

Scotland's Fiscal Framework – Call for Evidence from the Finance Committee of the Scottish Parliament

A Submission by:

**The Chartered Institute of Public
Finance and Accountancy**

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

Any questions arising from this submission should be directed to:

Don Peebles

Head of CIPFA Scotland
CIPFA in Scotland
Level 3 Suite D
160 Dundee Street
Edinburgh
EH11 1DQ
Tel: +44 (0)131 221 8653
Email: don.peebles@cipfa.org

Alan Bermingham

Policy and Technical Manager
(UK Devolved Regions and Ireland)
3rd Floor, Lesley Exchange 2
22 East Bridge Street
Belfast
BT1 3NR
Tel: +44 (0)2890 266 1653
Email: alan.bermingham@cipfa.org

1. Executive Summary

1.1 Within this submission, CIPFA will focus its evidence on:

- What the structure of the Scottish Fiscal Framework should look like
- The mechanisms that underpin the operation of the Fiscal Framework and;
- The opportunity the Scottish Government has to modernise its fiscal framework, ensure it is fit for purpose and fully supports a modern, forward looking democratic system of government in Scotland.

1.2 In order to underpin a successful fiscal framework, CIPFA advocates that the Scottish Government must be able to answer four critical questions:

- What is the current financial position of the Scottish public sector?
- What will be the impact of the medium to longer term financial plans, both revenue raising, borrowing and investing plans?
- What is the fiscal impact if further devolution takes place?
- How affordable and sustainable are those plans and what risks are being faced?

1.3 Crucial to answering those questions is having the appropriate supporting state level financial information on Scotland's overall finances. CIPFA would strongly urge that the Scottish Government develop the mechanisms and approaches to support putting that in place, a feature of which would be a balance sheet for Scotland.

1.4 CIPFA also makes the following conclusions and recommendations for the Committees consideration:

- The Fiscal Framework should have a legislative basis which requires the Government to set out its fiscal objectives and its policy for managing debt and raising taxes.

- The overall structure of the Fiscal Framework should be consistent with the UK Governments framework¹ and contain four elements (see appendix 1):
 - The Fiscal Policy Framework
 - The Fiscal Mandate
 - The Operation of the Framework and;
 - How Independent Fiscal Review will take place
- Principles underpinning the fiscal policy framework of financial sustainability, affordability and prudent financial management should be explicit in the policy framework statements.
- The Scottish Parliament should consider this an opportunity to develop a modernised, fit for purpose fiscal framework which includes all the necