Parliament, especially for explaining the content of the SFC's key annual assessment report.
- Specify that the Auditor-General audits the SFC's annual accounts, with the audited accounts included in the SFC's annual report.
- Identify the SFC Chair as the SFC's Accountable Officer, who would be required to appear before the Public Audit Committee of the Scottish Parliament, as needed or requested, to defend the SFC's annual financial statements.

Placing the SFC and the fiscal framework on a statutory footing

This report prefers that the present SFC bill focuses on putting in place the best possible arrangements for the statutory SFC's operational independence, access to data, governance arrangements, and its accountability before the Scottish Parliament. Any widening of the SFC's mandate, to include broad fiscal framework issues, could take place in a future legislative session of the Scottish Parliament. The possible adoption of a Scottish Fiscal Responsibility Law could take place after institutional weaknesses in UK-Scotland intergovernmental relations have been addressed and there is greater clarity and certainty concerning the wider fiscal framework issues.

A. Introduction

Independent Fiscal Institutions (IFIs), which include fiscal councils and parliamentary budget offices (PBOs), are proliferating. There has been an upsurge in the number of IFIs in recent years, especially in European countries (Debrun et al., 2013; OECD, 2015a; Debrun and Kinda, 2014).

In Scotland, the idea of establishing a Fiscal Policy Commission was first floated by the Government's Council of Economic Advisors (CEA) in December 2009 (see Recommendation 17 in CEA, 2009). To elaborate further on fiscal rules and the possibility of creating a SFC, the CEA formed a Working Group in 2012. The Working Group indicated that an independent Scottish Fiscal Commission should form a key part of the fiscal framework of an independent Scotland (CEA, 2013).

In May 2013, the Scottish Government (SG) announced proposals to establish an interim Scottish Fiscal Commission. In its *Report on proposals for a Scottish Fiscal Commission* (SFC), published in February 2014, the Scottish Parliament's Finance Committee welcomed the creation of the SFC on an interim basis. In June 2014, the Scottish Parliament endorsed the Scottish Government's nominations for the appointment of the non-statutory SFC's first chair and two other members (Finance Committee, 2014b). The SFC's first report was published in October 2014.

The interim's SFC's remit is limited to scrutinizing and assessing the SG's forecasts of revenues from fully devolved taxes as well as the economic determinants underpinning the SG's forecasts of non-domestic rate income.¹ For its assessment activities, the interim SFC is free to decide its analytic methods, modelling and approaches.

Following the "no" vote in Scotland's independence referendum in September 2014, there was a strong political consensus at the United Kingdom (UK) level that further devolution of fiscal powers and a strengthening of Scotland's Parliament should take place. Relevant recommendations were published in the report of the Smith Commission (2014).

The proposed additional devolution includes new responsibilities over certain taxes, welfare spending and borrowing in Scotland. Regarding the SFC, the January 2015 UK Command Paper 8990 noted that *it will be crucial that the remit and capacity of the SFC fully reflects expanded responsibilities. Given the increased importance of effective scrutiny as more responsibilities are transferred to the Scottish Parliament, independence, transparency and resources will be particular areas for further progress. It is the UK Government's view that the Scottish Government should bring forward proposals fully consistent with the OECD principles [for IFIs] and to enhance the SFC as part of agreement to a new fiscal framework for Scotland.*

In view of the need to strengthen Scottish Parliament oversight of fiscal developments in Scotland, which are currently determined by both the UK and Scottish Governments, in February 2015, the Finance Committee (FC) of Scotland's Parliament launched an inquiry on the Smith Commission's report and the UK Government proposals for an updated fiscal framework for Scotland. In June 2015, the FC published its recommendations pertaining to fiscal forecasting and fiscal institutions, notably fiscal rules for Scotland and the SFC.

¹ A Framework document between the SFC and the SG laid out the interim SFC's remit. See Annex 5 and also paragraph 2.3 of Scottish Government (2015).

As part of its legislative agenda for 2015/16, the SG has been planning to put the SFC on a statutory basis. To this end, during March-June 2015, the SG conducted a consultation on the statutory SFC (summarized in SG Consultation Analysis, 2015). At end-September 2015, the SG submitted to the Scottish Parliament a revised draft SFC bill, along with three helpful explanatory documents.²

The aim of this report is to provide further inputs for the Finance Committee's considerations of the revised SFC Bill. The report benefits from research on good international practices for IFIs and relevant country case studies. However, being a subnational IFI in a specific context – that of partial devolution of fiscal powers (which are evolving) – Scotland's statutory SFC will necessarily have some distinct features.

The report is laid out as follows. After the Introduction (section A), it reviews institutional models, mandates, size and forecasting activities of IFIs in various countries, including at subnational level (section B). Possible lessons for Scotland from four national-level IFIs are examined in Section C, with the detailed overviews of the IFIs in Belgium, Ireland, the United Kingdom, and the 50 States of the United States laid out in Annexes 1-4. The report also examines nine key characteristics of successful IFIs (section D). Partly drawing on the lessons from international experience – to the extent that it is relevant to Scotland's specific constitutional and institutional arrangements – section E presents, for consideration, some options and recommendations pertaining to the statutory SFC.

Given that other commentators have already responded to the Finance Committee's Consultation on Scotland's fiscal framework, as well as on the SG's Consultation on the SFC, a particular focus of the suggestions in this report is on:

- What could be amended, excluded from, or added to the draft SFC bill submitted to the Scottish Parliament in late September 2015.
- Practical considerations, options and recommendations concerning the statutory SFC's mandate, role in forecasting, independence, access to information, governance arrangements, resources, transparency and accountability.

B. Governance, mandates, size and forecasting activities of IFIs

Institutional models of IFIs

The extent to which the government, the parliament or other bodies exert influence on an IFI's governance arrangements, including appointments of the head of the IFI, differs widely. Parliamentary Budget Offices (PBOs) assist parliament in its oversight and scrutiny functions, and work primarily for the parliamentary Budget Committee (or the equivalent). A few IFIs are government agencies with considerable independence: the Minister responsible for the IFI seldom, if ever, intervenes. Other IFIs are stand-alone independent bodies. Five IFIs are independent bodies under the external audit office or the central bank.

²See www.scottish.parliament.uk/parliamentarybusiness/Bills/92309.aspx

Nine of the 34 member countries of OECD have not created an IFI; all are non-Euro zone countries (Figure 1). The reasons why several non-Euro zone countries have not created an IFI include: (1) no perceived need, because the country has adequate fiscal institutions (e.g., Poland³, New Zealand). For Poland, the Government rejected the idea of establishing an independent fiscal council on the grounds that it would not bring any value added, given that Poland already has a strong independent control authority (NIK), which may, inter alia, monitor fiscal rules.⁴ In New Zealand, the Treasury has a reputation for being nonpartisan and independent⁵; (2) there is already an “economic council” with a broad mandate for economic analysis, whose outputs also include fiscal analysis⁶ (e.g., Norway). Also, it is quite possible that some EU countries with low fiscal deficits and public debt, e.g., Estonia and Luxembourg, would not have established fiscal councils in 2014 had it not been for EU Regulation No 473/2013 that requires all euro-zone members to establish an IFI.

All IFIs, including those under the government, publish reports that are useful to parliament for its budget scrutiny activities, especially reports assessing the draft ex ante budget. For ex post budget scrutiny activities, the parliament is assisted by the IFI when it reviews how well the government has performed relative to its fiscal strategy and targets (including fiscal rules). By contrast, external audit offices assist parliament in its ex post detailed scrutiny of government budget programmes and financial management.

Mandates of IFIs

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

- **Assessing and/or preparing macroeconomic and fiscal forecasts.** This can involve: (1) *assessing* (and, possibly, formally *endorsing*) macroeconomic and fiscal forecasts of the government. To do this, the IFI may *prepare alternative fiscal forecasts* to the official forecasts. Alternatively the IFI may *compare* the official forecast with those of another forecaster; or (2) *preparing the official projections* of the economy and fiscal outlook. Such forecasts can be one-year ahead or, more frequently, over a medium-term period (3-5 years). In many cases, the IFI is also charged with (3) *assessing long-term fiscal sustainability*. Most IFIs assess the official economic and fiscal forecasts prepared by the Government’s “ministry of finance” (MoF)⁷ (see Table 2, Debrun and Kinda). IFIs that prepare alternative forecasts include the US Congressional Budget Office (CBO), and Korea’s National Assembly Budget Office (NABO). The UK’s Office of Budget Responsibility (OBR), along with the Netherlands’ Central Planning Bureau are the only EU-recognized IFIs that have a mandate to *produce* the official economic and fiscal forecasts.⁸

³ For a discussion of Poland, Germany and UK, see Kovás and Csuka (2012).

⁴ See footnote 28 of Szpringer (2015).

⁵ For a discussion on the merits of a fiscal council in New Zealand, see Ter-Minassian (2015).

⁶ Prior to EU Regulation 473/2013, Germany used to argue that it had adequate fiscal institutions, including the independent Council of Economic Advisors.

⁷ “Ministry of Finance” is used generically in this paper. It includes the “central budget office” (also used generically) that centralizes budget submissions and/or prepares the MTBF and the detailed annual budget estimates.

⁸ For Belgium, the EU-recognized IFI is the High Council of Finance. Another IFI – the Federal Planning Bureau – prepares the official forecasts. For details, see Annex 1 on Belgium.

Figure 1: Institutional Models for IFIs in 34 OECD countries

	No IFI	Under Parliament	Under Government	Standalone	Under External Audit Office	Under Central Bank
Australia						
Austria						
Belgium						
Canada						
Chile						
Czech Republic						
Denmark						
Estonia						
Finland						
France						
Germany						
Greece						
Hungary						
Iceland						
Ireland						
Israel						
Italy						
Japan						
Korea						
Luxembourg						
Mexico						
Netherlands						
New Zealand						
Norway						
Poland						
Portugal						
Slovak Republic						
Slovenia						
Spain						
Sweden						
Switzerland						
Turkey						
United Kingdom						
United States						

Sources: Debrun and Kinda (2014), updated by the author using Box 8 of ECB (2014) and OECD data.⁹

⁹ In 2015, the situation was fluid, with some countries creating new councils, e.g., Iceland was adopting legislation that included the establishment of an IFI. Also, in a few countries, there are two IFIs. In Figure 1, judgment is exercised in categorizing the countries under only one heading.

- **Assessing the fiscal stance and fiscal outcomes:** *monitoring* and *evaluating* the ex ante fiscal stance (medium-term budget projections against fiscal targets or rule) and the ex post fiscal outcome. The IFI may also be charged with making *recommendations* for correcting fiscal policies -- changing revenue and expenditure policies to achieve the officially approved fiscal targets. The monitoring remit applies especially in EU countries where there are EU and national fiscal rules -- long-lasting constraints on the fiscal deficit and debt¹⁰. Examples of IFIs with a strong “assessment” mandate include: the Irish Fiscal Advisory Council (IFAC) and Sweden’s Fiscal Policy Council; the latter, but not the former, is authorized to make fiscal policy proposals.
- **Costing of proposed fiscal policy measures** including those of alternative policies. This involves costing new expenditure policies and/or new tax and nontax measures. In some countries, costing is limited mainly to government proposals. In other countries (e.g., Australia) this function extends to the costing of political parties’ election manifestos. Since detailed costing work requires considerable resources, less than half of the IFIs in the world undertake this work. The two largest IFIs (CBO, United States and NABO, Korea) employ about 250 and 125 staff respectively, many of whom work on policy analysis and costings.

The weight given to the above three main mandates – and variants within them -- varies considerably between countries (see Table 2 of Debrun and Kinda, 2014). The tasks associated with the first two bullet points above are arguably the key roles of any IFI (Calmfors, 2011), with “costing” an optional (and costly) extra. In EU countries, the recent upsurge of new IFIs is partly in response to the EU’s emphasis on the second bullet point.

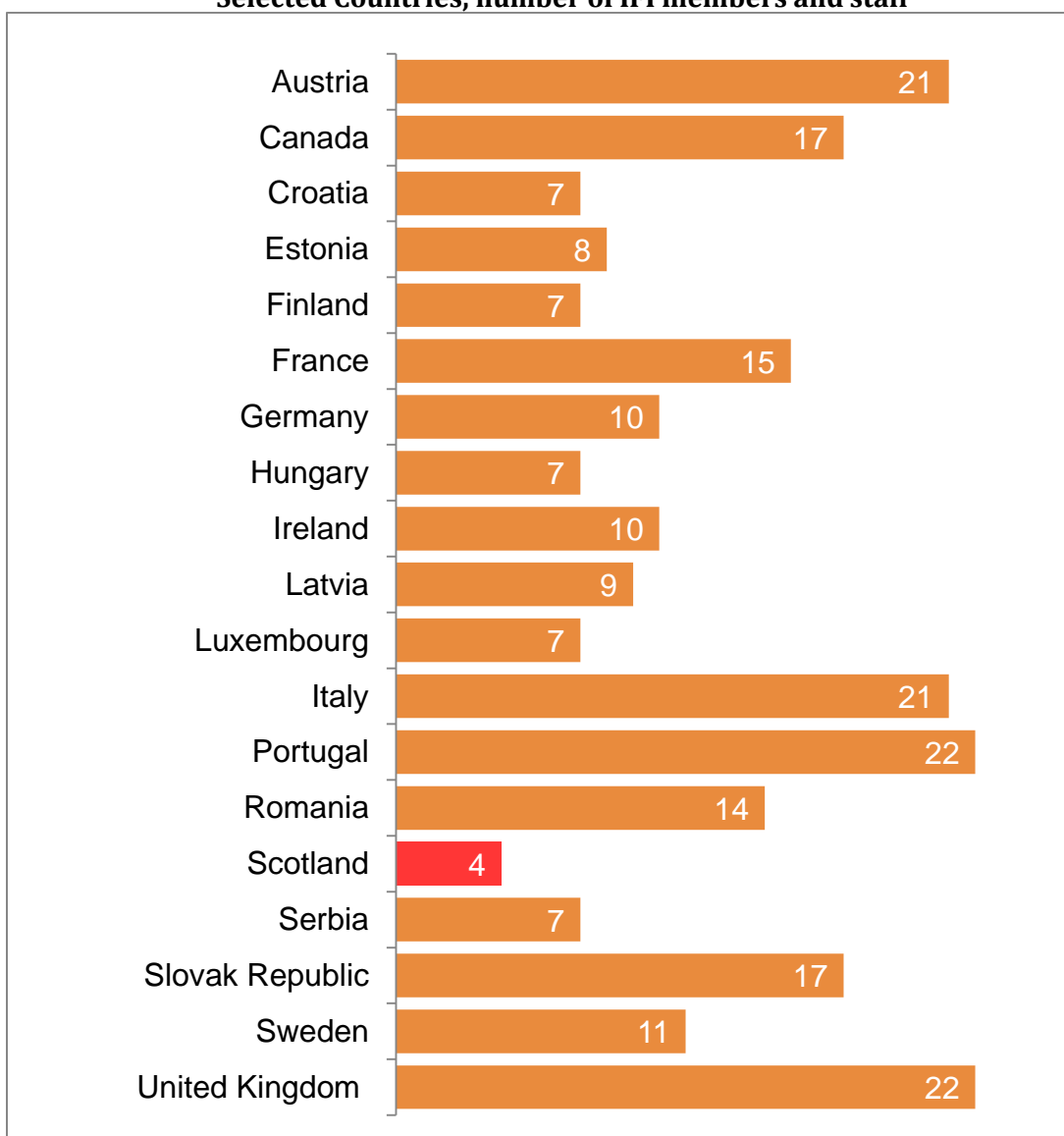
Some IFIs are also charged with **specialized regular tasks** such as quantifying the potential budgetary cost of all new draft laws. Others may conduct **one-off studies on specific issues**, e.g., improvement in the operation of fiscal rules. Finally, although it may not necessarily be specified in the law creating the IFI, most IFIs have **strong relationships with the media**. This is an implicit mandate.

Size of IFIs

Given the differing mandates and the intensity of staff needed for the “forecasting”, “assessment” and “costing” functions, the size of large¹¹ and medium-small IFIs varies considerably. Given its very limited mandate, it is not surprising that Scotland’s non-statutory Fiscal Commission is the smallest IFI in the world (Figure 2).

¹⁰ In countries with “fiscal deficit” rules, the deficit may cover “general government” – all levels of government including extrabudgetary funds of central/subnational governments (e.g., EU countries) or only central/federal government (e.g., Canada, United States). The deficit may apply to the cyclically adjusted deficit (e.g., EU countries) or to the unadjusted (or “headline”) fiscal balance. “Debt” can be defined to be gross debt (Euro-zone countries) or net debt (UK). Again, coverage of debt varies from “central government” to the “public sector”. Some countries also have “total expenditure” fiscal rules, which may include or exclude certain “obligatory” expenditures.

¹¹ Nine “large” IFIs – arbitrarily set at more than 25 staff -- have been excluded from Figure 2. The countries are: Australia (38 staff); Belgium (133 staff in two IFIs); Denmark (55); Korea (126); Mexico (38); Netherlands (120); Slovenia (75 staff in two IFIs); Spain (35 staff); and USA (251). See Table 4 of Debrun and Kinda (2014) and OECD (2015a).

Figure 2. Small-medium sized IFIs, 2015**Selected Countries, number of IFI members and staff¹²**

Sources: Table 4 of Debrun and Kinda (2014), which is based on a survey of IFIs in 2013. Since then, the number of leadership and staff of several countries' IFIs has increased. The author, thanks to OECD and country IFI websites, has updated data for most countries. The IFIs of Estonia, Germany and Luxembourg (created in 2013 or 2014) have been added.

For fiscal transparency, two good principles for forecasting are (see IMF, 2014, paragraphs 2.1.2 and 2.1.3):

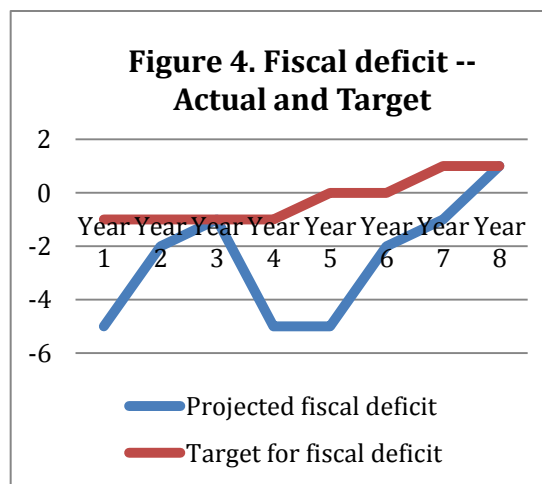
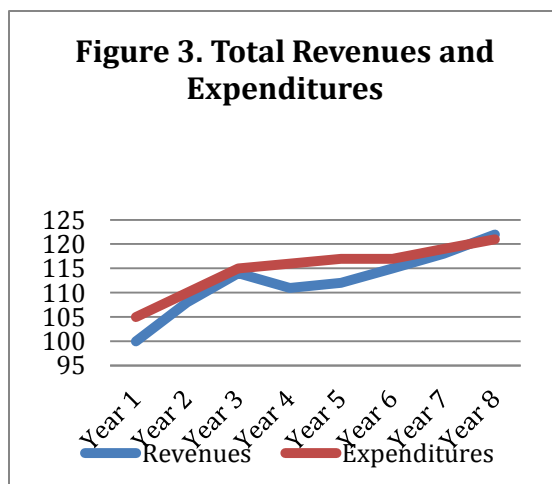
¹² The chart shows the headcount of IFI "managers" and staff. Ideally, the data should be adjusted to show the numbers on a full-time equivalent basis (or hours actually worked for the IFI).

- **Medium-term budget framework (MTBF):** Budget documentation should include outturns and projections of revenues, expenditures, and financing over the medium term, on the same basis as the annual budget.
- **Macroeconomic forecasts:** The budget projections are based on comprehensive macroeconomic forecasts, which are disclosed and explained.

Based on the first principle, it is now a standard practice for 120 governments around the world to present a MTBF to Parliament at the same time as the draft annual budget of revenues and expenditures (World Bank, 2013). The MTBF typically shows major categories of revenue and expenditures. Total revenues include various categories of direct and indirect taxes (e.g., personal and company income tax, VAT, excise taxes) as well as the main nontax revenues. Expenditures may be presented as “budget programmes” (or outputs or outcomes), or by specific sector or spending areas. Often countries’ budgets and MTBFs distinguish various categories of current and capital spending.

Whatever the categorization of the forecasts of revenues and expenditures, the IFI typically focuses on assessing the macroeconomic and fiscal projections of total revenues, total expenditures and the overall fiscal balance, especially relative to fiscal targets that the Government may have established. Figures 3 and 4 illustrate the key variables of a MTBF - those on which IFIs focus on. Fiscal balance projections feed into projected increases or decreases in net debt, another key variable of “macro” focus for IFIs.

To underpin the *fiscal* projections (especially for revenues), there is a need to prepare *macroeconomic* projections. Considerable resources and tools are needed for macroeconomic modelling work. All sectors of the economy are included: notably the production sector (private and public), price developments, the financial sector, the fiscal sector, and the external sector (imports, exports, capital flows, etc.). Economists develop macroeconomic models to ensure the consistency of projections across the sectors of the economy. They use models to simulate policy or other “shocks” to the economy. Variables or assumptions about real GDP growth (and its components), inflation, interest rates, exchange rates, oil prices, etc. are major “drivers” in multi-sector macroeconomic models. There is often a “fiscal block” within the overall macroeconomic model, which enables forecasters to develop baseline macro-fiscal projections. “Sub-models” for specific taxes, other revenues, or specific expenditures (e.g., welfare spending) may be developed.



The “Ministry of Finance” (MoF) usually prepares the official macro-fiscal projections.¹³ Table 1 (2nd column) shows that only the IFIs of Belgium, the Netherlands and the UK prepare the official macroeconomic and fiscal forecasts that serve as the main input for the MoF’s budget forecasts. In some countries, other publicly funded agencies, including IFIs, prepare alternative fiscal forecasts. Parliamentary budget offices, notably those of Korea and USA, are the only IFIs that are mandated by law to prepare alternative forecasts (Table 1, 4th column). Some “stand-alone” fiscal councils have arrangements with non-MoF agencies for preparing alternative macroeconomic and fiscal forecasts to help in its forecast assessment functions. Three examples are: (1) Ireland – the Irish Fiscal Advisory Council (prior to 2013); (2) Slovenia -- the Institute of Macroeconomic Analysis and Development; and (3) Sweden – the National Institute of Economic Research.

To perform their forecast assessment functions, some IFIs have found that they need tools for preparing their own benchmark forecasts. Others, with limited resources may *compare* the official forecast with those of another forecaster.¹⁴ Macroeconomic and fiscal models can be sophisticated and detailed, or simple and aggregated. In either case, the forecasting of macroeconomic and fiscal variables is not a simple mechanical exercise. In some countries, macroeconomic forecasts are prepared by various agencies (government or non-government). Detailed fiscal forecasts are prepared mainly by the MoF, especially the projections on the expenditure side (revenue forecasts are often driven by economic parameters, whereas spending forecasts are more likely to be determined by: (1) policy choices, e.g., setting nominal expenditure ceilings; choosing to index certain spending items to inflation; or (2) demographic variables, notably social transfers. In all cases, careful analysis of forecasts derived from the preferred model (or multiple models) is needed. Fiscal and other forecasts are typically adjusted judgmentally for various reasons.

The official macro-fiscal forecaster may prepare biased or unbiased forecasts. Some studies for European countries¹⁵ indicate that, for fiscal forecasts, official projections – especially for economic growth and government revenues -- were biased optimistically, i.e., with more than a 50% chance of being too high. To counter systematic and politically motivated forecasting biases, Jonung and Larch (2006) postulated that forecasts prepared by an IFI would be superior to in-house MoF forecasts.¹⁶ More recently, the EU has taken a strong view on the need to create an IFI. EU Regulation No 473/2013 requires euro-zone members to have its national medium-term fiscal plans and draft budgets based on independent macroeconomic forecasts, which means that macroeconomic forecasts must be produced or endorsed by an IFI. For a progress report on implementation, see ECB (2014).

In the UK, the reason for creating the OBR with its unique mandate was because the official UK forecasts for GDP and revenues in the decade prior to 2010 were biased upwards (see Annex 3 for details). Other countries have dealt with the “forecast bias” problem by creating a fiscal council with a strong “forecast assessment” function, rather than transferring the official forecasting unit out of the MoF and into an independent body. In a few cases,

¹³ The MoF may prepare projections in-house or it may rely on other official agencies such as a planning ministry or, in some countries, the Central Bank, if the latter has modeling expertise.

¹⁴ This is the case in a number of newly established IFIs in Europe. For example, the Latvian Fiscal Discipline Council compares the MoF’s forecasts with those of EC, IMF and Bank of Latvia.

¹⁵ For an overview of fiscal forecasting experience in Europe see, for example, Leal et al (2007).

¹⁶ Hughes Hallet (2003) had earlier proposed creating a Sustainability Council (an independent panel of experts) for enforcing fiscal rule compliance in the euro area.

including Slovenia and Sweden, the Fiscal Council does not have enough resources to produce the forecasts in-house, so it “contracts” a non-MoF government forecasting body to prepare the alternative forecasts.

Table 1. Forecasting Mandates and Practices of IFIs

Country	Independent Fiscal Institution	Regarding forecasts, does the IFI:			Is the IFI required by law to prepare alternative fiscal forecasts?
		Assess the official fiscal forecasts?	Prepare the official fiscal forecasts?	Prepare alternative fiscal forecasts?	
Australia	Parliamentary Budget Office	No	No	No	No
Austria	Fiscal Advisory Council	Yes	No	Yes	No
Belgium	High Council of Finance	Yes	No	No	No
Belgium	Federal Planning Bureau	n.a.	Yes	[scenarios]	No
Canada	Parliamentary Budget Office	Yes	No	Yes	No
Denmark	Economic Council	Yes	No	Yes	No
Estonia	Fiscal Council	Yes	No	No	No
Finland	National Audit Office – Fiscal Policy Audit Office	Yes	No	Yes	No
France	High Council for Public Finance	No	No	No	No
Germany	Independent Advisory Board to the German Stability Council	Yes	No	No	No
Ireland	Irish Fiscal Advisory Council	Yes	No	Yes	No
Latvia	Fiscal Discipline Council	Yes	No	No	No
Luxembourg	National Council of Public Finance	Yes	No	No	No
Italy	Parliamentary Budget Office	Yes	No	No	No
Korea	National Assembly Budget Office	Yes	No	Yes	Yes
Mexico	Centre for Public Finance Studies	Yes	No	Yes	No
Netherlands	Bureau for Economic Policy Analysis	n.a.	Yes	[scenarios]	No
Portugal	Public Finance Council	Yes	No	Yes	No
Slovak Republic	Council for Budget Responsibility	Yes	No	No	No
Slovenia	Fiscal Council	Yes	No	No	No
Spain	Autoridad Independiente de Responsabilidad Fiscal	Yes	No	No	No
Sweden	Fiscal Council	Yes	No	No	No
United Kingdom	Office for Budget Responsibility	n.a.	Yes	[scenarios]	n.a.
United States	Congressional Budget Office	Yes	No	Yes	Yes

Sources: OECD (2015a) with updates by the author.

Notes: the situation is fluid, especially for recently established IFIs. For column 1, a Yes response is given for countries that assess official forecasts in the context of assessing the fiscal stance relative to fiscal rules. For column 3, a No response does not necessarily mean that an IFI has never prepared alternative forecasts, unpublished or published.

In Belgium and the Netherlands, well-staffed long-established bodies produce the official macroeconomic and fiscal forecasts. These bodies were created with a wide mandate to prepare multi-sector economic plans and analyses, of which fiscal forecasting is one component. It would be inconceivable to envisage such a role for the SFC, given the large staffing requirements involved. Moreover, both Belgium and the Netherlands have established a second independent body for assessing conformity with EU fiscal rules. Belgium's High Council of Finance makes recommendations for fiscal policy targets at national and regional levels (see Annex 1 for details). In the Netherlands, since 2014, the Council of State has been designated as the independent budgetary authority that considers whether annual draft budgets meet EU fiscal rules (European Parliament, 2015). In summary, for two of the countries where an IFI prepares the official macroeconomic and fiscal forecasts, a second IFI has been established with assessment functions.

Canada had a period when it systematically produced pessimistic macro-fiscal forecasts. Following its debt crisis of the early 1990s, Canada's official forecasts for economic growth and budget revenues were biased downwards.¹⁷ The rationale was that it is preferable to have pleasant surprises (actual revenues being higher than forecast) than unpleasant surprises (revenues lower than forecast, with pressure to cut expenditure in the following year's budget). Canada wished to avoid another debt crisis and to begin running fiscal surpluses. Since actual federal revenues were higher than those projected, Canada was able to exit its high indebtedness more quickly than it would have if its projections had been unbiased or, worse, too optimistic, as in several European countries. Interestingly, during the decade to 2005, Canada did not need an IFI to complement its other fiscal institutions.

Irrespective of whether fiscal forecasts are biased, it is a good practice to prepare **sensitivity analyses** of how the macro-fiscal projections would change if some underlying assumptions (e.g., GDP growth, inflation, interest rates, exogenous variables such as export demand or world oil prices, the interpretation of "unchanged" government spending policies, etc.) were to change. Such analysis is important for **fiscal risk analysis**, which is also a good practice for all governments (IMF, 2014) and to which an IFI may also contribute. For example, IFAC (2015) identified nine separate risks in the fiscal outlook for Ireland. This allowed Ireland's IFI to make a statement concerning the balance of risks – positive and negative – in the official fiscal projections.

IFIs at subnational level

Few countries have established IFIs at subnational level. The USA is a major exception, where each of the 50 States has some form of a Legislative Budget Office (LBO). In Europe, IFIs have been established primarily at the national level only. This is especially in response to EU directives to have an IFI that monitors compliance with EU and national fiscal rules.

There are only a few non-USA countries where subnational IFIs have been, or are being, created, e.g., in Ontario¹⁸, Canada; in Catalonia, Spain. Scotland's SFC is one of the first IFIs in Europe to be established at subnational level.

¹⁷ Canada's "MoF" took the consensus forecasts for GDP and interest rates and, using a macro-fiscal model, adjusted these downwards and upwards respectively, to prepare a pessimistic scenario, including for the revenue projections of the federal budget. For details, see Bayoumi et al (2007).

¹⁸ Ontario's first Financial Accountability Officer was appointed in February 2015 (see www.fao.on.org/en/). The provincial IFI is modeled on Canada's PBO at federal level.

C. Possible lessons for Scotland from four IFI case studies

This section draws out possible lessons for Scotland from the IFIs that operate in Belgium, Ireland, the United Kingdom and the 50 States of the United States (Annexes 1 to 4 provide details). The four case studies were chosen because:

- **Belgium** is a country with three regions, each with distinct identities and considerable fiscal autonomy. Each region must contribute to the achievement of nation-wide fiscal objectives, particularly with regard to EU “general government” fiscal rules. Belgium’s two IFIs are unique: one IFI makes official forecasts and the other IFI makes recommendations on fiscal stance, including for each region.
- **Ireland** is an independent country influenced by the Westminster system. The Irish Fiscal Advisory Council (IFAC) is a recent institution. While IFAC does not prepare the official forecasts, it has developed its own forecasting tools to assist in fulfilling its mandate, which includes endorsing the official macroeconomic forecasts.
- **United Kingdom’s OBR** is also a recent creation with a distinct role of preparing the official fiscal forecasts for the United Kingdom. The OBR also has a role in forecasting Scotland’s devolved taxes over a five-year period.
- **50 States of the United States.** Independent LBOs at State level are amongst the oldest in the world. Their longevity may be instructive. The USA is the only country with widespread use of IFIs at subnational level.

Belgium: High Council of Finance (HCF) and Federal Planning Bureau (FPB)

Differences between the IFIs in Belgium and Scotland

The “policy target setting” and “independent forecasting” functions are performed by two quite different IFIs in Belgium. The closest parallels with the UK are:

- Belgium’s HCF = UK Treasury Ministers + representatives of Scottish ministers, Welsh ministers, N. Ireland ministers (c.f., Germany’s Stability Council). The HCF is a body of central and regional persons charged with setting the key parameters for national and regional fiscal policy targets. A comparable body does not exist in the UK. The Finance Ministers’ Quadrilateral is the closest parallel, but this body is less formal. Weak institutional arrangements for coordination between the UK and devolved administrations were repeatedly raised as a problem during the Smith Commission (2014). Whereas both the HCF in Belgium and the Treasury in the UK have a principal or federal “minister of finance” as the political head of their respective bodies, the HCF is serviced by a small secretariat, while UK Treasury ministers are serviced by the powerful HM Treasury.
- Belgium’s FPB is the equivalent of the OBR plus other government-funded bodies that prepare economic analysis and forecasts. The FPB has a much wider mandate than the OBR, as it conducts social, labour market, age-related, energy and environmental analyses, as well as economic and fiscal analyses.

Possible lessons for Scotland

Despite these large differences, possible lessons for Scotland and the SFC include:

- When there is political and linguistic fragmentation, a Joint Ministerial Committee, made up of Ministers from both central and regional governments, can be established for the setting national and regional fiscal targets, based on the recommendations of an advisory committee that is mandated to reach a consensus on medium-term fiscal objectives at central and devolved levels, consistent with fiscal rules for the nation as whole.
- In such a setting -- where the Council makes recommendations for fiscal targets at nation-wide and regional levels -- it is helpful to have an independent forecasting institution like the FPB. Unlike HM Treasury, the FPB publishes baseline projections not only at national level, but also for each of Belgium's three regions. However, Belgium's federal forecasting institution (the FPB) needs inputs from regional forecasting institutes. In Scotland (and other devolved UK regions) strong forecasting capacity is lacking.
- The FPB publishes economic and fiscal projections for 5 years ahead, with some details provided for national and regional fiscal projections, so as to highlight the evolution of revenues, expenditure, the primary balance and the overall fiscal balance of the Flemish, Walloon and Brussels regions. This illustrates what could be possible in the UK: separate economic and fiscal projections for England, Northern Ireland, Scotland, Wales, consistent with the OBR's economic and fiscal projections for the UK. Robust national and regional databases and skilled nonpartisan personnel are needed for such projections.
- It is possible to have an agency under a government ministry that produces credible economic and fiscal forecasts. It is helpful that Belgium's FPB is administratively under a ministry other than the Finance and Budget ministries.

The Irish Fiscal Advisory Council (IFAC)

Differences between the IFIs of Ireland and Scotland

There are a number of contextual differences between the IFIs of Ireland and Scotland. These are mainly linked to Ireland being an independent country and an EU member State. In particular, the IFAC was assigned tasks stemming from the EU's new fiscal governance system, including those laid out in the "fiscal compact" (for details, see chapter 5 of Jonung et al., 2015). The IFAC is both an integral part of the EU system of fiscal surveillance and a domestic fiscal watchdog, whereas the SFC will only be the latter. The mandates of the IFAC and the SFC therefore differ substantially.

Possible lessons for Scotland

The IFAC nonetheless provides a useful model for Scotland to study with respect to:

- Beginning as an interim body and being placed on a permanent basis as an

independent fiscal institution “half-way” between the government and parliament.

- Having a clear mandate laid out in law, as well as clear administrative arrangements concerning the size of the Council, recruitment, dismissal, etc. of members and staff. Although details are likely to differ between Ireland and Scotland, several provisions in the Schedule to Ireland’s Fiscal Responsibility Act provide a good model for Scotland to adapt in the legislation that places the SFC on a permanent basis.¹⁹
- Recognizing that forecasting is a labour intensive activity and, even with five staff, several with previous experience in short-term forecasting, it is challenging to develop and maintain in-house forecasting models, especially those used for the five-year macroeconomic and fiscal projections.
- Having statutory budget funding for the IFAC that cannot be changed by the government of the day. This shelters the IFAC from government-inspired budget cuts motivated by political reasons to “clip the wings” and independence of the IFAC.
- Having primarily a “secondment” model for staff serving the Council. However, Scotland does not have a central bank nor a strong forecasting / analysis body comparable to Ireland’s ESRI whose forecasts also provide a benchmark for IFAC.

United Kingdom: Office for Budget Responsibility (OBR)

Differences between the IFIs of the UK and Scotland

The OBR’s mandate was deliberately focussed on the medium and long-term sustainability of the public finances of the UK (Conservative Party, 2010). The OBR is unique amongst IFIs in that it *produces* the official medium-term fiscal forecasts, while it is not authorized to suggest or to cost alternative fiscal policy proposals that could help the UK Government get its fiscal strategy back on track should there be slippages in attaining medium-term fiscal targets.

In many respects, the OBR and the SFC are not comparable. The OBR (for multi-year projections) and the Scottish Government (for annual budget projections) are currently co-responsible for the preparation of official projections for devolved taxes in Scotland. Currently the Scottish Government does not present a MTBF with its annual budget submission to the Scottish Parliament. This is mainly because the UK determines total Scottish revenues and the overall budget balance. In view of the non-comparability of the main mandates of the OBR and the SFC, it is not possible to use the OBR to draw lessons for the SFC’s mandate.

Possible lessons for Scotland

The Budget Responsibility and National Audit Act 2011 is a useful model in the following additional areas:

- The BR&NA Act 2011 specifies the duty of the OBR to perform its tasks objectively, transparently and impartially.

¹⁹ One exception is the relatively weak legal provisions for “access to government data”.

- The OBR is held accountable to parliament for its outputs and the management of its annual budget and annual accounts.

Several elements of the OBR's governance arrangements were used to help prepare the SFC bill (e.g., providing a parliamentary committee with veto rights over the SG's appointment of the SFC members; remunerating SFC members and staff with comparability with the Scottish civil service; preparing an annual SFC report; and conducting an external review of the SFC after 5 years). Two other aspects to consider are:

- Establishing executive and non-executive members to govern the SFC;
- Having SFC annual accounts audited by the Auditor General, with the audited accounts being transmitted to the Scottish Parliament.

The OBR's Memoranda of Understandings (MoUs) could help guide the SFC's drawing up of MoUs with the SFC's key counterparts, notably Scottish Ministers (as represented by the SFC's main counterparts at working level: the Directorate General Finance, and Revenue Scotland), other Scottish fiscal bodies, the OBR, HM Treasury, HMRC and DWP. The MoUs would include the content and timing of provision to (and from) the SFC of budget-related information.

Legislative Budget Offices (LBOs) in the 50 States of the United States

Differences between the IFIs of the 50 States and Scotland

U.S. States' "governments" and "parliaments" are quite different from those in Scotland. First, each State is completely autonomous from the federal authorities for its fiscal management. A fiscal rule or strategy adopted at federal level (comparable to "London") generally has no bearing on the 50 States' fiscal frameworks²⁰. Second, nearly every State has its own fiscal rules, independent of those at federal level. Third, U.S. States' budgetary time horizon is focussed particularly on the short term: that of the annual or biennial budgets. Only a few State legislatures get involved with medium-term fiscal projections. State-level fiscal sustainability issues are generally not examined by State legislatures or the LBOs under them (even though some States have considerable debt, despite balanced budget rules). Fourth, LBOs serve the legislature exclusively, not the government. Their mandates and annual work programs primarily serve the needs of the budget committee(s) of the two houses.

Possible lessons for Scotland

Some features of LBOs in US States could be useful for the SFC:

- The mandate of the LBO. Some of the laws that establish the LBO clearly specify – and in sufficient detail -- the office's mandate, notably in the States where the LBO is a stand-alone entity. See, for example, the mandatory and discretionary tasks of Pennsylvania's Independent Fiscal Office in [Act 120 of 2010](#).

²⁰ Exceptions occur if the federal government were to cut earmarked transfers to States, or if the federal authorities were to transfer spending responsibilities to States without providing the finance (these are called "unfunded mandates").

- Laws spell out provisions for the LBO's access to information. In practice, there is good collaboration between the LBO and the Executive's agencies, particularly the Governor's Budget and Planning Offices and Treasury Departments.
- Appointment of the LBO Director. The procedure for the appointment of the LBO's director is quite often specified in law. The legislature's Committee that approves the Director of the LBO is composed of a balanced representation of political leaders from both sides. The principal of multi-party representation for the body deciding the appointment could be applied in Scotland.
- Nonpartisan staff. The laws establishing the LBO typically specify that the LBO staff are nonpartisan, without providing details. The LBO Director has considerable autonomy to manage his/her staff. For example, internal procedures are developed by the LBO Director to ensure that candidates for filling staff positions are not only apolitical (not active members of political parties) but also are not involved in advocacy (lobbying).
- Revenue forecasting. In nearly all of the 50 States, the government takes the lead in preparing budget revenue forecasts (although in three States, revenue projections are "outsourced"). Some States have adopted "consensus forecasting" of revenues, in which the Executive, the Legislature, and possibly outside bodies, agree on budget revenue forecasts.

D. Key Characteristics of Successful Independent Fiscal Institutions (IFIs)

Some IFIs were established 30 or more years ago. From these IFIs – and some of the more recently established ones – lessons can be drawn from their positive and negative experiences. After examining the experiences of 19 IFI case studies, in February 2014, the OECD Council endorsed 22 principles for IFIs (see OECD, 2015a). Based particularly on these principles, the following section identifies nine key success factors for establishing, operating and durably maintaining an IFI.

Success factor #1: Broad political consensus and credibility

An IFI needs wide support across political parties at the time of its establishment. For its part, the IFI needs to consistently deliver the outputs requested by the political consensus and maintain its independence from politics. In so doing, its credibility is enhanced.

In the absence of ongoing political consensus or of political competition (e.g., one-party states), the IFI may be destined to have only a short life (see case of Hungary, Kopits, 2011).

Success factor #2: Clear mandate

The IFI's obligatory or core mandate(s), as well as the IFI's optional tasks, should be clearly stated in a primary law.

There are no international standards for country-specific mandates. However, an IFI typically undertakes at least some of the assessment functions discussed in section B above.

While it is useful to study the mandates of other countries' IFIs (as is done in this paper), the mandate of the "local" IFI needs to respond to domestic needs, and fit into its specific constitutional, institutional and political environment.

Once the mandate and tasks are decided, the IFI's obligatory reporting requirements should be specified, preferably in the primary law establishing the IFI.

Success factor #3: IFI independence

Independence and non-partisanship are crucial. There are several aspects:

- **Political independence.** The IFI serves the interests of all major political parties represented in parliament and government, without discrimination.
- **Independent leadership.** The leadership of the IFI should be selected on the basis of objectivity, technical competence, and non-engagement in politics. To ensure apolitical leadership, the government alone should not propose candidates; cross-party consensus for appointments can be achieved by seeking the approval of the parliamentary "budget committee" (or equivalent) or by involving an independent panel (with Audit Office and/or Central Bank involvement, for example). Essential qualifications for IFI leadership are proven experience, competence in economics and public finance, and familiarity with budget processes.
- **Managerial independence.** The leadership of the IFI recruits and dismisses staff, and sets staff remuneration, which is similar to parliamentary and/or government service remuneration and also consistent with local labour laws.
- **Operational independence.** The leadership of the IFI is free to formulate the IFI's annual work program, consistent with its mandate. The IFI has both the right and the obligation to report on its analysis, without political interference.
- **Financial independence.** The IFI proposes its own budget, consistent with its mandate. Disputes over the proposed budget are resolved by discussions with both parliament and the government. For budget size, see success factor #6 below.
- **"Policy independence".** If the IFI has a mandate to make fiscal policy recommendations (usually not the case), this mandate should be fulfilled without political interference.

Success factor #4: Access to information

- **Access to information.** The IFI needs to have ready access to all government and other official documents needed to carry out its functions. Any restrictions (e.g., for national security and confidentiality of individual taxpayers) should be defined in legislation.

Success factor #5: Transparent governance arrangements

The IFI's governance structure should be clearly laid out in a primary law.

The leadership can be collegial (a “council”) or a single chairperson. For the latter, a non-executive oversight board and/or panel of independent experts to advise on the IFI annual work programme, can be helpful. Strict conflict-of-interest standards should apply, especially when IFI members hold positions elsewhere.

The chairperson of the IFI should preferably be a full-time position, with remuneration consistent with comparable positions elsewhere. Term contracts for the IFI leadership team should be delinked from electoral cycles.

The grounds for dismissing the leadership of the IFI should be laid out in law. Parliament should be involved should there ever be a dismissal.

Success factor #6: Adequate resources, guaranteed from the budget

The IFI’s resources should be commensurate with its mandate and tasks. The manner in which the IFI’s budget (spending on IFI members, staff and operations) is determined should be similar to that of other independent bodies such as the national audit office.

The following dispositions reduce the risk of cuts in IFI funding for political reasons:

- An IFI-specific budget line is provided in the Annual Appropriations Act.
- The IFI’s annual budget is determined by a statutory (or “permanent”) appropriations procedure, e.g., the annual budget, including updates for inflation and expansion of mandate, is “rolled over” from an appropriate base-year budget.
- Multi-annual budgetary commitments are approved by the political authorities and made available publicly.

Success factor #7: Transparency and relationship with the media

All IFI reports and analysis, including clear statements of methodology and assumptions, should be published in the IFI’s own name. Publications should be available free; the IFI’s website is an ideal tool for disseminating IFI publications.

The IFI should seize opportunities to communicate with the media and other stakeholders. Frequent media coverage enhances the visibility of the IFI’s outputs and is a channel for the IFI to communicate its essential messages.

Success factor #8: Accountability and oversight

The IFI’s key analytical outputs should be linked with the annual budget cycle and presented to parliament in a timely manner, to facilitate parliamentary scrutiny and debate on the Government’s draft annual budgets and budget updates.

Parliament (especially the budget committee) should be empowered to:

- Require the IFI leadership and senior staff to make appearances and answer questions relating to IFI analysis and reports.
- Scrutinize the IFI's draft annual budget and the IFI's annual report, including the IFI annual budget outcomes and audited financial statements.

An external evaluation of the IFI's work and effectiveness, by a panel of independent experts, should be conducted periodically.

Success factor #9: Legal framework

The IFI's primary law may be one component of a more comprehensive fiscal responsibility law. This is because, in many countries, the IFI's mandate is intimately linked to the fiscal framework, including medium-term budget frameworks (MTBFs) and/or fiscal rules.

The key features of the IFI – especially its mandate and governance arrangements – should be laid out in a primary law. The Government, by itself, should not make fundamental changes in the IFI's mandate and governance arrangement, e.g., by adopting a secondary law or regulation. Parliament should endorse such changes by amending the IFI law.

The drawing up of Memoranda of Understandings between the IFI and MoF and other central government offices are useful complements to primary law, especially for elaborating on the access and timing of economic and fiscal information to be supplied to (or received from) the IFI.

E. Scottish Fiscal Commission: Options and recommendations

A critical stage in the SFC's development has been reached. After initiating the creation of the SFC in 2014, the SG held a Consultation with the public on the SFC, with a view to putting the SFC on a statutory basis. In late September 2015, the results of the SG's Consultation were published and a SFC bill was submitted to Parliament, along with Explanatory Notes, a Financial Memorandum, a Policy Memorandum, and a Delegated Powers Memorandum. The SFC bill incorporated a number of useful recommendations made during the Consultation, including some to strengthen the SFC's independence and accountability (e.g., removal of the SG's power to require the SFC to report to it; inserting requirements for an annual SFC report and a periodic external review of the SFC).

The SG considered the Finance Committee's (FC's) recommendations on Scotland's Fiscal Framework, published in late June 2015. Some of the recommendations were taken on board in the SFC bill. Others were not taken on board. In particular, the FC had recommended that there should be a legislative requirement for the SG to prepare a Scottish Charter for Budget Responsibility. It also recommended establishing two fiscal rules – on the budget balance and on net debt respectively.

There is presently a tension between the FC's recommendations pertaining to Scotland's fiscal framework and the SFC bill. In particular, in the SFC bill, the Scottish Government proposes a limited-scope SFC, without reference to the wider fiscal framework.

This section examines eleven specific issues relating to the statutory SFC. These are partly based on OECD's 22 principles for IFIs. Some suggestions for amending the SFC bill are made, including for further strengthening the independence of the statutory SFC.

1. Obtaining political consensus

In 2013, the Scottish Government took the initiative to create the SFC on an interim basis. The appointments of the chair and members of the interim SFC were transparent, in part because the FC of the Scottish Parliament was involved. During the FC hearings of the SG's proposed candidates for the interim SFC's members, three members of the FC voiced their concerns that there may be a conflict of interest for two members of the SFC who, at the time, were also members of the SG's Council of Economic Advisors (CEA).²¹ This incident should not obscure the fact that there was widespread political party acceptance that the SFC's creation is considered an important development for Scotland.

During 2015, the Scottish Government has actively sought public participation and views on the SFC that is planned to be placed on a statutory basis during the current parliamentary session. The SG's Consultation during March--June 2015 was a concerted effort to ensure that the views of any political party, institution, association, NGO or private individual could be heard. Although the Consultation revealed differences of opinion, especially concerning the mandate of the statutory SFC, there nonetheless was a consensus that the SFC will be one important component of Scotland's new institutional arrangements for its evolving fiscal framework.

Recommendation 1 – Obtaining political consensus

- A. The Finance Committee should continue to play its key role in examining major issues pertaining to the SFC. Opposition and Government Members of Parliament should continue to voice their views on SFC-related issues, with a view to obtaining a consensus whenever possible.

2. Clarifying the SFC's mandate as specified in the SFC bill

In 2009, the SG's Council of Economic Advisors proposed a wide mandate, notably a SFC that could *review the fiscal outlook for Scotland, examining the revenues likely to be available to the Scottish Government from the UK Government, any other revenue sources, and the future expenditure implications of current policies, including such items as PFI commitments, changing demography, and pension costs* (CEA, 2009, paragraph 7.32).

The interim SFC established in 2014 has a very limited mandate compared with that proposed by the CEA in 2009, when the primary focus was a SFC with a focus on assessing the macro-fiscal outlook. In the SFC bill, the SG has adopted the principle that the statutory SFC's functions should evolve in line with the fiscal powers devolved to the Scottish Parliament via UK legislation, notably various Scotland Acts (SG Explanatory Notes (2015), paragraphs 4, 12).

Although the mandate of the proposed statutory SFC is slightly wider than that of the interim SFC, it falls short of that proposed above by the CEA in 2009. The mandate proposed

²¹ As from March 2015, the two SFC members were no longer members of the CEA.

in the SFC bill is quite limited compared with the CEA Fiscal Commission Working Group's 2013 recommendation that "*the SFC's priority should be on assessing the sustainability of net borrowing and the stock of public debt*" (CEA, 2013, page 9).

Importantly, the SFC bill satisfies OECD Principles 3.1 – 3.3, summarized in Success Factor #2 in section D above.²² In particular:

- Policy Memorandum (2015) identifies the SFC's core mandate.
- The SFC bill identifies the obligatory mandates of the SFC.
- These tasks are clearly linked to the annual budget cycle.
- The SFC bill identifies the SFC's optional tasks.
- The SFC bill clearly identifies prohibitions on the SFC activities.

These five issues are discussed in turn.

The SFC's core mandate

The SFC bill does not explicitly identify the SFC's core mandate. In contrast, the SG's Policy Memorandum (2015), paragraph 33, identifies "*the core function of the Scottish Fiscal Commission will be to provide independent scrutiny of tax forecasts and other fiscal projections prepared by the Scottish Ministers to underpin the Scottish Budget process*". This is a relatively clear statement of the SG's vision of the SFC's core functions. This remit is much narrower than that of many national IFIs (especially in EU countries). Typically, an IFI's "assessment" remit often relates both to the forecasts and to the fiscal forecasts trajectories against national fiscal rules or fiscal targets

Under its proposed core mandate, the SFC could conduct independent scrutiny of all fiscal projections prepared by Scottish Ministers. In this context, it is useful to distinguish forecasts that are prepared by the SG and those determined by the SG. The latter are mainly forecasts of devolved taxes and budget spending portfolios. The former include all forecasts, including those made by the UK authorities, notably the block grant from the UK budget. It would be useful for the SFC to assess both types of forecasts, which include: (1) all revenues of the Scottish budget, inclusive of the transfers from the UK budget under the block grant and the assumptions underlying them; (2) all borrowing by the SG; and (3) all expenditure projections, at the aggregate level and at the level of spending for each portfolio.

Sub-sections 2 (3) and 2 (4) of the SFC bill allow the SFC to prepare reports, should it decide to, on "*other fiscal factors*", which are defined as "*any forecast, assumption or projection which the Scottish Ministers use to ascertain the amount of resources likely to be available for the purposes of sections 1 to 3 of the Public Finance and Accountability (Scotland) Act 2000*".

Also, since sections 1 to 2 of the SFC bill refer to spending approval by the Scottish Parliament, it would be logical to begin section 2 of the SFC bill with a clear statement of the core purpose of the SFC along the following lines:

²² The three OECD principles are shown in full on page 9 of SG Policy Memorandum (2015).

- *The core function of the Scottish Fiscal Commission is to provide an independent assessment of the realism of the macroeconomic and fiscal (revenue, expenditure and borrowing) forecasts prepared by the Scottish Ministers in the context of submission of the annual budget to the Scottish Parliament.*

The above formulation of the SFC's core mandate would allow the SFC to assess the SG's estimates of the amount for the annual block grant for spending in Scotland and the assumptions underlying it. This would require the SG to document, in each draft annual budget, how the UK authorities have applied the Barnett formula and the basis for the estimates of increments or decrements ("consequentials") in adjusting the formula and hence the grants from the UK available for Scotland's budget.

In FC (2015) paragraph 61, the Finance Committee noted that some commentators pointed to how Scotland could be penalized by using the Holtham indexation method for adjusting the block grant when there is additional tax devolution.²³ It is important for the SG to document the estimates of the "consequentials" and for the SFC to comment on these estimates should it judge that it is necessary as part of its assessment of total resources.

The above formulation would also allow the SFC to assess the expenditure estimates in the draft annual budget bill. This is a wider remit for the SFC than that envisaged in the SFC bill, which is confined to the SFC assessing the forecasts of the taxes and borrowing that have been devolved in successive UK Scotland Acts.

The SFC's obligatory mandate for devolved taxes and borrowing

Concerning devolved taxes, Sections 2 (1) (a) to (c) of the SFC bill charge the SFC with specific responsibilities, notably to assess the SG's forecasts of taxes that have been fully devolved in Scotland Acts. These assessments are obligatory.

The SFC bill allows the SG to initiate additional obligatory specific assessments. This widening of the SFC's specific tasks would occur when the UK Parliament authorizes new Scottish Parliament tax responsibilities, including for Scottish income taxes and Scottish VAT shares.²⁴ Scottish Statutory Instruments (SSIs), under section 5 of the SFC bill, would be the means of extending the SFC's mandate for specific tax forecast assessments.

Section 2 (1) (d) of the SFC bill charges the SFC with another obligatory responsibility, namely to assess the SG's projections of its borrowing requirements. This is an important new responsibility for the SFC, relative to the remit of the non-statutory SFC.

Borrowing by Scotland is constrained by UK legislation. Under the Scotland Act 2012, there are quantitative limits on the amounts and conditions for revenue borrowing and capital borrowing by the SG. In Queen's Speech (2015) and in line with the Smith Commission's report, *additional borrowing powers will be agreed between the UK and Scottish Governments as part of a new fiscal framework for Scotland*. These agreements are likely

²³ For example, see J. Cuthbert's 2015 submission to the Finance Committee, www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Dr_JR_Cuthbert.pdf.

²⁴ Seely and Kemp (2015) discuss and summarize Smith Commission tax proposals. Also, Queen's Speech (2015) refers to "*The Scotland Bill 2015 would provide the Scottish Parliament with the first ten percentage points of standard rate VAT revenue raised in Scotland (and 2.5% reduced rate)*".

to take place outside UK legislation, as the Scotland Bill 2015, which had completed its second reading in the UK House of Commons in July 2015, did not propose to change the borrowing limits of the Scotland Act 2012 (although it is possible, at the time of writing, that the UK Government could still initiate changes in these limits in the legislation).

It is to be hoped that, in each annual budget, the SG will provide details on the agreed borrowing for current and capital expenditures. Future borrowing projections of the SG is a key component of Scotland's medium-term budget framework (MTBF). Along with fully and partially devolved taxes, and UK block grant transfers, these provide estimates of the total resources for financing the expenditure that is contained in each year's annual Budget bill. For fiscal transparency, it is appropriate for the SG to provide full details for its proposed borrowing in the draft annual Budget Act that it submits to the Scottish Parliament. Provided the SG prepares borrowing projections for a multi-year period, the SFC can conduct its assessments for borrowing over a multi-year period ahead (see below).

The SFC's optional tasks

The SFC bill provides the SFC with the freedom to prepare reports on non-obligatory functions, notably its assessment of "other fiscal factors". If section 2 of the SFC bill were to be amended to first state clearly the SFC's core mandate – as proposed above – the SFC would be able to prepare, according to its own work programme, any report on "other fiscal forecasts". For example, if the SG were to prepare a report on Scotland's fiscal sustainability, the SFC would be free to assess the SG's analysis. Similarly, the SFC bill would allow the SFC to provide a commentary twice a year on the OBR's Scottish tax forecasts (as recommended by Finance Committee, 2014a), which is a legal requirement for the OBR.

The SFC's prohibitions

Sub-section 2 (6) (b) prohibits the SFC from *considering the effect of any alternative fiscal policies to those of Scottish Ministers*.²⁵ This is a strong prohibition. SG Policy Memorandum (2015) explains that this provision was inserted in the SFC bill so as *to prevent the Commission being drawn into political discussions. The Commission may, however, consider the effect of alternative forecasting assumptions or methodologies on revenue forecasts*. The latter phrase is not included in the SFC bill.

Many IFIs, especially those that are primarily serving parliament, consider the effect of alternative fiscal policies. The costing of alternative revenue and expenditure measures is a key mandate of many parliamentary budget offices (PBOs). Provided the PBO produces unbiased estimates, the costings of alternative policies can be useful for all political parties. For example, the USA's Congressional Budget Office periodically publishes its costings of about 80 different revenue and expenditure policy alternatives.²⁶ The CBO (and other PBOs that do such costings) are not drawn into political discussion because of this work. Similarly, at US State level, LBOs often prepare alternative costings of fiscal policies (see Annex 4).

²⁵ More specifically, policies relevant to the SFC functions, as stated elsewhere in section 2.

²⁶ For example, the 2015 CBO publication showed the year-by-year impact of 79 different revenue and expenditure policy alternatives over the 10-year period 2015 to 2024. See www.cbo.gov/sites/default/files/cbofiles/attachments/49638-BudgetOptions.pdf.

This restriction on the SFC's mandate could be justified on a pragmatic ground, namely that the SFC is a new body and should prioritize its work and focus on its forecast assessment activities. Since the costing of alternative revenue and expenditure policies is labour- and time-intensive, it could be argued that the SFC should, at this stage, be disallowed from examining alternative policies. Once the SFC is well established and is fulfilling its core functions to the full satisfaction of all Scottish stakeholders, the prohibition could be lifted.

While this argument has some merits, this report takes the view that the statutory SFC should not be restricted from considering policy alternatives, while it should be restricted from recommending alternative fiscal policies. The reasons are: (1) it is preferable, even now, to allow the statutory SFC to consider the impact of policy alternatives, rather than include this prohibition in the SFC Act, which may be difficult to amend at a later time period; and (2) the Financial Scrutiny unit of the Scottish Parliament already publishes useful information on alternative policies, e.g., for the Scottish income tax rate.²⁷ The SFC should not be deprived of publishing comparable studies, provided it does not recommend a preferred option, i.e., enter the realm of normative analysis.

Recommendation 2 – Clarifying the SFC's mandate as specified in the SFC bill

- A. Identify the SFC core mandate in the SFC bill. For example, begin section 2 of the bill with a new subsection that specifies clearly the core mandate of the SFC, using the wording along the lines suggested above.
- B. Note that the proposed formulation of the SFC's core mandate is wider than that proposed by the SG, as it would allow the SFC to assess the SG's forecasts of expenditures made in the context of annual Budget Acts. The proposed new sub-section 2 (1) could replace the present sub-sections 2 (3) and (4) in their entirety.
- C. Note that the SFC's mandate, as proposed in the SFC bill, requires the SFC to prepare obligatory reports on assessments of SG forecasts of fully devolved taxes and borrowing, while, at the same time, permitting the SFC to prepare, voluntarily, other reports pertaining to the SG's forecasts of other revenues and expenditures included in annual Scottish Budget bills.
- D. Replace sub-section 2 (6) (b) with a phrase along the following lines: *The SFC may examine the impact of alternative fiscal policies, provided it does not make a recommendation on any preferred fiscal policy.* If judged necessary, add: *The SFC may also consider the effect of alternative forecasting assumptions or methodologies on the budgetary forecasts of Scottish Ministers.*

The next two sections of this report examine other issues pertaining to the SFC's mandate, notably: (1) the SFC's forecasting role; and (2) the possibility of widening the SFC's mandate to include broader fiscal framework questions.

3. Deciding on the SFC's forecasting role

In its June 2015 report, the Finance Committee recommended that *the SFC should carry out its own forecasts*.²⁸ As shown in Table 1, most IFIs do not produce the official macro-

²⁷ See www.scottish.parliament.uk/ResearchBriefingsAndFactsheets/S4/SB_14-14.pdf.

²⁸ In its 2014 report on the SFC, Finance Committee (2014a) recommended that *if the remit is to provide a commentary on Scottish Government forecasts, it is essential that to ensure its independence,*

fiscal forecasts. Some IFIs prepare alternative fiscal forecasts that serve as benchmarks for assessing the plausibility of the official projections. The IFIs that prepare the official forecasts (Belgium, Netherlands and the UK) have about 100 staff²⁹ working on preparing macroeconomic and fiscal projections, reflecting the labour intensive nature of forecasting. Moreover, in Belgium and the Netherlands, a second IFI – a council – has been designated as the IFI to assess implementation of EU Regulation 473/2013 relating to EU fiscal rules.

The EU strengthened its fiscal framework regulations because some countries had not been complying with EU fiscal rules, which was partly a result of upward biased GDP and revenue forecasts. In Scotland, there is not a long enough track record of SG forecasting of devolved taxes to know whether there is any systematic bias in its forecasts. In the absence of evidence of bias in the SG's revenue forecasts, there is little reason to contemplate the possible removal of the official forecasting function from the Scottish Government.

The SFC bill assumes that the SG alone prepares the official macroeconomic and fiscal forecasts, with the SFC “assessing the reasonableness” of the SG's forecast of devolved taxes and borrowing. The bill does not disallow the SFC from preparing alternative forecasts, which would be used to benchmark the SFC's forecasts, in the absence of other external forecasters, e.g., those of a central bank, an international organization that Scotland belongs to, or a Scottish forecasting institution with a strong track record. On the other hand, the SFC bill does not require the SFC to produce its own forecasts.

Internationally, it is rare for an IFI law that establishes an IFI with assessment functions to require the IFI (in the same law) to prepare its own forecasts (Table 1, final column). Whether or not the IFI prepares alternative forecasts is a choice of the IFI. For example, Ireland's Fiscal Responsibility Law requires IFAC to *provide an assessment of the official forecasts*. To fulfill this task, the IFAC, on its own initiative, recruited staff and developed in-house models to prepare its own forecasts, to provide a benchmark for assessing the macroeconomic and fiscal forecasts of Ireland's Department of Finance (DoF).³⁰

On the other hand, some of the recently created fiscal councils in Europe, e.g., those in Estonia, France, Germany, Latvia, Luxembourg and Slovenia, have very few staff, if any, with strong forecasting skills. They are “strong in council members” and “weak in staff” (at least at the time of writing). These IFIs, whose assessment mandates may be quite restricted (in view of other government-financed institutions), tend to use external forecasts to benchmark the official government forecasts. Many of these new fiscal councils in Europe are required to assess how well projected aggregate fiscal developments are performing relative to fiscal rules, as opposed to assessing the realism of the forecasts per se. To conclude, the statutes underlying IFIs do not usually “dictate” how the IFI should go about its assessment functions, e.g., by requiring it to prepare alternative forecasts.

the SFC should have no role in producing the forecasts. This recommendation is interpreted by the author to mean that the SFC should have no role in producing the official SG forecasts.

²⁹ The (federal/central) Planning Bureaus of Belgium and the Netherlands have about 100 staff, many of which work on short- and long-term forecasting. Although the OBR only has about 20 staff, the first OBR external review drew attention to the fact that *the OBR is dependent on approximately 125 full-time equivalent employees from other government agencies* (Page, 2015, pp. 10).

³⁰ As a result of the enhanced EU rules on fiscal surveillance, the IFAC must endorse the DoF's macroeconomic forecasts.

Some fiscal councils prepare alternative macroeconomic and fiscal forecasts by obtaining access to the models and databases of other forecasters: either the model(s) of the official forecaster or those maintained by an alternative forecasting body. In this context, the interim SFC has had access to, and understands, the SG's methods and data for preparing the official forecasts of devolved taxes. It would not be difficult for the SFC to change the SG's "model" parameters and to prepare alternative fiscal forecasts. It would be more complicated, though not impossible, for the SFC to build an alternative "model" (or models) for forecasting the Scottish economy, devolved fiscal variables and, in the longer term, medium- or long-term fiscal scenarios or fiscal sustainability analyses.

To assess the official fiscal forecasts (for revenues, expenditure and borrowing) as well as for the macroeconomic projections underlying them, staff with strong analytical skills and prior forecasting experience would be needed for the SFC. It will take time to build up a strong forecasting capacity within the SFC.³¹ Such capacity is nonetheless urgently needed. It would be desirable to begin strengthening of the SFC's analytical and forecasting skills, by SFC staff recruitment, as soon as possible.

In the near future, as the SFC continues to focus especially on assessing the reasonableness of forecasts of devolved taxes, the SFC will need analytical in-house support to help it examine the sensitivity of baseline ("central case") forecasts to the underlying assumptions and parameters. Property-based taxes have a greater degree of uncertainty relative to more stable taxes such as those based on consumption or incomes that fluctuate less than property values during economic cycles. As part of its duties, the SFC would also comment on the risks inherent in the SG's forecasts.

The SFC also needs to be able to delegate to the SFC staff the task of examining errors in past SG fiscal forecasts. This involves decomposing forecast errors, to ascertain whether the errors are due to exogenous events (e.g., Scottish economy shocks or policy changes³²), inappropriate forecasting models and methods, or errors in judgment. Conducting post mortems of the sources of errors in previous forecasts is a task of any forecasting agency. The SFC also needs secretariat support to document the underlying assumptions and parameters of forecasting models, methods and data, so that the write-ups of the SFC's forecast assessments are fully transparent and, over time, engender widespread trust.

Recommendation 3 – Deciding on the SFC's role in forecasting

- A. Note that, in the SFC bill, it is appropriate for the statutory SFC to assess the SG's macroeconomic and fiscal forecasts and, if needed, publish alternative forecasts, rather than produce the official macroeconomic and fiscal forecasts.
- B. Consider whether it is necessary to require, in the SFC bill, a remit for the SFC to prepare alternative macroeconomic and fiscal forecasts to those of the SG.

³¹ Unlike say, Ireland for example, Scotland has a very limited number of forecasting bodies that could provide staff to the SFC. In Ireland, the IFAC secretariat staff have been seconded from the ESRI, the central bank, and government ministries; most staff had prior economic forecasting experience in their "parent" institution (see Annex 2).

³² When macro-fiscal forecasts are prepared with the intent of changing policies in order to obtain a different outcome (e.g., getting the fiscal programme back on track), the original forecasts will necessarily be "wrong". In this sense, baseline fiscal forecasts are often destined to be inaccurate.

- C. Note that in performing its assessment role, the SFC needs capacity to produce its own macroeconomic and fiscal forecasts, which is a labour intensive task. Begin recruiting SFC staff with macro-fiscal forecasting skills, to assist the SFC in their assessment-of-forecasts activities.
- D. Note that there are several tasks associated with assessment of forecasts, including examining the SG's perceptions of fiscal risks, as well as the errors in past forecasts. These will be integral tasks of the SFC Secretariat. Such tasks do not necessarily have to be spelt out in the SFC Act.

4. Considering a widening of the SFC's mandate

The Finance Committee of the Scottish Parliament has recommended that *there should be a legislative requirement for the SG to prepare a charter for budget responsibility* (see FC, 2015, paragraph 25). The FC also recommended that *Scotland's fiscal framework, while being consistent with the UK overall fiscal framework, should allow flexibility for the SG to pursue distinct fiscal policies*.

A Charter for Budget Responsibility is a document that could spell out Scottish Minister's responsibilities and commitments in the following areas: medium-term fiscal strategy; MTBF projections; fiscal risk assessments; fiscal rules, e.g., on borrowing and total (net) debt, fiscal sustainability and debt analyses; and fiscal data quality.

Medium-term budget framework projections and fiscal risks

In the SFC bill, the SFC does not have a mandate to assess the SG's medium-term fiscal strategy and fiscal framework. Although the SFC bill does not prevent the SFC from conducting its assessment functions for multi-year forecast periods, this could only be done if the SG were to change its current practice of not presenting a MTBF to the Scottish Parliament at the same time that it submits its annual draft budget.

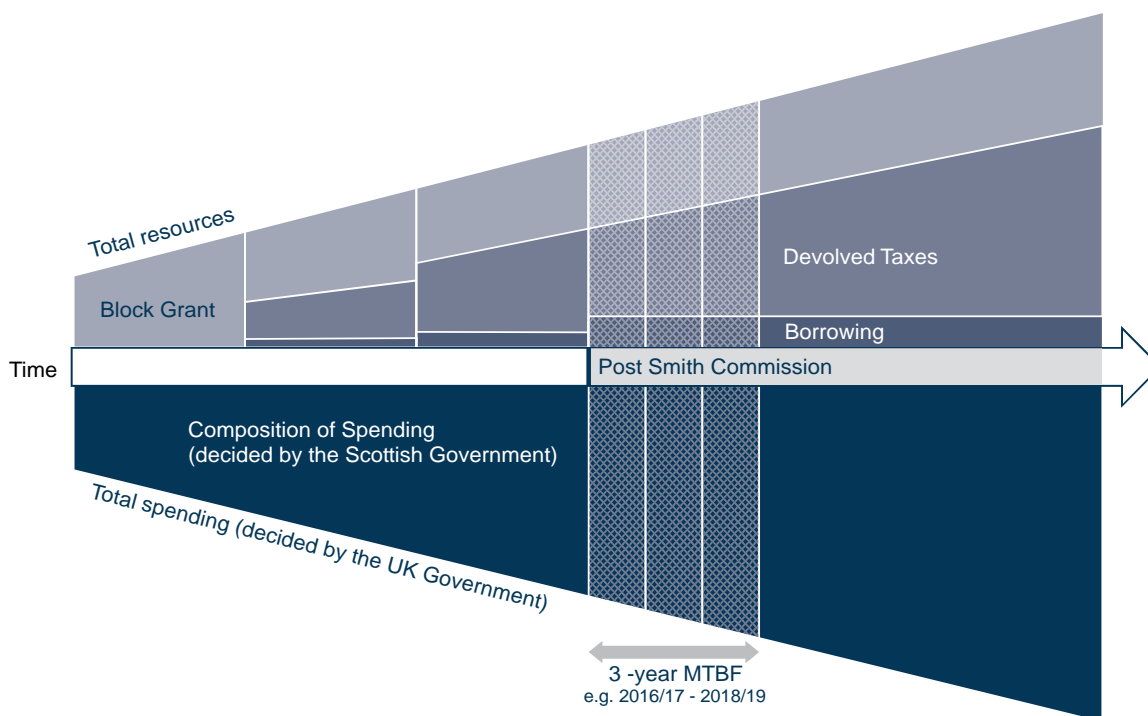
If the SFC's core mandate were to be clarified as proposed above, the SFC could, in the first instance, assess Scotland's MTBF. This would require the SG to regularly publish updated MTBF projections and their underlying assumptions (the key aggregates of the MTBF are largely determined in HM Treasury, at least those covering the years of each UK Spending Review period). For fiscal transparency, it would be useful for the SG to prepare and submit MTBF projections to the Scottish Parliament at the same time as it submits its draft annual budget bill. Such MTBFs are shown schematically in Figure 5.

If the SG were to prepare MTBF projections, the SFC could assess their realism and comment on key components, including the basis of the adjustments in the Barnett formula, which, along with borrowing, determine the total resources available for spending in Scotland.

In its assessment activities, the SFC could reiterate its messages concerning shortcomings in Scottish data. In its October 2014 report, the SFC urged the SG to take early steps to enhance the accessibility and quality of historical data. Similar messages were communicated by Audit Scotland (2015). When stressing the need for Scottish public sector data to be comprehensive, transparent, reliable and timely, Audit Scotland pointed to the absence of

reconciled data for the balance between funding and spending and the overall level of borrowing for the devolved Scottish public sector as a whole. In other words, there are discrepancies in the base-year data of the budget framework, shown conceptually in Figure 5. Over a medium-term forecast period, it is unknown whether these discrepancies are constant, increasing or decreasing. The SFC could play an important role in highlighting data discrepancies and the risks incurred in projecting data with underlying weaknesses.

Figure 5. Budget Resources and Spending in Scotland



It is also important for the SFC to assess the SG's perceptions of major risks in annual and medium-term macroeconomic and fiscal projections relevant to the Scottish public sector. This would include the fiscal risks of local authorities, corporate bodies owned by the SG, and Public Financing Initiatives (PFIs) that could impact adversely (or favorably) Scottish public finances. With an expanded mandate, the SFC could begin making assessments of the quality of SG fiscal risk analysis.

Fiscal rules, fiscal targets, medium-term fiscal strategy, and fiscal sustainability analyses

In its 2015 report on the fiscal framework, the Finance Committee (FC, 2015, paragraph 36) recommended that *Scotland's updated fiscal framework should include two fiscal rules: a balanced budget rule to govern the level of borrowing, and a limit on net debt*. To date, the SG has not formally adopted such fiscal rules. The Finance Committee also recommended that *the remit of the SFC should include judging the performance of the SG against its fiscal targets and assessing the long-term sustainability of public finances [in Scotland]* (see paragraphs 133 and 139, FC, 2015).

Presently, the SG has a golden rule – a balanced budget for current transactions, with a self-imposed constraint on borrowing for infrastructure projects.³³ Currently, there is no (net) debt rule, although the Finance Committee in 2015 also recommended that *the SG should agree on a debt rule with the UK Government, consistent with the UK fiscal framework*.

These recommendations would require the SG to adopt fiscal rules and to propose fiscal targets specific to Scotland for a medium-term period, broadly consistent with those of the UK's MTBF and its medium-term fiscal objectives (currently until 2019/20). The targets would be accompanied by an annual and medium term budget policy strategy -- a document that outlines the SG's tax and budget spending priorities consistent with its medium-term strategy, which would describe the MTBF and quantify the ongoing budgetary impact of the SG's economic and social programme outlined in SG (2015). This would enable the Scottish Parliament and the public to have a better idea of where Scotland's public finances, based on existing constitutional arrangements, are heading for the next few years ahead.³⁴

It would be difficult to implement the FC's fiscal sustainability recommendations in the absence of a regularly updated SG medium-term fiscal strategy document, which would be the basis for prolonging the projections even further, e.g., for periods of 20 to 50 years. Fiscal sustainability analyses focus especially on the dynamics of fiscal deficits and increases in public debt. At this stage, the SG does not prepare a long-term fiscal sustainability analysis. Such a debt analysis would use base-year data derived from the SG's annual public sector assets and liabilities, which are published and audited each year.

Should a Charter for Budget Responsibility be introduced now?

With the imminent adoption of the SFC Act, it is legitimate to ask: "Should the present SFC bill be not only the vehicle for placing the SFC on a statutory basis, but also the legal instrument for implementing the Finance Committee's recommendations relating to the wider fiscal framework?"

In some countries (e.g., Hungary, Ireland, Slovakia), the legislation relating to the wider fiscal framework, especially fiscal rules, was the same law that formally established the IFI. In fact, the IFI in those countries were established to complement the fiscal framework and fiscal rules. In contrast, in Scotland, the strategy has been reversed: first create the IFI, and later, prepare the wider fiscal framework – the MTBF and fiscal rules.

The pros and cons of extending the SFC bill to include key "fiscal framework" issues are:

- **Pros.** The window of opportunity is now. Without too much work, a few generally worded phrases relating to the wider fiscal framework could be inserted into the SFC bill. Details could be elaborated later, when the Charter for Budget Responsibility is drafted by the SG and presented to the Scottish Parliament. A Fiscal Responsibility Act (FRA) could be adopted in 2016/17 or beyond.

³³ The SG limits revenue commitments related to capital investment to a maximum of 5% of expected annual [Departmental Expenditure Limit] DEL budget. For details, see Hudson (2013).

³⁴ The medium-term budgetary projections would be based on total Scottish revenues and expenditures (and fiscal balance) on which the Scottish annual Budget Act is based and not on hypothetical revenues and expenditures ("GERS estimates") such as those published in SG (2014a).

- **Cons.** Considerable time is needed for further discussions on these issues, which are complex and controversial. Discussions are first needed within the SG, the Scottish Parliament and with other partners, especially those in the UK.

Improving intergovernmental relations

The Smith Commission (2014) emphasized the need to address weaknesses in intergovernmental relations (IGR) between the UK and Scotland, Wales and N. Ireland. Also, FC (2015) paragraph 145 identified two important difficulties in IGR on fiscal issues: (1) most bilateral relations between the national and devolved governments take place on an ad hoc basis, which leads to a lack of transparency and accountability; and (2) there are questions about the purpose of the formal institutions that do exist. The UK is not like Belgium and Germany, which have formal institutions for IGR on fiscal matters that regularly meet and lay the basis for fiscal targets at national (federal) and subnational (regional) levels. In the UK, there are no formal mechanisms for allocating the UK Government's year-by-year fiscal targets until 2019/2020 for the fiscal balance and net debt between the UK, Scotland, Wales, N. Ireland (and, possibly, England). These institutional weaknesses in IGR need to be addressed; otherwise the SG will continue to be thwarted in preparing a MTBF that is fully coherent with medium-term fiscal objectives for the UK (as a whole) and its devolved entities.

Given the institutional weaknesses in IGR within the UK, it may be preferable to resolve them as a prerequisite to expanding the SFC's mandate to include the wider fiscal framework assessments. Once the pre-requisites are met, the SFC's core mandate could be re-oriented towards that of assessing the SG's ex ante fiscal stance and the attaining of SG fiscal targets and/or fiscal rules, which are as yet not well defined. If, during the current legislature, the "fiscal framework" issues were to be combined with "SFC issues" in one bill, there could be a strong risk that the SFC Act would not be adopted prior to the May 2016 elections.³⁵

For these reasons, it may not be suitable to advance, at this stage, with the preparation of a wider "fiscal framework +SFC" bill (a Scottish Fiscal Responsibility Act). However, the choice of adopting a FRA is a political one. While risky, it would not be impossible to adopt a FRA during the current legislative session. It depends partly on whether a consensus could be reached on the need to prepare a FRA that would include the obligation for the SG to prepare a Charter for Budget Responsibility. If the SFC bill were to be substantially amended to include fiscal framework issues, the draft law would also need to re-write the section on the core mandate for the SFC.

Recommendation 4: Considering a widening of the SFC's mandate

- A. Urge the Scottish Government to prepare: (1) a medium-term fiscal strategy document that would include a quantified MTBF, which would be submitted to the Scottish Parliament as part of annual budget documentation; and (2) a comprehensive analysis of medium-term fiscal risks, including those from PFIs.

³⁵ In Ireland, discussions on the draft Fiscal Responsibility Act in 2012 (which included with Ireland's creditors, the IMF/EU/ECB troika) were prolonged mainly because it took time to resolve differences of view on the "fiscal rules" section of the Act. In contrast, it was easier to reach agreement on the "fiscal council" sections of the Act.

- B. Reiterate the previous Finance Committee recommendations for the adoption by the Scottish Government of two fiscal rules: a balanced budget rule to govern the level of borrowing, and a limit on net debt.
- C. Note that the Scottish Government may not yet be in a position to prepare its own fiscal sustainability analyses, which, in the longer-term, the SFC could assess.
- D. Urge the SG to do all that it can, within its powers, to improve the functioning of intergovernmental relations, especially with a view to putting in place mechanisms for deciding on Scotland's fiscal framework broadly consistent with that of the UK.
- E. Consider whether it is appropriate to revamp substantially the SFC bill, by adding provisions on the wider fiscal framework (MTBF, fiscal targets, etc.), for which the SFC would have an assessment role.
- F. Assess the risks of delaying the adoption of the SFC Act, should a broader Scottish Fiscal Responsibility Bill be proposed during the current legislative session.

5. Ensuring SFC independence prior to publication of its main assessment report

In line with OECD Principle 3.3, the SFC bill establishes a clear link with the Scottish annual budget cycle. In particular, the bill requires the SFC *to lay its report prepared under section 2(1) before the Scottish Parliament on the same day as that on which the Scottish Ministers lay before the Parliament the draft Scottish budget* (section 4 (1)). For its other reports, the SFC is free to decide the timing of submission, provided the report is *before the Scottish Parliament as soon as reasonably practicable after the report is prepared* (sub-section 4 (2)). These provisions would not prevent the SFC from combining, in a single report, its obligatory and non-obligatory assessments of fiscal forecasts.

The “same day reporting” requirement could undermine the SFC’s independence. The requirement would require the SFC and the SG to hold bilateral discussions prior to “budget day”. Most likely, the SG would share confidential budget information with the SFC, including its revenue and borrowing forecasts, possibly prior to their finalization. The SG Policy Memorandum (2015), paragraph 16 appears to indicate that it is desirable for the SFC to *exert significant influence over the forecasts that underpin the Scottish Draft Budget*. This report takes the opposite view: it is undesirable, as it could change the SFC from being an “independent assessor” of the SG’s forecasts to being a part-time advisor to the SG for its own budget forecasts prior to “budget day”.

In a certain sense the SFC will always have a “forecast advisor” role, since its assessment reports provide an independent view on how the SG’s forecasting techniques could be improved. This was certainly the case for the SFC’s first assessment report, published in October 2014, and the discussions prior to it, during which time the SFC sought to understand the SG’s “models” for forecasting devolved taxes. The STC’s report highlighted the data deficiencies, which limits the rigour and solidity of the SG’s forecasts.³⁶ However, this initial “advisory” role is likely to diminish from now on, since the SFC now understands how the SG makes its forecasts. In the future, to assess the SG’s forecasts, the SFC may

³⁶ In particular, there is a lack of Scotland-specific time-series data for a number of variables needed for the tax revenue forecasts. This thwarts the SG in making its fiscal forecasts.

develop its own “models”, to provide benchmark forecasts for ascertaining whether the SG’s forecasts are plausible (or “reasonable”) or not.

Thus the SFC should step back from being closely involved with the SG when the SG is preparing the official fiscal forecasts. During a given budget round, the SFC would develop its own fiscal forecasts independently of the SG. For the SFC, to maintain its distance from the SG during its preparation budget forecasts, it may be preferable to assess the SG’s forecasts only once they are submitted to the Scottish Parliament.

The SFC bill could therefore require the SFC’s assessment report to be submitted to the Scottish Parliament “as soon as practicable” after budget day. To be relevant, the SFC’s assessment report(s) should be submitted to the Scottish Parliament and published rapidly after “budget day” (publication is, appropriately, an obligatory requirement, under subsection 4 (5)).

Sub-section 4 (3) of the SFC bill requires the SFC to send a copy of its draft report to Scottish Ministers prior to presenting the same report to the Scottish Parliament. This would open the door for the SG making substantive changes in the content of the SFC’s report, thereby undermining the SFC’s independence. To enhance the SFC’s independence, it is desirable to eliminate sub-section 4 (3) from the SFC bill.

If the SFC judged that SG comments for factual checking of its assessment reports are needed, the MoU could specify the timing of providing its draft report to the SG and receiving non-substantive comments from the SG. However, the SFC’s assessments of the SG’s forecasts must be those of the SFC alone.

To reduce further the risk of SG interference in the SFC assessment work, eight safeguards are desirable:

- (1) A Memorandum of Understanding (MoU) that specifies the forecast-related information and data to be shared between the SFC and the SG on predetermined dates (working backwards and forwards from “budget day”). MoUs are typically drawn up voluntarily between the IFI and other bodies.
- (2) For transparency, the MoU should be published.
- (3) Formal contact would take place at discrete times, including possibly before budget day (the SG’s forecasts are finalized before the Cabinet Secretary for Finance presents the draft annual budget bill to the Scottish Parliament).
- (4) The SFC should avoid frequent contact with the SG in carrying out its mandate.
- (5) The SFC should prepare its own fiscal forecasts independently, prior to sharing them with the SG. The SFC’s benchmark forecasts could influence those of the SG in the subsequent budget round.
- (6) The MoU could be supplemented, when needed, by formal letters indicating precisely when additional SFC/SG meetings are to take place, the agenda for the meeting, etc. For transparency, important letters and Minutes should be published on the SFC’s website.
- (7) The SFC should nurture relationships with any other institutions in Scotland or in the UK that provide views helpful for the SFC’s forecast assessment activities.

- (8) The SFC should develop good relationships with the media, which helps to establish the SFC's independence from the SG and improve its visibility.

These detailed safeguards do not need to be included in the SFC Act. The focus of attention should be on whether the SG's forecasts are reasonable, not on any differences in forecasts unless substantial. In this context, the SFC bill could require the SFC to highlight the reasons why it finds the SG's to be reasonable or otherwise.

The UK and Irish cases illustrate that the independence of the SFC would not be under threat if the above conditions were met. In the UK, the OBR's independence has not been undermined by the HM Treasury's sharing of confidential pre-budget information with the OBR. Such information is needed, inter alia, by the OBR for its role in certifying UK government policy costings. Similarly, in Ireland, the IFAC's independence has not been undermined by the sharing of IFAC's benchmark macroeconomic forecasts (which are prepared independently, using in-house models) with those of the Department of Finance during the course of IFAC's endorsement of the Irish Government's macroeconomic forecasts. In both cases, a MoU governs how the information sharing is to take place. In both cases, the IFIs are free to disagree with the Government's own forecasts.³⁷

Since forecast uncertainty and the margin for error in both macroeconomic and fiscal forecasts can be substantial – especially for medium-term forecasts – IFIs prefer to focus on their core “assessment” mandates rather than emphasize small technical differences in forecasts, e.g., differences in view on some components of GDP or of specific tax elasticities. In Scotland, it is possible that the SG and the SFC may have such minor differences in view.

To maintain its independence, the SFC needs to be free to disagree with any aspects of the SG's fiscal forecasts. Should there be substantive differences of view between the SG and the SFC regarding either the macroeconomic or the fiscal forecasts, it is important that the Scottish Parliament and the public are informed in the SFC's reports.

Recommendation 5 - Ensuring SFC independence prior to publication of its main assessment report

- A. Change sub-section 4 (1) of the SFC so that, instead of the SFC laying its report before the Scottish Parliament “*on the same day as that*” on which the SG lays its draft budget before Parliament, to read “*as soon as practicable after the day...*”.
- B. Require, in the SFC bill, the SFC to highlight the reasons why it finds the SG's forecasts to be reasonable or otherwise.
- C. Eliminate sub-sections 4 (3) and 6 (2) from the SFC bill. The SFC's independence could be undermined if it were to be required to submit a copy of its report to the Scottish Government prior to the report's submission to the Scottish Parliament.
- D. Encourage the SFC and the SG to draw up, as a matter of urgency, a MoU relating to the SFC's forecast assessment functions, and to publish the MoU on the SG and SFC websites.
- E. Note that a MoU requirement does not need to be included in the SFC Act.

³⁷ In the UK, HM Treasury continues to make its own forecasts in-house, using its own models, especially for alternative policy scenarios (which the OBR is not permitted to make).

6. Enhancing specific aspects of the SFC's operational independence

The SG wishes to establish a SFC that “is independent of the Scottish Ministers and that it is seen to be so” (SG, Explanatory Note, 2015, paragraph 14). Following the SG Consultation, in which many participants highlighted the need for the SFC to be independent, the SG modified its March 2015 early draft of the SFC bill so as to strengthen the statutory SFC's independence. A notable example was the removal of an earlier provision that would have *required the SFC to prepare a report on fiscal matters as the Scottish Ministers may specify*. This would have been inconsistent with section 6 of the SFC bill concerning its independence.

The Scottish Parliament and its committees, via its law amending powers, should play the key role whenever the mandate of the SFC is to be modified substantively. In this context, the SFC bill (section 5) allows the SFC's mandate to be modified by Scottish Ministers by using secondary legislation, notably a Scottish Statutory Instrument (SSI). It could be argued that the SFC's independence would be undermined should the SG “dictate” an expansion of the SFC's obligatory functions. However, the use of the SSI (affirmative procedure) provides the Scottish Parliament with the right to veto any specific expansion of the SFC's mandate. Also, Section 5 of the SFC bill places strong restrictions on the use of SSIs. In particular, a SSI could not be used to amend the SFC's main functions. SSIs would only be used for modifying SFC obligatory assessments of specific taxes, particularly those to be devolved in the Scotland Act 2015, as well as in other future decisions.

Another area of SFC independence concerns the discretion that the SFC has to undertake work on its own initiative. The SFC will be free to prepare reports pertaining to its core function and it is *not subject to the direction or control of any member of the Scottish Government*. Section 6 is consistent with OECD principle 3.2. The SFC's independence (as specified in sub-section 6 (1)) could be strengthened further, by indicating that the SFC is not only independent of Scottish Ministers but it is also *not under the direction or control of the Scottish Parliament and any other Scottish body*.

The SFC's independence would also be enhanced if sub-section 6 (2) (“*This section is subject to any contrary provision in this or any other enactment*”) were to be removed from the SFC bill. It would be preferable for section 6 of the SFC bill – on SFC independence – to be unqualified.

In this context, section 23 concerns “General Powers” of the SFC, which are primarily related to the SFC's independence. In particular, the SFC can “*do anything it considers expedient for the performance of its functions*”. Section 23 would, for example, allow the SFC to draw up MoUs, not only with the SG, but also all relevant actors in Scotland and the UK. It may be preferable to combine section 23 with sub-section 6 (1), i.e., section 23 could be inserted in place of sub-section 6 (2).

To strengthen further the SFC bill's provisions relating to the SFC's independence, it may be helpful to add a clause (perhaps in section 6) that indicates that *the SFC must perform its duties objectively, transparently and impartially*. SG Policy Memorandum (2015) explains that section 23 of the SFC bill would, inter alia, allow the SFC to prepare and publish technical working papers related to its statutory functions. If this is what is in mind – and it is a good practice – it could be inserted as a new “liberty” of the SFC at the end of section 4 (on SFC reporting requirements).

Finally, Section 26 on Ancillary Powers confers wide-ranging powers on Scottish Ministers to make “incidental” regulations. SG Delegated Powers Memorandum (2015) indicates “*the reason for taking the power is to enable the Scottish Ministers to institute the Commission and address any unforeseen situations as soon as it is practical for them to bring forward regulations. Whilst the power is wide-ranging it is vital that the Scottish Fiscal Commission interacts well with Scots law and the changing fiscal landscape in Scotland.*”

The provision of such wide-ranging regulation-making powers to the SG appears to contravene the widespread political acceptance that the SFC must be independent and seen to be independent. First, section 27 (2) of the SFC bill provides an adequate basis for Scottish Ministers to issue regulations allow the statutory SFC to formally begin its operations. Second, the SFC can be expected to interact well with Scots law, especially fulfilling its obligations under the SFC Act. Third, regarding *the changing fiscal landscape in Scotland*, section 5 already confers on Scottish Ministers the power to initiate incremental changes in the SFC’s mandate by SSI. Should the changes in the fiscal landscape in Scotland be substantial, the Scottish Parliament should be the key actor for making final decisions on major changes. In conclusion, it would be desirable to remove section 26 from the SFC bill.

Recommendation 6 - Enhancing specific aspects of the SFC’s operational independence

- A. Note that section 5 of the SFC bill provides restricted powers to Scottish Ministers to modify the SFC’s mandate regarding assessments of specific devolved tax forecasts. Since the Scottish Parliament has veto rights over SSIs, these provisions of the SFC bill do not undermine the SFC’s independence.
- B. Strengthen sub-section 6 (1) to indicate that the SFC is not only independent of Scottish Government but also is not under the direction or control of the Scottish Parliament and any other Scottish body
- C. Consider adding the following clause to the SFC bill (in section 6): *The SFC must perform its forecast assessment duties objectively, transparently and impartially.*
- D. Consider integrating Section 23 of the SFC bill into Section 6, while strengthening the latter as follows: *The SFC acts independently while performing the functions assigned to it through these statutes, and it is not subject to the direction or control of the Scottish Government, the Scottish Parliament and any other public or private entity.* Consider eliminating sub-section 6 (2).
- E. Consider expanding section 4 to indicate that the SFC may, on its own initiative, publish any research and other papers related to its statutory functions.
- F. Eliminate section 26 on “Ancillary Provisions” which confers wide-ranging powers on Scottish Ministers to regulate the SFC activities and thereby undermine the SFC’s independence.

Other aspects of the SFC’s independence – concerning its access to information and its management independence (governance) -- are discussed in the next two sections.

7. Obtaining access to information

OECD Principle 6.2 states *that any restrictions on access to government information should also be clearly defined in legislation. Appropriate safeguards may be put in place as regards protection of privacy (for example, taxpayer confidentiality) and of sensitive information in the areas of national defence and security.* While sub-section 7 (3) provides an adequate basis for respecting this principle, it is succinct.

SG Explanatory Note (2015) cites two examples of Scottish Acts that could restrict SFC access to data: notably the Data Protection Act 1998 or the Revenue Scotland and Tax Powers Act 2014. It may be useful to expand sub-section 7 (3) to elaborate on the main justifiable grounds for restricting SFC access to data (e.g., non-access to tax information of individual taxpayers).

The SFC's independence would also be undermined if the Scottish Government or the UK Government refused to provide essential fiscal information in a timely manner. In this regard, the use of the words "at reasonable times" (twice) and "reasonably" (twice) in section 7 (1) of the draft SFC bill risks giving the Scottish Government too much discretion on deciding what information to provide and when to provide it. It may be preferable to be unequivocal and remove the words "reasonable" or "reasonably", so as to provide the SFC ready access.

Of course, the SG cannot instantaneously provide any information that the SFC may require. In this context, it would be helpful to introduce a sub-section in the SFC bill that requires the SFC to indicate the set of information to which it requires regular and automatic access, in accordance with a pre-defined calendar. Details for such a provision in the SFC bill would be spelt out in the MoU to be signed with the SG. The SFC could include provisions on access to the SG's macroeconomic and fiscal forecasting models and their underlying assumptions. Such a provision is included in Portugal's "fiscal council" law – see Annex 6. The Portuguese law also includes two subsections that sanction any public body that does not provide access to required fiscal data and information in a timely manner. Relevant parts of the "access to information" section of Portugal's law could, after appropriate modification, be used for amending the SFC bill.

To fulfil its mandate, the SFC needs information not only from the Scottish Government and the Scottish bodies listed in section 7 (2), but also direct access to Scotland-specific information held by UK bodies, notably HM Treasury and the OBR (for economic and fiscal data, including projections), HMRC (Scottish tax data), DWP (welfare spending in Scotland) and, possibly, NHS. Ideally, these bodies should also be listed in the SFC bill.

For its independence, the SFC should be authorized by law to contact directly such bodies, and to draw up Memoranda of Understandings (MoU) with them, which, inter alia, would specify which information and data is regularly needed and the maximum time delay for its provision. In the SFC bill, the SFC should be provided with open-ended access to public bodies that hold data and information needed to fulfil its mandate, without being obliged to request Scottish Ministers to draw up a SSI to place another public body on the SG-controlled list, as is required by subsections 7 (2) (e) and 7 (4) of the SFC bill.

If, for constitutional and/or legal reasons, it is not possible for the SFC to have direct access to UK public bodies, then Scottish Ministers should be encouraged to urge the UK to provide a legal basis for the SFC to access essential information held by UK agencies. In view of further and imminent tax devolution to Scotland, direct access appears to be particularly urgent, given that some Scottish taxpayer (aggregate) data is held by HMRC. Indirect access, in which the SFC would request the Scottish Government to obtain the data from UK agencies, would be an unsatisfactory second-best alternative and could thwart the effectiveness of the SFC's assessment work.

Recommendation 7 -- Obtaining access to information.

- A. Consider expanding sub-section 7 (3) with a view to elaborating on the main justifiable grounds for restricting SFC access to data (e.g., confidentiality of taxpayer information).
- B. Consider eliminating the words "at reasonable times" and "reasonably" in section 7 (1) (on "Access to Information") of the SFC bill, and replace them with a sub-section such as: *"the SFC shall indicate the set of information to which it requires regular and automatic access, in accordance with a pre-defined calendar"*.
- C. Consider strengthening the SFC bill's "access to information" provisions further by adding sub-sections that sanctions public bodies that do not provide to the SFC essential information in a timely manner (consider Portugal's "fiscal council" law as a model – see Annex 6).
- D. Ensure, by legislation, that the SFC has direct access to Scotland-specific fiscal data and information that is held by UK bodies such as HM Treasury, the OBR, HMRC and DWP. Draw up MoUs between the SFC with each Scottish and UK body that holds Scotland-specific data and information needed by the SFC to fulfil its mandate.
- E. Eliminate the final phrase of subsection 7 (2) (e) as well as sub-section 7 (4) of the SFC bill, which requires the SFC "to plead its case" before the SG in order to obtain access to data necessary for its mandate. Replace subsection 7 2 (e) by a clause that provides the SFC with direct access to data and information held by public bodies in the UK.
- F. (In the case where Recommendations D and E cannot be implemented, for constitutional reasons). Urge the SG to initiate draft legislation in the UK parliament that would provide the SFC with direct access to Scottish data held by UK agencies.

8. Reducing Scottish Government influence on SFC governance arrangements

The Scottish Ministers play a predominate role in the SFC bill's governance arrangements for the SFC, notably for: (1) the appointment of SFC members (sub-sections 11 (2, 3)); (2) the number of Commissioners (sub-sections 11 (4, 5); (3) disqualification of members (section 12); (4) the terms of appointment (section 13); and (5) the removal of SFC members (section 16). The Scottish Parliament is involved only in some of these aspects, notably the appointment of SFC members and their possible removal (section 16).

There are other options for SFC governance arrangements that would enhance the independence of the SFC's members and staff. At present, other Scottish bodies that are objective and nonpartisan do not play any role in these matters.

Internationally, apart from countries like Belgium, Ireland, Netherlands, and the UK, where the Government also plays the predominant role in proposing/appointing IFI leadership and members, there are a variety of arrangements elsewhere. Examples are:

- The external audit office plays a role in proposing and appointing the leadership or members of the IFIs of France, Finland and Portugal. In France, the President of the Court of Accounts (CoA) is automatically the President of the High Council of Public Finance (HCPF), with 10 other members. The CoA President appoints 4 members from the CoA. Parliament appoints 4 members. The Economic, Social and Environmental Council nominates 1 member, and the Director of the National Statistics office is automatically a HCPF member.
- The Central Bank plays an important role in proposing /appointing the chair of the councils of Estonia and Portugal. In Estonia, the central bank Governor proposes candidates, which are appointed by the central bank Supervisory Board (Board of Governors). In Portugal, the Governor of the Central Bank and the Auditor-General are, in effect, a 2-person panel for nominating candidates to the 5-person Fiscal Policy Council, with formal appointment by the Government.
- Employer and Employee Organizations in Austria play an equally weighted role to that of the Government in proposing new council members.
- A selection review committee is set up in Canada, to propose a short list of three candidates for the PBO chair,
- Parliament plays the predominant role in appointing the directors of most PBOs, e.g., Australia, Italy, Korea, United States (both the federal CBO and State LBOs). In Slovakia, the chair of the 3-person Council for Budget Responsibility is elected by a vote of 3/5ths in the National Council (Parliament); Parliament also elects (by simple majority) the other two members, one of whom is proposed by the Central Bank and the other by the Government.

By lessening the voice of the Government in decision making for IFI governance, these arrangements help ensure that the chosen candidates for IFI membership are nonpartisan, the most competent, and the best suited for leading an independent IFI.

Several countries' IFI legislation also list the key qualifications needed for IFI leadership and/or membership.

In view of the above international practices, the following paragraphs discuss alternative arrangements for SFC governance and makes suggestions in five areas.

1. The appointment of SFC members

The SFC bill proposes that *Scottish Ministers may appoint a person as a member [of the SFC] only if the Scottish Parliament has approved the appointment*. This wording provides Parliament (via its committees) with a veto right over SFC member appointments. The SFC bill, like most other IFI laws, is silent on the various procedural steps involved:

- Pre-selection of potential candidates;
- Short-list of candidates;

- Review of short-list;
- Proposal of a candidate; and
- Formal appointment.

In Scotland, without a central bank, but with an external audit office and other reputable organizations, there are various possibilities for involving non-Government and non-Parliament institutions in appointing the Chair and members of the SFC.

Amongst the various options, one possibility would be to form a small SFC member selection panel that would propose a short list of three candidates to a relevant committee of the Scottish Parliament (on which government and opposition members are representatives). The parliamentary committee would narrow the choice down to one person, after which the Scottish Government and/or the Scottish Parliament would formally appoint the SFC Chair and Commissioners.

A two- or three-person selection panel could be composed, for example, of the SFC chair, 1 representative from Audit Scotland, along with a representative from a reputable and independent organization that responded to the Scottish Government's 2015 Consultation. After review, the Finance Committee of Parliament could choose one candidate, after which there would be a review by the Commissioner for Ethical Standards in Public Life in Scotland, prior to formal appointment by the Scottish Government or the Scottish Parliament. This ordering could be reversed.³⁸ If this procedure (or something similar) were to be agreed, then section 13 (2) ("*Scottish Ministers may determine other terms of appointment, so far as not provided in this Act*") could be eliminated.

Some small European countries appoint foreigners to the IFI, e.g., Ireland, Portugal, Slovenia and Sweden. Portugal's IFI legislation requires two non-Portuguese EU citizens to be on the five-person Council. This enhances the independence of the IFI in a small country, where the pool of eligible candidates for the IFI is not large. This possibility could be explicitly included in the SFC bill.

The SFC bill does not include provisions on the qualifications of SFC members (but has a long article on disqualification). Ireland's Fiscal Responsibility Law, for example, includes the following qualification requirements:

- *Having competence and experience in domestic or international macroeconomic or fiscal matters*
- *To the extent possible, an appropriate balance between men and women.*

The first bullet point above allowed Ireland to appoint three of its initial Council members who were living outside Ireland including one non-Irish national. Similar provisions could be included in the SFC bill, especially if it were to recruit SFC members from abroad.

Concerning qualifications for membership, Sweden's Ordinance that established its IFI requires the Swedish Fiscal Council to present proposals for council membership that

³⁸ In her submission to the 2015 SFC Consultation, the Auditor General of Scotland observed: "*it may increase the appearance of independence further if the members of the Commission were appointed by Parliament with the agreement of Ministers*".

balance scholarly expertise in economics with practical experience in economic policy making, and it should strive for a gender balance.

2. The number of SFC Members

The present SFC is composed of a chair and two members. The SFC bill establishes the number of SFC members to be 2 to 4. With its present responsibilities, a three-person SFC appears adequate.

Should the SFC's mandate expand, five Commissioners may be required, two of which could be non-executive (see below). However, at this stage, the need for SFC staff is more pressing. Based on international experience on the number of members of stand-alone fiscal councils in small countries, there does not appear to be a need to increase the size of SFC members to beyond five.

It is recognized that some of recently created fiscal councils in Europe are “council heavy” and “staff thin”. However, these fiscal councils were created principally to fulfil the obligations of EU Regulation 473/2013, relating to assessing compliance with EU fiscal rules. In establishing these councils it was judged necessary to have more than 5 council members (even up to 15³⁹) primarily because many members are needed for these councils to reach a consensus opinion on fiscal stance and even fiscal policies, rather than merely assessing the fiscal forecasts of the Government.

Some small countries, e.g., New Zealand, have not established a fiscal council at all, even though they have considered it. In a recent External Review of the NZ Treasury Policy Advice, an international consultant considered the usefulness of a fiscal council in New Zealand. Should a Council be established, Ter-Minassian (2014) recommended “a small number of well-respected national, and possibly international, figures, with substantial fiscal expertise, previous policy experience, and strong communication skills”.

In view of these considerations on the number of fiscal council members, there does not appear to be a need for Scottish Ministers to be authorized in the SFC Act to increase, by SSI, the number of SFC members to more than five.

In the case of the OBR and Portugal's Fiscal Policy Council, the five members are divided between three Executive members and two non-executive members, who act in an advisory capacity (see OBR note – Annex 3). The present non-executive members of the OBR are not remunerated. Consideration could be given in the SFC bill to establishing two non-executive SFC members who would provide oversight the SFC's three executive members

3. Disqualification of members

Appropriately, the SFC bill excludes the appointment to the SFC of sitting politicians – those in the Scottish, UK and European parliaments. Office-holders are also excluded, which is appropriate if they are political appointees.

³⁹ Examples of the number of fiscal council members for IFI created since 2012 are: Austria (15), Estonia (6), France (10, plus the Chair), Germany (9), Latvia (6), and Luxembourg (7).

In the SFC bill, civil servants would also be excluded from SFC membership (sub-sections 12 (1) (a) (xii)) as well as. This exclusion is questionable. In Westminster-tradition countries civil servants often provide apolitical advice to the Government of the day. Also, in Sweden, for example, one member of Sweden's Fiscal Policy Council, who is the chair of another government agency, previously been the Budget Director in the Ministry of Finance.

The exclusion of civil servants appears to be total. Would retired civil servants also be ineligible for SFC membership? Would non-Scottish civil servants, even active (but near-retirement), also be excluded? This exclusion could perhaps be eliminated from the SFC bill. The decision of SFC membership of any potential candidates who are civil servants, or have been civil servants, could be made during the selection and appointment process, as discussed above.

Should former MPs or political appointees be excluded from SFC membership? The statutes for Portugal's fiscal policy council, for example, exclude those who have been active in politics in the preceding two years, after which they become eligible for membership. The principle of a "cooling off" period from an active life in politics, prior to potential IFI membership, is sound. It could be incorporated into the SFC bill.

4. Term length(s) for SFC members

OECD principle 2.3 recommends that term lengths and the number of terms for the leadership of the IFI be specified in legislation, with the term length being delinked from electoral cycles. Section 13 of the SFC bill is inconsistent with this principle, as term lengths are not specified. Rather, the term length is left to the discretion of Scottish Ministers. This could result in SFC membership terms being linked with the parliamentary electoral cycle. Separately, under section 12 (3), Scottish Ministers are authorized to not reappoint a person who is or has been a member.

There are no international norms on term lengths and the renewal of terms of IFI members. However, given that the normal parliamentary electoral cycle in Scotland is now 5 years, two 4-year terms may be appropriate. This option is perhaps preferable to a once-only longer term, e.g., 6-7 years. Concerning reappointments, several countries allow IFI leaders to be appointed for a second term.⁴⁰

Whatever the fixed term limit, it would be useful to continue to stagger the starting/ending dates of SFC members, as is done presently, so as to avoid a bunching of the departures of Commissioners and a disruption to SFC work. Section 24 of the SFC bill appears to be consistent with such staggering (assuming that there are no voluntary resignations by SFC members which is permitted in section 15 of the SFC bill).

5. Removal of SFC members

Section 16 of the SFC bill authorizes Scottish Ministers to remove SFC members for three reasons, subject to the approval of the Scottish Parliament. It would be useful in the SFC Act to spell out the conditions under which Scottish Ministers could consider a member to be

⁴⁰ As discussed in Annex 4 on USA states, there are no term limits for the heads of the LBOs. However, LBOs serve the Legislature and are not directly comparable to the SFC, which is being created as a stand-alone independent Commission, neither under the Government nor the Parliament.

“otherwise unfit to continue to be a member”, otherwise section 16 (1) (b) (i) could be open to abuse (e.g., when a Scottish Government has a majority in the Scottish Parliament).

Reasons for being “otherwise unfit” include:

- Incapable because of ill health, physical or mental.
- Significant conflict of interest.
- Misbehaviour, criminal or non-criminal, as ascertained by judicial authorities.

Should there ever be a removal on these grounds, under section 16 (2), the Finance Committee of Parliament, which has cross-party representation, would be consulted. Although this may be implicit in the phrase “subject to approval of the Scottish Parliament”, it may be useful to make this explicit in the SFC Act.

Recommendation 8 - Establishing transparent governance arrangements.

- A. Consider inserting in the SFC bill a requirement for establishing a SFC member selection panel composed of independent actors such as Audit Scotland, the SFC Chair, and a representative from a non-partisan organization. The selection panel would establish a short-list of candidates prior to following appointment procedures involving both the Scottish Parliament and the Scottish Government.
- B. Consider adding to the SFC bill (e.g., using either the Irish or Portuguese IFI examples) that would allow the appointment of SFC members who do not reside in Scotland and who are not necessarily UK citizens.
- C. Consider adding to the SFC bill a clause on the qualifications needed for SFC membership, as well as for gender balance.
- D. Note that a maximum of five Commissioners is likely to be adequate for the SFC, even if the SFC’s mandate is expanded.
- E. In view of point D, consider removing sub-sections 11 (4) and (5) from the SFC bill.
- F. Consider adding to the SFC bill provisions for two non-executive SFC members.
- G. Reconsider whether active civil servants who have not been involved in politics could, under certain conditions (especially those approaching retirement age or are non-Scottish civil servants), be eligible to be SFC members. Decide whether sub-section 12 (1) (a) (xii) should be eliminated.
- H. Consider specifying a limited time period (e.g., 2-4 years) for which former politicians are ineligible for appointment to the SFC.
- I. Replace section 13 (1) and 12 (3) of the SFC bill with an unequivocal position on term length for SFC members, for example 4 years, with a once-only renewal of the 4-year term (alternatively, a once-only longer term of 6-7 years).
- J. Elaborate on the SFC bill’s provisions for removing an “unfit member of the SFC”, notably by adding (at least): (a) incapable because of ill health; (b) significant conflict of interest; and (c) committed state misbehavior.
- K. Consider adding to section 16 (2) of the SFC bill an explicit requirement to involve the Finance Committee of the Scottish Parliament should there ever be a proposal by Scottish Ministers to remove a SFC member.

9. Providing the SFC with adequate resources

The SFC's future budgets will be composed of expenses for: (1) SFC members (mainly fees); (2) SFC staff salaries; and (3) expenses for materials and services, including for building rental, administrative services, travel, etc.

1. *SFC members*

As discussed above, the present three-person Commission has allowed the SFC to fulfil its remit. Two more members (non-executive) could complete the number of SFC members.

For budget purposes, the question arises as to whether the members of the statutory SFC should be full-time or part-time. In this regard, OECD principle 2.4 recommends that the head (chairperson) of an IFI should preferably be a remunerated and full-time position. Once the SFC begins recruiting staff for its Secretariat (see below), the SFC chair will need to be present relatively frequently, to provide oversight and direction for the work of the SFC staff. The chair of the SFC also has an important public relations role, to promote the SFC's interests and work. In this context, the Chair needs to interact with the Government, the Parliament, the media and civil society organizations, since the SFC chair is the key person for giving the SFC visibility and credibility in Scotland, the UK, and international forums. The time needed to accomplish such tasks could be substantial. If the SFC chairperson position is not full-time, it should probably be at least 50% full-time equivalent (FTE).

There are no OECD guidelines for the remuneration of non-Chair IFI members. Four "fiscal council" IFIs that are comparable to the SFC (Ireland, Portugal, Slovenia and Sweden) have various practices, including: (1) reimbursement of employers of IFI members for time spent on IFI work, notably universities – Ireland (for some IFAC members); (2) flat rate fees per month – Sweden; (3) fees for travel / attendance (Slovenia, where council members are not otherwise remunerated) or time spent on IFI work (some IFAC members); and (4) Portugal – where all members of the Executive Committee are full-time, with remuneration determined by a special remuneration committee.

Section 17 of the SFC bill establishes the principle that the Commission may pay its members either remuneration or expenses for work performing SFC functions, subject to the approval of Scottish Ministers. In the Financial Memorandum accompanying the SFC bill, it is assumed that the statutory SFC will be remunerated in line with Public Sector Pay Policy for Senior Appointments. This is one option.

Another option for setting the daily fee of the SFC members (and, possibly, a salary for the Chair, if it were to become full-time) would be to involve an independent panel for determining the remuneration and/or fees for expenses incurred by SFC members. For example, the "SFC remuneration" panel could be the same panel as that proposed above in relation to appointments of SFC members. A third option would be to have the Finance Committee of Parliament vet remuneration / fee packages for SFC members, following propositions from Scottish Ministers for the remuneration/fees of SFC members.

2. *SFC staff*

By September 2015, the SFC had recruited a secretary, but had not yet recruited a Chief of Staff, an obligatory position in the SFC bill (section 18 (1)). Key aspects of the work of the

Chief of Staff will be to provide the SFC members with guidance and technical information needed to assess macroeconomic and fiscal forecasts. Report drafting would be another task. The Chief of Staff would direct other SFC staff and provide on-the-job training for incoming staff. It is a key position for the SFC's functioning.

The number of SFC staff to be recruited depends on the SFC's mandate. To assess both macroeconomic and fiscal forecasts (revenues, expenditures, budget balance) several SFC staff would be needed, especially if the Scottish Government begins publishing a medium-term budget framework of revenues, spending and borrowing. The fiscal councils of Ireland and Sweden (with about 5 staff) may provide some guidance for the SFC. However, these two councils have a full-fledged mandate. On the other hand, unlike in Ireland and Sweden, the SFC staff would not have access to a non-MoF government agency to assist it in its macroeconomic and fiscal forecasting activities. Slovenia's fiscal council had no staff, which created a risk for its on-going existence (OECD, 2015a).

A pragmatic way forward may be to recruit, say 3 staff in addition to the existing secretary, and see whether there is a need for further staff. In the meantime, the SFC members would benefit from the immediate assistance of a qualified Chief of Staff, who would also build further capacity inside the SFC to make forecasts of devolved taxes.

The SFC itself should be the main body that determines the remuneration for SFC staff. If SFC governance were to include non-executive members, the latter could provide guidance to the SFC chair as to the level of staff remuneration. In line with OECD principle 2.6, the level of Scottish civil servant's remuneration and employment conditions for comparable positions could be used to establish benchmarks for SFC staff remuneration. In this context, it would be useful to remove the need for the SFC to seek prior approval of Scottish Ministers when setting SFC staff remuneration packages. For example, sub-section 18 (3) could be re-worded as follows: *The Chief of Staff and other staff are to be employed on such terms as the Commission may determine, following remuneration and employment guidelines applicable to Scottish civil servants.*

3. SFC budget

The Financial Memorandum of the SFC bill contains estimates of the running costs of the SFC during a transitional period and annual budget estimates as from 2017/18. The annual recurring costs for operating the SFC are estimated by the SG to amount is £850,000. Key assumptions (for costing purposes) are: (1) SFC members remain at three, each working 1.5 days per week for the SFC; (2) SFC staff is built up to six full-time equivalents (FTEs); (3) all major non-salary costs (rent of office space at commercial rates, IT services, administrative and professional services, travel, etc.) for operating the SFC are included in the estimates.

The SG's estimates are generous relative to comparable small IFIs elsewhere, for which the annual budget is roughly £60,000⁴¹ times the number of members and staff. In view of the

⁴¹In Ireland, for example, in 2014, the operating budgeting of the IFAC was 800,000 Euros; this budget supported 5 Council members and 5 staff, i.e., the per person total cost was 80,000 Euros or about £60,000. Similar calculations show that Slovakia's IFI is also about £60,000 per person. Sweden's fiscal council per person budget is approaching £70,000 and Portugal's IFI around £80,000 (but note that the 3 executive Council members are all full-time). Estimates for the "low-budget" councils recently established in Europe (see footnote 39) range from £12,000 per person in Estonia

SFC's relatively limited mandate, it may not be necessary to build up to 6 staff by 2017/18. On the other hand, the SFC will need strong in-house forecasting expertise, given that the SFC will not have access to non-MoF forecasting agencies in Scotland or international organizations (EU, IMF, OECD), as is the case in many countries.

The proposed budget for the SFC allows swapping between SFC budget "line items". For example, if it is decided to step up the time involvement of the SFC chair, to at least ½ time (or even full-time), the SG's budget estimates would allow the SFC chair to be remunerated in function of time spent on SFC business.

OECD principle 4.1 for IFIs indicates that the *IFI's budget should be published and treated in the same manner as the budget of other independent bodies such as audit offices. Multi-annual funding commitments may further enhance IFIs independence.*

Concerning publication of the SFC's budget, in its draft annual budget for 2015/16, the SG presented the expenditure estimates for the Scottish Parliament and Audit Scotland under one heading. It would be appropriate for the SFC, as an independent body corporate (c.f., section 10), to have a budgetary treatment similar to that of the Scottish Parliament and Audit Scotland. In particular, in Spending Reviews, prior to determining DEL limits for Scottish Government portfolios, the SFC's annual budget should first be deducted from total resources (the block grant and borrowing), using a procedure analogous to that used by the SG when it deducts the costs of the Scottish Parliament Corporate Body and Audit Scotland from total Scottish spending (determined mainly by the UK Spending Review).

Concerning multi-annual funding commitments, the SG does not yet submit a MTBF, with some details of estimated spending over a 3-5 year period, to the Scottish Parliament as part of its annual budget documentation. This does not obviate the SG and the SFC from drawing up multi-year funding agreements for the SFC's future annual budgets.

Section 17 of the SFC bill does not provide assurances of the "permanency" of the SFC's funding. It would be useful to strengthen this section so as to:

- Ensure the SFC's budget will be charged on and paid out of Scotland's Consolidated Fund.
- The SFC initial full-year base-year annual budget, e.g., those provided in the Financial Memorandum for 2017/18, be updated annually thereafter (e.g., by indexing the SFC to changes in a Scottish consumer price index)

The SFC bill could also add a section indicating that the annual and medium-term budget for the SFC would be drafted by the SFC. Outside the SFC bill, the SFC should be encouraged to enter various service level agreements, as needed, to operate the SFC, e.g., with the University of Glasgow should office space continue to be provided and a fully managed IT service contract (c.f., paragraph 15 of the Financial Memorandum).

(but note that Estonia's budget excludes the cost of 2 staff and office space provided "free" by the Central Bank of Estonia) to about £40,000 per person in France. For the OBR, the per person cost is approximately £80,000, i.e., roughly similar to that for the SFC.

Recommendation 9. Providing the SFC with adequate resources

- A. Note that SG's estimates for the recurrent annual costs of operating the SFC are generous relative to the SFC's limited mandate. The SFC's budget estimate could be reduced, contingent mainly on re-assessing how many staff are actually needed during the next 2-5 years and whether non-executive Members (which would be low cost, since quite part-time) become part of SFC management.
- B. Note that some EU countries have recently established Fiscal Councils with a considerable number of part-time council members (6 to 15) with few staff. As a result, the annual budgets of these councils are considerably less than the per person full-year costs of the SFC as estimated in the Financial Memorandum.
- C. Take a view as to whether the Chair of the SFC should be a full-time, near full-time position, 50% FTE position, or less than 50% FTE position.
- D. Consider involving a special SFC remuneration panel or the FC of the Scottish Parliament, instead of solely relying on Scottish Ministers, to determinate SFC members' remuneration or fees for expenses and/or time spent on SFC business.
- E. Note that, for costing purposes, the SG has assumed that the SFC, once fully operational, would have six FTE staff and that this number is in line with comparable fiscal councils, notably those in Ireland and Sweden.
- F. Consider recommending that three staff plus a secretary may be adequate for the SFC's needs during the next 1-3 years, after which the need for more staff could be reviewed.
- G. Encourage the SFC to recruit a Chief of Staff as a matter of urgency.
- H. The SFC itself should determine the level of SFC staff remuneration and employment, with reference to guidelines of Scottish civil servants. In this context, remove the need for the SFC to seek prior approval of Scottish Ministers and re-write sub-section 18 (3) (see above, for a suggested text).
- I. Provide, in each draft annual Budget (spending) Bill and in each periodic Spending Review, a budgetary treatment for the SFC similar to that of the Scottish Parliament and Audit Scotland.
- J. Establish, with the Scottish Government, a multi-year funding agreement for the SFC, with the agreement being reviewed by Parliament's Finance Committee and subsequently published. Insert in the SFC bill a section that indicates that the revenues of the SFC's annual revenues shall be received from Scotland's Consolidated Fund and that the SFC's annual spending budget shall be prepared by the SFC (within the constraints of law).
- K. Consider introducing a section in the SFC bill so as to ensure that the SFC's annual budget increases in a transparent manner from an agreed initial base level (e.g., a revised estimate for 2017/18).

10. Ensuring transparency, accountability and oversight of the SFC

The SFC is designed to be a body that promotes fiscal transparency. At the same time, the statutory SFC must be transparent and accountable in its own operations. The transparency of the SFC will help to build its credibility.

The publication by SFC of its reports and main correspondence on its website www.fiscal.scot provides a good start to implementing OECD principles 7.1 to 7.4 on the transparency of IFIs. These four principles relate especially to the publication of IFI reports in the IFI's own name, and the advance announcement of IFI report release dates.

The SFC's first report (SFC, 2014) pointed to ways in which the SG could improve its methods for forecasting the devolved taxes. It also highlighted the need to improve the availability of data, including that needed by the SFC held by the UK and not yet available to the SFC. While it is too early to comment on the SFC's track record of its assessment activities, the SFC's recommendations are fully consistent with its independent fiscal watchdog role.

Section 4 of the draft SFC bill provides a legislative basis for continuing these practices. The SFC will have both the flexibility and the obligation to publish (after presentation to the Scottish Parliament) of any non-obligatory reports consistent with its mandate.

Apart from requiring the SFC to present an Annual Report to Parliament (section 8) the SFC bill does not contain provisions for the SFC's accountability to Parliament in regard to the SFC's financial management, including audit of its annual accounts. In this context, it would be useful to strengthen the SFC bill by including adding sections that require the SFC to:

- Appear before the Finance Committee of the Scottish Parliament as soon as practicable (and in agreement with the FC) after publication of its key annual report pertaining to the SFC's assessments of the forecasts of revenues and spending in Scotland's annual budget.
- Prepare annual financial statements in a format similar to those of other independent bodies (e.g., the Scottish Parliament) and present them to the Auditor General for audit, no later than, say, 3 months after the end of the year to which they pertain.
- Identify the SFC Chairperson as the Accountable Officer and require that person to appear before the Public Audit Committee of the Scottish Parliament if and when needed.

The present SFC bill is silent as to the SFC's responsibilities to have its annual accounts audited by the Auditor General and to defend the SFC's budget outcomes before the Scottish Parliament. As a possible model for a new section relating to these issues, see Box 1 of the note on Ireland's IFAC (Annex 2).

Concerning the SFC Accountable Officer, the SFC bill's Financial Memorandum assumes that the Chief of Staff post will incorporate the role of statutory Accountable Officer. It is preferable that the SFC Chair plays this role, given the Chair's seniority, experience, and responsibility to "sign off" on all SFC activities, including the SFC's Annual Report and Annual Accounts. By way of comparison, the Auditor General is the Accountable Officer of Audit Scotland: she defends Audit Scotland budget outcomes before the Scottish Parliament, as required by section 18 of the Public Finance and Accountability (Scotland) Act 2000.

In section 25 of the SFC bill, amendments to six Scottish Acts relating to public bodies are proposed. Each Act will add references to SFC. Under Sections 31 to 32 of Part 3 of the

Public Services Reform (Scotland) Act 2010, the SFC will have additional reporting requirements, which will add to the SFC's accountability. In particular, the SFC will be required to publish detailed information on SFC expenditures on overseas travel, hospitality and entertainment, external consultancy, public relations, high-value payments, and improvements in SFC efficiency. Such reporting obligations will require the SFC to set up detailed accounting and reporting formats. The administrative costs of such obligations should not be underestimated.

Concerning accountability other than to Parliament, OECD principle 9.1 recommends that IFIs should develop a mechanism for an external evaluation of the IFI's work. In this context, section 9 of the SFC bill already provides for an external review every 5 years. Additional options for enhancing external oversight of the SFC are: (1) appointing non-executive SFC members (see above); and/or (2) appointing a panel of independent experts to guide the formulation of the SFC's annual work program. Such a panel (whose experts are unremunerated) exists in the UK (see Annex 3).

Recommendation 10 – Ensuring SFC transparency, accountability and oversight

- A. The SFC should continue to maintain its openness, by publishing all reports and major correspondence, and to seize available opportunities to make its messages known in the media and elsewhere. In so doing, its credibility will be reinforced.
- B. Consider, in the interests of ensuring that the SFC is an accountable institution, strengthening the SFC bill by adding provisions that require:
 - SFC appearances before the Finance Committee of the Scottish Parliament, especially for explaining the content of its key annual assessment report associated with the annual Scottish budget.
 - The SFC to prepare annual financial statements and submit them to the Auditor General for audit within statutory deadlines.
 - The identification of SFC Chair as the SFC's Accountable Officer, who would be required to appear before the Public Audit Committee of the Scottish Parliament. Ideally, it would be desirable to initiate amendments in the UK Public Finance and Accountability (Scotland) Act 2000, with a view to putting the SFC on a similar footing to that of Audit Scotland.
- C. Note that when other Scottish Acts are amended, as proposed in Section 25, additional detailed reporting obligations will be imposed on the SFC, which will enhance SFC accountability, while adding to the SFC's administrative costs.
- D. Consider adding to the SFC bill, or alternative less-formal arrangements, a reference to a panel of experts to advise the SFC on its annual work programme.

11. Placing the SFC on a statutory footing

The key issues for which there is room for further debate concern the:

- **SFC's mandate.** This report has argued that the core mandate of the SFC should be to assess all forecasts of the SG – including its macroeconomic projections, its MTBF,

as well as the projections and the underlying assumptions of the annual forecasts of devolved taxes, the block grant transfers, SG borrowing and expenditures. The SG envisages that the SFC's immediate obligatory role is confined to assessing forecasts of devolved taxes and borrowing, as permitted by the Scotland Act 2012 and the forthcoming Scotland Act 2015.

- **SFC independence, including access to information.** Recommendations 5 to 7 above make suggestions for augmenting further the independence of the SFC. The statutory SFC would be a stand-alone IFI, neither under the direct influence of the SG, nor under the Scottish Parliament.
- **Scottish Government influence on SFC governance arrangements.** In the SFC bill, some governance aspects of the statutory SFC risk being under the control of Scottish Ministers. Recommendation 8 makes several suggestions for strengthening the independence of the statutory SFC from the SG, including by establishing a special panel for determining SFC appointments and remuneration.
- **SFC size, governance, budget, and oversight arrangements.** There are a number of omissions, including the SFC's accountability to the Scottish Parliament, which could usefully be addressed in the SFC Act.

Even prior to adoption of the SFC Act, the SFC could draft Memoranda of Understandings (MoUs) and Service Level Agreements (SLAs) with the bodies that provide economic and fiscal information. The SFC bill permits the SFC to *regulate its own procedures* (section 19). This report takes the view that the SFC Act, MoUs, SLAs and the SFC's own internal regulations provide the basis for an adequate legal and regulatory framework for the statutory SFC.

It may be premature to consider widening the SFC bill to include wider fiscal framework issues such as requiring the SG to prepare a medium-term fiscal strategy, a MTBF, or adopt fiscal rules. At this stage, it may be preferable for the SFC Act to include sound provisions for the above four bullet points. Any widening of the SFC Act, to include wider fiscal framework issues and a broader mandate for the SFC, could take place in a future legislative session of the Scottish Parliament.

In the meantime, the SG could be encouraged to do what it can to reform institutional weaknesses in IGR at UK level. If new sections were to be drafted on an expanded mandate of the SFC, notably to include sections on the fiscal framework, including fiscal rules and an obligation for the SG to prepare a Charter for Fiscal Responsibility, there is a strong risk that this would retard adoption of the Act during the current legislative session. It seems preferable to wait until there is greater clarity and certainty concerning the wider fiscal framework issues.

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Annex 1: Belgium: High Council of Finance (HCF) and Federal Planning Bureau (FPB)

Background and legal basis of the HCF and the FPB

The HCF is an advisory body to the federal Ministry of Finance. It prepares normative recommendations and assessments of fiscal policy. According to CurrIstine et al. (2013) the HCF is not legally independent from the Government. The HCF has nonetheless gained a reputation for quality independent analysis.

The HCF was established by Royal Decree in 1936. Since 1969, the HCF has been restructured several times. In 1989 when federal constitutional reforms were being implemented to give more fiscal autonomy to sub-national governments⁴², the Public Sector Borrowing Requirement (PSBR) section was established in the HCF, to reconcile increased subnational autonomy of regions with macroeconomic and budgetary stability (in 1988, the general government fiscal deficit was 7% of GDP and gross debt was 125% of GDP). In 2006 the Taxation and Social Security Contributions section of the HCF was revamped.

The Federal Planning Bureau (FPB) produces the macroeconomic forecasts used in the federal budget. The FPB was created in 1959. When a 1994 law created the National Accounts Institute (NAI), the FPB was placed under the NAI as one of the NAI's three component bodies.⁴³ The FPB's role is to prepare economic analyses and forecasts. The 1994 law indicates that the FPB is under the joint authority of the Prime Minister and the Minister of Economic Affairs.

It could be considered that Belgium has two IFIs: the HCF, which deals with the “normative” side by making recommendations for fiscal policy targets; and the FPB, which is limited to “positive” economics (Bogaert et al, 2006), i.e., economic and fiscal analysis and, especially, forecasting. The publications of both IFIs are impartial. Although the federal government appoints the members of the HCF, the HCF is functionally independent.

In December 2013, under a cooperation agreement, the HCF was designated as Belgium's “independent fiscal institution” under the new European fiscal framework. The cooperation agreement is between the federal, regional and community governments, and was ratified by the parliaments of each entity.

The HCF plays an important role relating to EU fiscal rules and the Stability and Growth Pact (SGP). Since 1998, based on the SGP, Belgium has drawn up medium-term budget targets for the federal and subnational authorities (regions, communities and local authorities). These generally follow the HCF's recommendations for multi-year borrowing targets.

⁴² Under the 1989 decentralization arrangements, the main sub-federal entities are three Regions and three Communities.

⁴³ Although a legal entity, the NAI does not have any staff or budget; it regroups the FPB, Statistics Belgium and the National Bank of Belgium (central bank). As from 2016, the Flemish, Walloon and Brussels Regions will be represented on the governing Board of the NAI.

The mandates of the HCF and the FPB

The HCF's 2006 decree (Article 2) provides the HCF with a broad mandate:

- “To be responsible for advising the Minister of Finance and the Minister of Budget in the development of fiscal, financial and budgetary policy”

The 1989 Special Financing Law requires the PSBR section of the HCF to:

- Prepare an annual opinion on the financing needs of the budgets of the governments at federal and subnational levels.

The PSBR section may, on its own initiative, or upon request of the federal Minister of Finance:

- Advise on restricting the borrowing requirements of one or more authorities should this be needed to avoid a structural derailment of the overall deficit. However, the HCF has until now never made use of its capacity of restricting the borrowing requirements of an authority.

The PSBR section must take into account the findings of the annual report on the budgetary and social consequences of ageing, which are published by the HCF's Study Group on Ageing created by law in 2001.

The Taxation and Social Security Contributions section of the HCF can

- Issue an opinion on issues related to taxation and social security contributions.

The mandate of the PSBR section was enhanced in late 2013 (see Box 1, OECD, 2015b):

- The HCF proposes multi-year fiscal targets that are set in nominal and structural terms, taking into account a fair burden sharing of the fiscal consolidation efforts. On the basis of HCF's Opinion, the federal, regional and community governments have to conclude an agreement on the fiscal path and its breakdown.
- The HCF monitors the different governments' budget outcomes. In the event of significant deviations from the targets, a correction mechanism will be triggered, the implementation of which will, in turn, be monitored by the HCF.

In summary, the HCF plays a crucial role in not only setting coherent multi-year fiscal targets for the general government and for the sub-national governments but also for:

- Assessing compliance with fiscal targets, for both “general government” and the budgets of the federated entities.

The Federal Planning Bureau, on the other hand, has the role of:

- Preparing annual and medium-term macroeconomic and fiscal projections (see the Publications sub-section below)

Budget and staffing

The HCF consists of 24 members with five-year renewable terms. The 2006 HCF decree requires the Chair of the HCF to be the federal Minister of Finance. The PSBR section consists of 12 members, six of which must be experts in budgeting and economics. Three of these are proposed by the National Bank of Belgium, one by the federal Minister of Finance, one by the federal Minister of Budget and one jointly by the federal Ministers of Finance and Budget. These two ministers also propose the other six members, upon proposals from the governments of the communities and regions (see OECD 2015b for details). The other 12 members are nominated in the Taxation and Social Security Contributions Section, also with due regard for regional/community representation. The King formally appoints the members of the council.

Given Belgium's delicate political, regional and linguistic balances, there can be delays in HCF appointments. For example, following regional elections in 2004, there was a two-year hiatus in the HCF's activities, due to delays in finding the appropriate balance of HCF members.

The work of the two sections of the HCF is supported by a secretariat of 12 staff plus two administrators, appointed by the federal Minister of Finance. The Federal Planning Bureau provides separate administrative support to the HCF's Study Group on Ageing. The staff are civil servants and full-time members of the Research Department of the Staff Service Strategic Expertise and Support of the Federal Public Service (= "ministry" of⁴⁴) Finance. HCF staff work part-time on HCF business and part-time on other work.

The HCF does not have any significant expenditures of its own. Members do not receive any salaries, as they have other full-time jobs. Membership only entails attendance at a small number of meetings a year. Unlike some countries where fiscal councils have been threatened with budget cuts when they have been perceived to be overly critical of the government, this is not a possibility in Belgium.

The Federal Planning Bureau has its own annual budget to support a staff of nearly 100. In Belgium's annual federal budget, the FPB has its own budget line item, amounting to about 10 million euros. About one third of the FPB's staff work in the FPB's General Directorate, which is responsible for preparing the economic and fiscal projections. The FPB also receives compensation for contractual research work completed for third parties.

The independence of the FPB is visible in its recruitment policy. The FPB has its own recruitment procedures and it is not subject to the rules that apply to most of the federal government (which is through the central recruitment service).

Access to information

The HCF has no difficulty in accessing data since the Minister of Finance appoints the secretariat staff from the FPS Finance. The Cooperation Agreement of December 2013 stipulates that the HCF should be granted access to all information it needs to carry out its mission, particularly the enhanced mandate of the PSBR section.

⁴⁴ Since reforms in public administration in 2000, use of the word "ministry" was replaced by "Federal Public Service" (FPS). Thus, the Ministry of Finance is now FPS Finance.

Publications of the HCF and the FPB

All reports of the HCF are published in both French and Dutch on http://finance.belgium.be/en/about_fps/high_council_finance. The reports are technical and include discussions of methods and assumptions. The PSBR section generally produces two reports a year⁴⁵, notably those relating to:

- The recommended multi-year fiscal targets for each level of government in view of the stability programme (the report is published in the Spring – often March).
- An assessment of the compliance of the budgetary outcomes of the previous year with the targets of the stability programme for each level of government, including for individual regions and communities. This report, which was formerly generally published in the autumn and now in July, may include specific recommendations for the budget balances of individual authorities.

The FPB prepares and publishes:

- Short-term (one-year ahead) economic forecasts (but not including fiscal projections). The so-called “economic budget” forecasts provide an input for budgetary policies and projections of the federal government, regions and communities.
- Medium-term (five year) economic outlook including detailed projections of the general government accounts (federal, social security, federated entities and local) based on a no-policy-change assumption. These projections are used by the HCF to make its recommendations for borrowing targets. The macroeconomic outlook also serves as a starting point for the elaboration of the stability programme.
- Long-term projections of age-related budgetary expenditures (for the HCF’s Study Group on Ageing).

As an example of its projections by region, in July 2015 the FPB published economic and fiscal projections year by year until 2020, with separate projections for the Flemish, Walloon and Brussels regions. Table 20 of FPB (2015) shows fiscal 5-year projections for the nation as a whole and Tables 21-23 show 5-year fiscal projections for the three separate regions (national and regional projections for GDP and its components are also published in the same report). Each table shows the following (but in more detail):

Total Revenues
Taxes
Nontax revenues
Transfers
Total Expenditure
Primary Expenditure

⁴⁵ In 2015 three reports will be published.

Operating expenditure
Investment spending
Non-social transfers
Social transfers
Interest on debt

Primary balance
Balance to finance

The FPB uses a macro-economic model with “top-down” features to produce its forecasts are national level. For its regional projections, the FPB collaborates with closely with three forecasting bodies in each region,⁴⁶ which contribute heavily to the regional projections.

Relationship with parliament, government, other agencies and the media

The HCF has no formal relationships with the federal and regional parliaments. While parliamentary committees are cognizant of HCF’s recommendations, the parliamentary committees generally do not discuss HCF reports and recommendations.

The HCF is an advisory body for governments, with limited institutional independence from the Governments. As noted, the federal Minister of Finance officially chairs the HCF, without however being actively implicated in the concrete working of the HCF. The governments are not obliged to take on board the HCF’s recommendations. In practice, however, the HCF proposals are taken on board, especially since late 2013 when the HCF’s monitoring responsibilities were enhanced.

The FPB is an independent government agency under the “ministry” of Economy.⁴⁷ The FPB has considerable autonomy in its operations. It provides the “no-policy-change” economic and fiscal forecasts to the HCF, for use in its target-setting and monitoring activities. The National Bank of Belgium is on the Scientific Committee of the Economic Budget and, as such, may comment on FPB’s forecasts.

Oversight and evaluation of HCF and FPB

The HCF does not have an oversight board or panel of advisors to guide its work. Nor is the HCF’s work systematically subjected to peer review. Although the independence of the HCF could be questioned (see, for example, Uhoda, 2013), the HCF has received some positive evaluations in the literature and by international financial institutions.

Being an autonomous agency of public interest, the annual accounts of the FPB are subject to audit by the Court of Audit www.ccrek.be/EN/index.html.

⁴⁶ Notably: Institut Bruxellois de Statistique et d’Analyse, Institut Wallon de l’Évaluation, de la Prospective et de la Statistique, et Studiedienst van de Vlaamse Regering.

⁴⁷ In Belgium, besides FPS Economy, there are two other separate “ministries”: FPS Finance (primarily a “revenue ministry”) and FPS Budget that prepares the annual federal budget.

Annex 2. The Irish Fiscal Advisory Council (IFAC)⁴⁸

Background for establishing the IFAC and its legal basis

During 2008-10, Ireland's financial and fiscal crises deepened. In late 2010, the government committed itself to reduce the very high fiscal deficit and approved a package of measures to improve budget management. These included introducing a medium-term budget framework (MTBF) with multi-annual ceilings on expenditure, creating a fiscal advisory council, and preparing a draft Fiscal Responsibility Act (FRA). These measures were included in Ireland's financial assistance program for 2010-13 agreed with IMF/EC/ECB. At the time, the European Union was urging Euro-zone countries to strengthen their fiscal frameworks, including by introducing numerical fiscal rules and by establishing an IFI.

In July 2011, the Minister of Finance announced the establishment of the IFAC on an interim basis. There was wide support across political parties for IFAC (despite a change in government in early 2011). Sweden's Fiscal Policy Council was influential in the design of the IFAC, as it was seen to be economical, with part-time council members (made up of academics and other independents), and the absence of making its own fiscal forecasts.

To get the IFAC operating quickly, the Economic and Social Research Institute (ESRI) provided support services and accommodation. These arrangements have continued, with the ESRI now being reimbursed from the IFAC's operating budget for the services provided. The accounts, HR, IT and facilities support functions provided by the ESRI for IFAC are set out in a Service Level Agreement, which is reviewed annually by the two institutions.

During the interim period, the IFAC had a unique opportunity to contribute to IFAC's design. In January 2012, the IFAC's report on "Strengthening Ireland's Fiscal Institutions" (McHale, 2012) included views on all pertinent issues for the creation of the IFAC as a permanent IFI. The majority of its recommendations were accepted and included in the FRA.

The IFAC was formally established as an independent statutory body in the FRA, approved by parliament in 2012. Besides laying out the IFAC's mandate, the law requires the Government to prepare a MTBF and establishes fiscal rules consistent with EU fiscal rules.

The IFAC's mandates

The IFAC has five main mandates (see www.fiscalcouncil.ie). The first four are included in the FRA 2012 and the fifth obtained a legal basis in the Ministers and Secretaries (Amendment) Act 2013.

- To assess the official macroeconomic and budgetary forecasts prepared by the Department of Finance (DoF) and published twice a year: in the Budget and Stability Programme Update in the spring and in the annual Budget in the autumn.
- To assess whether the fiscal stance of the Government is conducive to prudent economic and budgetary management, with reference to the EU Stability and Growth Pact.

⁴⁸ This chapter has benefited greatly from the note on Ireland in OECD (2015a).

- To monitor and assess compliance with the budgetary rule as set out in the FRA. The rule requires the Government's budget to be in surplus or in balance, or is moving at a satisfactory pace towards that position.
- To assess whether any non-compliance with the budgetary rule is a result of "exceptional circumstances". This could mean a severe economic downturn and/or an unusual event outside the control of Government.
- To endorse, as it considers appropriate, the macroeconomic forecasts prepared by the DoF. This role for the IFAC conforms to an EU regulation of July 2013 and it is elaborated in a Memorandum of Understanding between the IFAC and the DoF.⁴⁹

To assist in fulfilling its mandate, the IFAC has developed a fiscal-feedback model for assessing the impact of macroeconomic/budgetary developments and whether the targets for the general government deficit will be achieved. While this model is helpful for one-year ahead forecasts, the IFAC has still working on developing a fiscal forecasting model that would be helpful for 5-year forecasts. Model developmental work requires skilled staff with prior modelling experience, which IFAC has, but it also requires time. This type of work can only take place in the "off-season", i.e., outside the report preparation time.

Budget and staffing

During 2011-12 set-up period, the IFAC received a grant from DoF's annual budget. As from FY2013, and based on provisions in the Fiscal Responsibility Act, the council's budget is guaranteed as "non-voted expenditure", i.e., it does not require annual parliamentary approval. Thus, the FRA provides assurances of ongoing annual funding for IFAC irrespective of the composition of the government and the parliament.

Box 1 provides key details of the Act's provisions for the IFAC's administration and budget. The IFAC has flexibility on how to spend its funds within the ceiling provided.

The 4-year terms of IFAC's five members are decoupled from the 5-year parliamentary election cycle. The Minister of Finance can only dismiss Council members if they are incapable through ill-health, misbehaviour, conflict of interest, or other serious disqualifications listed in the FRA. Fiscal Council members are not required to be Irish nationals. Three of the five original members resided outside of Ireland. An international presence on the council is thought to have enhanced its objectiveness.

Although part-time, the IFAC members' work requires a significant time commitment. Arrangements are in place either to compensate Council members' full-time employers for the time spent on IFAC work, or to provide fees for services provided to the IFAC. Fees are set at a rate benchmarked on comparable other non-commercial State-sponsored bodies.

⁴⁹ See www.fiscalcouncil.ie/wp-content/uploads/2011/07/IFAC_MoU_Readable.pdf

Box 1. Key Legal Provisions Relating to IFAC's Administration and Oversight

IFAC Members, Term of Office, Resignations and Terminations

The Fiscal Council consists of five members, each appointed by the Minister of Finance according to specific criteria (competence, domestic or international experience, etc.). Members have a 4-year term of office, with no more than two consecutive terms. Members may resign at any time. The Minister of Finance may remove a member from office, but only under very restrictive conditions (see below). Members must resign if they accept political positions or are candidates in Irish or European elections.

IFAC Staff

The Council appoints IFAC staff, after prior consent of the Minister, following consultation. The IFAC staff are paid out of the moneys at the disposal of the IFAC. If staff accept political positions, they stand seconded from IFAC employment and are not See paid by the IFAC.

Funding

The expenditure incurred by the IFAC is charged on and paid out of the Central Fund. The amount in FY2013 was capped at €800,000. Annual changes in IFAC's budget since then are linked to the annual percentage change in the Harmonised Index of Consumer Prices.

Accounts and Audit

The IFAC must keep annual accounts of receipts and expenditure, which are signed by the chair. The IFAC chair is accountable before the Comptroller and Auditor General who reports annually to the House of Representatives of Parliament. After its establishment, IFAC worked hard to put in place appropriate policies and procedures, to conform to Ireland's Code of Practice for the Governance of State Bodies, which imposes various reporting requirements on IFAC.

Appearances before *Oireachtas* Committees

The IFAC chair shall, when requested in writing by a Committee of the House of Representatives, give evidence to that Committee of IFAC's financial management. Any parliamentary committee can request the IFAC chair to account for the performance of IFAC's functions.

Annual report

IFAC must prepare a report of its activities during the year, as soon as practicable after end-year.

Source: Schedule to the Fiscal Responsibility Law, 2012.

Initially the IFAC had three full-time secretariat staff, all of which were seconded from official agencies in Ireland. Since 2012, the IFAC has added two additional staff to develop its modelling and forecasting capabilities. IFAC has developed their own Code of Business Conduct that includes a section on conflict-of-interest. Most staff continue to be on secondment from bodies such as the central bank, the ESRI and the Department of Public Expenditure and Reform. This enables dynamic young people to gain in-depth experience and responsibility in fiscal forecasting and management before returning to their "home" institutions at the end of their secondment periods.

Access to information

The FRA is not explicit concerning the IFAC's access to information. According to Article 8 (7), *the Fiscal Council has all such powers as are necessary for, or incidental to, the performance of its functions*. This phrasing is one possible weakness of the legislation. On the hand, the FRA prohibits the IFAC from disclosing confidential information. The Minister declares in writing the information that is considered confidential.

In practice, the IFAC has had reasonable access to government information. There have been cases where slow responses have delayed IFAC's analysis (OECD, 2015a). The delays were due to the information not being easily accessible, rather than unwillingness to supply the information.

Publications

IFAC publishes two assessment reports a year. Typically these reports have four substantive parts, notably the assessments of: macroeconomic forecasts; budgetary forecasts; compliance with fiscal rules; and the fiscal stance.

The IFAC publishes analytical notes, working papers and other documents on its own initiative. In September 2014, the Council published its first Pre-Budget Statement, which set out the macroeconomic and fiscal context for the 2015 Budget. The council also publishes an Annual Report that summarizes its activities in the previous 12 months.

Relationship with parliament, government, other agencies and the media

The IFAC is independent from both the government and the *Oireachtas* in its operations. To assist parliamentary scrutiny of annual budgets, the Chair of IFAC presents IFAC's Fiscal Assessment report to the *Oireachtas* Joint Committee on Finance, Public Expenditure and Reform and answers questions from committee members. Transcripts of these appearances are posted on the IFAC's website. Council members may also appear before other parliamentary committees as requested.

The lower parliamentary house would approve any dismissals from the IFAC should the Minister of Finance ever initiate a dismissal. As noted, the hiring of IFAC staff needs prior consent of the Minister. These arrangements potentially limit the IFAC's administrative independence.

For its assessment activities, the IFAC is reliant on access to information from the Department of Finance, as well as data of the Central Statistics Office (CSO) and the National Treasury Management Agency (NTMA). Although IFAC has suggested that it would be useful to have written memoranda of understandings (MoUs) pertaining to data sharing arrangements, to date no MoUs in this area have been drawn up with DoF, CSO and NTMA.

The IFAC is transparent and uses its website as the main way of communicating with the public and the media (see www.fiscalcouncil.ie/publications).

Oversight and evaluation of IFAC

Like all state-funded institutions, IFAC is subject to audit by the Comptroller and Auditor General. IFAC's Annual Report includes audited IFAC financial statements. The relevant committee of the *Oireachtas* may choose to scrutinize the audit report.

IFAC's Strategic Plan for 2014-2016 suggested that a peer review take place in 2015. Accordingly, in early 2015, an evaluation was prepared by a three-member independent peer review. The evaluation report (see Jonung et al, 2015) was submitted to the IFAC, sent by IFAC to the Minister for Finance and the *Oireachtas* Joint Committee on Finance and Public Expenditure and Reform, and published on the IFAC website in June 2015.

Annex 3. United Kingdom: Office for Budget Responsibility (OBR)

Background for establishing the OBR and its legal basis

As from 2000, fiscal forecasts in the UK were optimistic. Also, the credibility of the fiscal rules relating to borrowing and net investment “over the cycle” was undermined by the discretion the government exercised in deciding the dates on which the economic cycle started and finished. The fiscal rules were suspended in late 2008 following a sharp rise in the fiscal deficit.

The idea for an Office for Budget Responsibility (OBR) was first proposed in September 2008 by the then opposition Conservative party. Following the May 2010 parliamentary elections, the new coalition government launched the OBR in its interim form. The coalition government also replaced a temporary fiscal rule by a mandate to balance the cyclically adjusted current balance by the end of a five-year rolling horizon, with public sector net debt targetted to be falling as a share of GDP in 2015/16. Following the May 2015 parliamentary elections, the new Conservative government announced plans to replace these fiscal rules with a target for a headline surplus in 2019/20 and each subsequent year and for public sector net debt as a share of GDP to fall in every year.

In its interim form, the OBR comprised a three-person Budget Responsibility Committee (BRC) chaired by a former Treasury Chief Economic Adviser. Aided by a small secretariat of Treasury employees, the OBR quickly began preparing macro-fiscal forecasts. The interim OBR was also tasked with providing advice on the arrangements for the permanent OBR.

Following an inquiry by the House of Commons Treasury Select Committee (TSC), in September 2010 the TSC published a report pertaining to the OBR’s permanent arrangements. The interim OBR also provided advice on the permanent body.⁵⁰ Both reports emphasized the OBR’s independence and accountability; the interim OBR elaborated on the permanent OBR’s roles and responsibilities. The reports’ key recommendations were taken on board in the Budget Responsibility and National Audit (BR&NA) Act, adopted in March 2011. These included:

- The OBR was established with its own legal personality and independence for appointing its own staff.
- A clear remit and core tasks for the OBR.
- Other requirements, notably that:
 - The responsible parliamentary select committee should have a veto over the appointment or dismissal of the Chair of the OBR and the BRC members.
 - Government officials should support the OBR when it prepares forecasts.
 - The OBR should have a right of access to the information it needs.
 - The legislation establishing the OBR should not require future governments to

⁵⁰ See http://budgetresponsibility.org.uk/wordpress/docs/obr_permanent_body_advice_120710.pdf

- use OBR forecasts.
- The permanent OBR should be subject to a comprehensive review no later than five years after it is established by statute.

Although the OBR was endorsed across party lines, the opposition in 2010 expressed some concerns about the adequacy of safeguards for the OBR's independence.

OBR's mandate and tasks

The BR&NA Act, along with the Charter for Budget Responsibility that elaborates on the Act, lay out the OBR's responsibilities, which have a strong forecasting element.

Mandate: To examine and report on the sustainability of the public finances

Tasks:

(at least twice a year)

- Produce the official 5-year economic and fiscal forecasts, at dates determined by the Chancellor of the Exchequer.
- Assess the government's progress in achieving its fiscal targets.

(at least once a year)

- Analyse the long-term sustainability of the public finances.
- Assess the accuracy of fiscal and economic forecasts previously prepared by OBR.

The Charter also requires the OBR to:

- Scrutinize and certify the government's policy costings.⁵¹ The Charter makes it clear that the government, not the OBR, is responsible for all policy decisions and policy costings.

The UK government is responsible for all policy decisions. For policy costings, HM Treasury quantifies the direct impact of policy decisions on the public finances. In certifying the official estimates of policy costings, the OBR is required to state whether it agrees or disagrees with the government's costings, or whether it has been given insufficient time or information to reach a judgement. To date, the OBR and HM Treasury have not disagreed on the estimates of the impact of any policy costings.

The Act proscribes the OBR from considering the impact of alternative policies. In contrast, many IFIs – particularly Parliamentary Budget Offices – quantify the budgetary impact of modified or new tax and/or expenditure policies. The OBR's projections are based exclusively on government policy, including both existing policies and those communicated to the OBR by HM Treasury during the annual budget process.

With the exception of making policy suggestions, the OBR may undertake any other analysis relevant to its mandate. The OBR also provides testimony and evidence to Parliamentary committees, as required by the Act or upon request.

⁵¹ The costing of policies is described in an OBR briefing paper:
http://cdn.budgetresponsibility.org.uk/27814-BriefingPaperNo_6.pdf

There have been proposals to expand the OBR's mandate to include the costing of pre-election policy proposals. While not ruling out this possibility, it would be difficult for the OBR to take on this role without considerable expansion of its present resources. Also, for policy costings, there would need to be a political consensus as to which parties would have access to the OBR's expertise, which policies would be assessed, the timetable for delivery, etc. (for further details, see Chote, 2014).

Budget and staffing

The OBR has a separate budget line in the Treasury Group budget (as is the case for other "arm's length" agencies). As such, it is part of Treasury's annual Departmental Expenditure Limits (DEL). In the two instances to date that the OBR's budgets have been set, the OBR and the Treasury have agreed on a multi-annual budget for OBR. This provides some safeguards for the OBR's budget.

The Chair of the OBR, who is also the OBR Accounting Officer, is personally responsible for safeguarding the public funds provided to OBR. Formally, he is responsible to the Principal Accounting Officer in the Treasury for ensuring that the OBR operates within its agreed budget and (if required) for appearing before the Public Accounts Committee of Parliament for the OBR's stewardship of public funds. The OBR's annual report, which is submitted to Treasury and laid before Parliament, includes details of the OBR's budget and expenditure. The publication of OBR's annual report also provides some safeguard for the OBR's budget.

The Budget Responsibility Committee, comprising the OBR Chair (full-time) and two other members (part-time), has executive responsibility of the OBR. The BR&NA Act requires at least two non-executive members to support and challenge the three executive members. The Chancellor of the Exchequer appoints the OBR Chair with the consent (veto right) of the TSC of the House of Commons. The two other members are also appointed the Chancellor, after consultation with the OBR Chair. Appointments are for 5 years, renewable once. The BRC members' remuneration follows that for similar senior civil service positions and is disclosed in the OBR's annual report.

The OBR is responsible for recruiting and remunerating staff, consistent with the Civil Service Management Code and with the OBR's operating budget. In 2015, the OBR had 19 full-time staff, in addition to the 3 BRC and 2 non-executive members. The multi-year funding agreement agreed with Treasury agreed in May 2014 envisaged an increase in staff through 2017/18, to allow resources to be devoted to the OBR's expanded mandate, notably to assess the welfare spending cap and make medium-term forecasts for taxes devolved to Scotland and Wales.

Access to information

The BR&NA Act provides the OBR with the *right of access (at any reasonable time) to all Government information, which it may reasonably require for the purpose of the performance of its duty*. The Act also entitles the OBR to *require from any person holding or accountable for any Government information any assistance or explanation which the Office reasonably thinks necessary for the performance of its duty*. In practice, the law has been respected: the OBR has received and obtained data and analysis from relevant government departments

and agencies, especially the Treasury, HM Revenue and Customs (HMRC), and the Department for Work and Pensions (DWP).

Publications

The OBR must produce and publish:

- Economic and fiscal outlook, at least twice a year
- Fiscal sustainability report, annually
- Forecast evaluation report

Since 2014, the OBR has also produced a Welfare Trends report. This was requested by the Government at the same time that the OBR acquired a new role pertaining to the new welfare spending cap.

The OBR is required to lay its legally mandated reports before Parliament. Besides the Charter, Memoranda of Understanding between the OBR, the Treasury, HMRC and DWP provide details on the content, timing, etc. of data and information needed for the OBR's publications.⁵²

The OBR has discretion to prepare additional reports. In practice, it publishes Discussion papers, Working papers, Occasional papers, Briefing papers, Monthly public finances updates, and Press releases.⁵³ All OBR reports must be published and sent to Parliament.

Relationship with parliament, government, other agencies and the media

The OBR has closer relations to the government than to parliament. For example, the BR&NA Act states that *the Treasury may make to the OBR such payments out of money provided by Parliament as the Treasury considers appropriate*. The OBR is nonetheless a legally separate entity, with freedom to spend its own budget as it wishes. As mentioned above, the OBR has also been given a multi-year budget, which is published.

The OBR's broad governance and management framework – and its relationship to the Treasury -- is laid out in "Framework Document" (updated in 2014). As noted, the Chancellor of the Exchequer appoints the Chair of the OBR, subject to a veto right of the TSC. Normally UK parliamentary committees do not have veto rights over appointments.

All of the OBR's analytical and other budget-related reports, along with the OBR's Annual Report, are laid before Parliament directly. The OBR is directly accountable to Parliament for the content of its publications and pronouncements. Importantly, neither the government nor the parliament has a right of direction over the OBR's analysis.

The OBR's outputs require close communication with government departments to get the information and data needed for its forecasts. The OBR has agreed to Memoranda of Understandings with HM Treasury, HMRC and the DWP. The interdependence with these

⁵² The various documents are summarized in:

<http://budgetresponsibility.org.uk/independence/legislation-and-related-material>.

⁵³ For details, see <http://budgetresponsibility.org.uk/category/publications>.

three government departments provides the OBR with capacity far beyond its actual staff size. The OBR purchases administrative support services (finance and human resources) from the Treasury and accommodation services from the Attorney General's Office (these are set out in service level agreements).

Besides testifying to Parliamentary committees, BRC members and OBR staff give presentations at outside events. More generally, the OBR operates in a transparent manner, using its website as the main way of communicating with the public and the media. Besides publishing all its reports on <http://budgetresponsibility.org.uk>, the OBR also publishes the assumptions and methodologies underlying its forecasts, as well as important correspondence, e.g., letters to the Director-General Finance of the Scottish Government concerning the estimates of receipts from taxes devolved to Scotland.

Oversight and evaluation of OBR

The non-executive committee of the OBR must keep under review the way in which the OBR's main duties are performed. In this context, the BR&NA Act requires that *the non-executive committee appoints a person or body to review such OBR reports as the committee determines*. The terms of reference (not required by the law) of the first external review of the OBR included examination of the quality of the OBR's publications, the effectiveness of its methodologies and governance, and the capability of the OBR team. This external review was completed in August 2014 (see Page, 2014). The evaluation was positive concerning OBR's fulfilment of its mandate. The report cautioned expanding the OBR's mandate to cost the budgetary implications of opposition parties' pre-election manifestos.

The OBR is subject to internal audit that follows UK government standards. The OBR's annual accounts are subject to external audit by the Comptroller and Auditor General, who certifies the OBR's accounts and reports to the Treasury, which in turn submits a copy of the audit report to Parliament.

On its own initiative, in 2011 the OBR established a seven-person panel of economic and fiscal experts to help develop and scrutinize the OBR's work programme and methods. The advisory panel membership was refreshed and expanded to eight in 2014. Panel membership is on a *pro bono* basis for a three-year term extendable by mutual consent.

Annex 4. Legislative Budget Offices (LBOs) in 50 States of the United States

Background for establishing Legislative Budget Offices (LBOs⁵⁴)

The 50 States of the USA are mirror images of the federation, in the sense that each State has a written Constitution, a bicameral legislature (a House of Representatives and a Senate),⁵⁵ and an Executive (“government”) headed by a Governor who is directly elected by citizens in elections that are independent from the elections for the State legislature. These arrangements are in sharp contrast to Westminster countries, where the Prime Minister and Cabinet ministers are elected in legislative elections and remain in parliament after elections, i.e., legislative and executive powers are not separate in countries of U.K. inheritance.

Budgets are annual in 30 States and biennial⁵⁶ in 20 States. Budgets become laws when signed by the State Governor, who has the authority to veto budget line items approved in Appropriations Laws. In contrast, the President of USA can only veto an Appropriation Act in its entirety, i.e., he/she is not authorized to veto line items of Appropriations Bills.

Both houses of the legislature have equal powers and each house approves the annual/biennial budgets. Each house may have a “budget committee” and/or appropriations committees. Some States have established a Joint Budget Committee.

LBOs were established to provide budget support to the legislature. The precise reasons differ across states, but most often it was to provide to the legislature an analysis of the Governor’s draft budget. The need for independent budget revenue forecasts from those of the Executive was the motivating factor for establishing Pennsylvania’s Independent Fiscal Office (IFO) in 2010. However, this is seldom a reason for establishing an independent LBO.

Legislative Audit Offices have also been set up in many U.S. States. They are not considered in this section. The sole reason for excluding an analysis of these offices is to avoid this note becoming too long. Although independent legislative audit offices are distinct from the LBOs, in some States, they play an important role in evaluating tax and spending initiatives. Although these evaluations are usually ex post, in some States, such as Delaware, Virginia and Washington, the Legislative Auditor gets involved in costing draft budget proposals. Whether ex ante or ex post, such evaluations feed into State budget approval processes.

Models of LBOs and their legal status

All LBOs serve the legislature and every LBO is independent of the Executive, reflecting the strong separation of powers in U.S. States. LBOs service mainly the budget committee, but may also serve other committees and individual members. The appointment of the director of the LBO is exclusively made by the legislature.

⁵⁴ Both “LBO” and “budget committee” are used generically in this subsection, to denote offices and committees known by different names in various States.

⁵⁵ Nebraska is an exception. It voted to merge its two houses in 1934. The first unicameral house in 1937 passed more bills than its predecessor, at half the administrative cost of running two houses.

⁵⁶ In 16 States, biennial budgets are those that approve, once every two years, appropriations for spending in two consecutive years. In 4 States, the biennial budgets are appropriations that are approved, every two years, for a 24-month period. See NASBO, Table 1, including Notes.

Sixteen States have established a stand-alone LBO by a law (Table 1). California's Legislative Analyst's Office (www.lao.ca.gov) is the oldest. Established in 1941, it served as a model for the creation of the federal Congressional Budget Office (CBO) in 1974. About 2/3rds of the State-level LBOs were created prior to 1975, i.e., they have existed for over 50 years. Pennsylvania's IFO, created in 2010, is an exception.

Other States have contemplated creating an independent LBO, with or without broadening the mandates of the nonpartisan staff that already serve the "budget committee". For example, in 2015, in Minnesota, an initial proposal to create a stand-alone LBO was later changed to a LBO that would transfer some of the duties of the Department of Minnesota Management and Budget to the Office of the Legislative Auditor. In the event, political leaders were unable to agree and the proposal died, at least for 2015.

In 12 other states, a law (10 states) or a resolution (2 states) of the legislature have established a budget committee (joint or within each house). The legal framework provides for the committee (or "commission") to be serviced by nonpartisan staff. In several States, the nonpartisan staff draft the appropriations laws. These staff could be considered to work for a LBO, even though the law has not formally created an LBO. Such "LBOs" have been in existence for many years, e.g., the nonpartisan staff serving Colorado's Joint Budget Committee since 1959.

Thus, in 26 States, both houses of the legislature have adopted a law that establishes a LBO or nonpartisan staff serving the budget committee(s). The Governor also signed the LBO's founding law. Hence, these LBOs had wide political support at the time of their creation. In addition, the legislatures of two other States (Hawaii, Michigan) led to the creation of a LBO by resolution of the legislature (Table 1).

In the 22 other States, the LBO is not a stand-alone office or dedicated nonpartisan staff serving primarily the budget committee. Rather, the "LBO" is a division of the legislature's research department. Although the staff are nonpartisan, these divisions are not independent LBOs in that they do not have their own budgets nor authority over staffing. However, in practice, these divisions of legislative research offices have not suffered abrupt changes in budgets or in staff numbers, a reflection of the recruitment policies and governance structures for all nonpartisan staff of State legislatures.

In summary, all 50 states have some form of a LBO, even though 22 of them are not independent of the research offices of their legislature. In most states, the LBO has existed for several decades, despite political party power shifts in state legislatures.

LBOs' roles and remits

U.S. States' LBOs give emphasis to the following:

- **Assessing forecasts:** Only a few LBOs prepare medium-term projections for economic and fiscal aggregates (Pennsylvania's IFO is one example). LBOs infrequently prepare comprehensive forecasts of budget developments for 1-2 years ahead, since the "official" revenue, spending, borrowing and debt forecasts are prepared by the Governor's "central budget office(s)". In some States, fiscal forecasts are prepared in a consensus manner, with input from the legislature's "LBO". Also, some LBOs are involved in revenue forecasting. In three States, revenue forecasting is completely independent from both the executive and the legislature (see below).

Table 1. Legislative Budget Offices – 50 States of USA

Models of LBOs	Established by law, i.e., approved by both Houses of the Legislature plus the Executive			Established by Resolution or Administrative Rules	
LBO is:	A stand-alone unit devoted to budget issues	Nonpartisan staff serving “budget” committee(s) or a Commission established in law	Nonpartisan legislative research staff that examine budget	Nonpartisan staff of budget-related committee(s)	Nonpartisan legislative research staff that examine the budget
Serving primarily the budget and/or appropriations committees, but also other committees and members of both Houses (33 States)	16 States: AL, AK, CA, CT, DE, LA, MT, NC, NE, NH, OR, PA, TN, UT, VT, WI	2 States: TX, WA	14 States: AR, FL, NJ, IN, IA, KS, MD, ND, NV, NY, OH, SC, SD, WY		1 State : KY
Serving primarily the Joint Budget Committee of both Houses (5 States)		4 States: AZ, CO, MS, NM	1 State: ID		
Serving primarily the budget committee(s) in each house or one house only (12 States)		4 States : GA, MI, VA, WV	1 State : OK	2 States: HI, MN	5 States : LA, MA, ME, MO, RI

Sources: Websites of the legislatures of 50 States; internal document of National Conference of State Legislatures (NCSL)

Note: For the list of standard abbreviations of each State, see <http://state.1keydata.com/state-abbreviations.php>

- **Assessing fiscal stance:** LBOs do not make policy recommendations, but they may make suggestions for ensuring that the State's Constitutional balanced budget rule⁵⁷ is respected in the annual/biennial budget to be adopted by the General Assembly (the legislature). After adoption of the annual/biennial budget, some LBOs *monitor* budget implementation. Outside sessions of the legislature, budget analysts of LBOs may analyze specific fiscal policy measures, at the requests of House/Senate members (with a view to proposing them in future annual/biennial budgets or supplementary budgets). LBO analyses of such proposals are confidential until endorsed by the legislature's budget committee(s).
- **Costing.** For most LBOs, detailed *analysis* and checking of the plausibility of spending policies of the Governor's proposed annual budget is a very important activity. LBOs spend less time on analyzing revenue proposals. Many LBOs have a team of analysts to examine the spending requests of each State-owned agency. Proposals for changes in the budget are presented to relevant committees of the legislature. "Fiscal Notes", which cost specific revenue or expenditure measures, are prepared for this purpose. Some LBOs prepare over 1000 Fiscal Notes during each budget session. Some LBOs are also charged with examining the budgetary cost implication of each new piece of legislation presented in the legislature.

Several LBOs are involved in drafting appropriation bills. This is a time-consuming activity during budget sessions, especially in the States that have multiple appropriations bills. In Arkansas, for example, the legislature approves over 100 appropriation bills every year.

Size and budgets of LBOs

Well over half of the LBOs have 15 professional staff or less. Only a few LBOs have more than 30 staff. California's Legislative Analyst's Office (LAO) has a staff of 43 analysts and about 13 support staff. The LAO is second in size to the 100+ staff (not counting a large number of IT staff) of Texas' Legislative Budget Board (LBB). However, Texas' LBB is active, along with staff under the Governor, in scrutinizing Texan government agencies' initial draft proposals. In many States, the executive branch alone carries out such scrutiny, without input from the legislature at such an early stages of budget preparation.

The size of the LBO's budget obviously varies with staff numbers. As a rough rule of thumb, for each staff member, the average operating cost of the LBO is \$100,000. As one example: the annual budget for the 16 staff and non-salary expenses of the nonpartisan staff of Colorado's Joint Budget Committee was \$1.8m in FY2015.

Staff salaries are aligned to those of other nonpartisan staff serving the legislature. Remuneration packages are usually not much different from similar positions in the executive. However, in at least one State, the LBO staff salaries are a little lower than in the executive's Budget Office, resulting in staff recruitment/retention difficulties. A university degree is a prerequisite and several LBOs have staff have Masters degrees and even PhDs.

Assurance of LBO independence

LBOs have been established by a political consensus. As noted, LBOs' mandates have frequently been established in a law. LBOs are seen by political leaders to be most useful for

⁵⁷ Balanced budgets are a legal requirement in 46 States, debt/borrowing restrictions operate in 40 States, and revenue and/or expenditure rules are in place in 28 States (see Tables 9-11, NASBO, 2015). Also, some States require super-majorities to pass a tax or revenue increase.

providing budget analysis and drafting / analysing budget-related legislation, while refraining from making policy recommendations. Given this, to the knowledge of this author, no U.S. State LBO has ever had its activities deliberately cut back because of politics.

The Director of a typical State LBO is appointed by a bipartisan committee, which is composed of senior representatives of the two political parties (the Speakers, Majority and Minority Leaders of each house, plus the chair and/or delegated appointees of Budget or Appropriations and/or other Committees of the two houses). In principle, the same bipartisan committee should formally re-approve the Director every two years, following the biennial legislative elections for the House of Representatives and part of the Senate. In practice, however, the LBO's Director's leadership is usually not questioned by the incoming new political leaders. As a result, most LBO Directors stay in their positions for many years. For most LBO Directors, there are no term limits. One exception is the Director of Pennsylvania's IFO, who is on a six-year term that can be renewed multiple times.

Directors of LBOs generally have the authority to appoint and fire their nonpartisan staff, without any oversight of a committee of the legislature. When recruited, the LBO director ensures that the incoming staff are not involved in politics.

Having established credibility over many years, LBOs' own annual/biennial budgets are generally rolled over, with little change from year to year apart from inflation-linked increases for operating costs. If the LBO wishes to increase the number of staff, justification is needed. Increases in staffing can occur, for example, when the legislature decides to increase the number of its committees. Conversely, LBOs' budgets can contract if the number of committees declines (this occasionally happens).

If there were a decline in the operating budget of the executive branch (for economic reasons or for balancing the State's budget in the face of persisting revenue shortfalls), the nonpartisan staff of the legislature – including the LBO – would generally follow suit. LBO directors have discretion on how to manage infrequent budget cutbacks, e.g., by freezing or reducing non-salary costs such as postponing travel, placing staff on unpaid leave, or not recruiting temporary staff during legislative sessions.

Workload and Standard publications of LBOs

Many LBOs prepare the following documents for the budget committee(s) of the legislature:

- Analysis of draft legislation – the Governor's proposed budget and the budget law as it evolves through the appropriations approval process in the legislature.
- Draft appropriations bills and supplemental appropriations bills.
- Briefings and drafts for hearings for committee members.
- Fiscal Notes for proposed measures or legislation that has a budget impact.
- Appropriations Reports of the approved budget
- Budget In Brief – a summary of the budget, as approved by the General Assembly.

Some LBOs participate in:

- Revenue forecasting. About half the States participate in “consensus forecasting”, in which the executive and legislative branches, possibly with inputs from outside forecasters (see below for more details).
- Monitoring budget execution, by publishing monthly fiscal reports.
- Hearings – to explain non-policy aspects of the proposed or approved budget, including budget approval procedures.

Few LBOs participate in:

- Preparation of medium-term fiscal projections.
- Monitoring compliance with fiscal rules, except to ensure that the adopted budget is consistent with the State’s balanced budget rule, debt/borrowing rule, and/or revenue/expenditure rules.
- Meetings with the media.

A lot of the LBO’s work is determined by regular outputs required by law. However, LBOs generally also have discretion to initiate their own work, which is completed during the “off-season” – when the legislature is not meeting.

Nearly all outputs of the LBOs are published, especially in those States with an Open Records Law. State legislatures’ committees’ proceedings are also generally open to the public (especially in States that have adopted Open Meetings Laws), although there are also a few statutory exceptions.

Revenue forecasting

Forty-six States have a legal obligation for the Governor to present a balanced (operating) budget to the legislature. Optimistic revenue projections would lead to the adoption of a budget with spending appropriations that would prove to be un-financeable, at least by regular revenues. When revenue shortfalls occur, either in-year spending cuts would be needed or short-term borrowing (if allowed) would take place.

To minimize the risk of projecting revenues optimistically, a number of States have adopted “consensus forecasting” for budget revenues, in which either: (1) the executive, the legislature, and possibly outside experts meet and agree on suitable budget estimates for each major tax; or (2) the most plausible individual revenue projections of each participant in the “consensus group” are combined.

In nearly all States, the executive branch takes the lead in revenue forecasting. The legislature is not involved at all in about one third of the 50 States. However, in about two thirds of the 50 States, the legislature at least monitors, and possibly changes, the “official” revenue forecasts. In Montana, the legislature alone prepares the official budget revenue projections. In three States -- Hawaii, Nevada, and Washington -- the official revenue projection process is “outsourced” to independent councils or experts (entirely the private sector in Nevada).⁵⁸

⁵⁸ For details of institutional arrangements, see pages 37-38 of Boyd and Dadayan, 2015.

Although one may expect that consensus forecasting and/or the outsourcing of revenue forecasting to independent bodies might reduce forecast errors, Boyd and Dadayan, 2015, observe that, in the literature, there is very little relationship between consensus forecasting and forecast accuracy. This could be because it takes time to reach a consensus and that less-timely forecasts are less accurate. However, based on their own survey of institutional arrangements in the 50 States these authors conclude that consensus forecasting tends to lead to lower forecast errors. They suggest that efforts should be made insulate forecasting from the political processes.

Annex 5. Remit of the interim Scottish Fiscal Commission

The Commission's initial non-statutory purpose, remit and duties are set out in the Framework Document drawn up between the Commission and the Scottish Government in September 2014. The SFC's initial remit and duties are to:

- 1) Establish and maintain its independence from the Scottish Government;
- 2) Undertake independent scrutiny and assessment of forecasts, prepared by the Scottish Government, of receipts from Land and Buildings Transaction Tax and Scottish Landfill Tax and of the economic determinants underpinning Scottish Government forecasts of non-domestic rate income;
- 3) Decide what analytic method, modelling and approach to assessment the Commission will use to undertake its work;
- 4) Determine what analytic and secretariat resource the Commission requires and where to obtain that from;
- 5) Specify what information and data it requires from the Scottish Government;
- 6) Inform the Scottish Government of the timing of its programme of work;
- 7) Lay before the Scottish Parliament a report of its assessment of the Scottish Government's forecasts of tax receipts from the devolved taxes, and of the economic determinants underpinning forecasts of non-domestic rate income, at the time the Scottish Government publishes, and lays before the Scottish Parliament, its draft Scottish budget;
- 8) Respond to external enquiries concerning the information, data, analysis, judgments and conclusions which the Commission publishes; and
- 9) Conduct its business independently with integrity and transparency, and ensure records are retained to provide an audit trail for the external assessment of its work and use of public funds.

Annex 6. Portuguese Fiscal Policy Council: Access to information

Article 8 of the 2011 Law (*Lei n.º 54/2011*) Establishing the Council

- 1 — The Council shall have access to all the economic and financial information necessary for the accomplishment of its mission and all public entities are duty bound to supply this information in good time, as well as additional clarification in response to requests.
- 2 — The Council shall indicate the set of information to which it must have regular and automatic access, in accordance with a pre-defined calendar.
- 3 — The access to information mentioned in the above clauses 1 and 2 shall be subject to the legal restrictions in terms of State secrecy, judicial secrecy and banking secrecy.
- 4 — For the purposes of the assessment set out in paragraph a) of Article 6, the Government shall provide the Council with the macroeconomic models used and their underlying assumptions.
- 5 — Should any public entity not fulfil the duty of providing the information in good time, this shall be stated on the Council's webpage.
- 6 — Should the Council consider such non-fulfilment serious, the President of the Republic, the Assembly of the Republic [Parliament], the Tribunal de Contas [External Audit Office] and the Banco de Portugal [Central Bank] shall be duly informed.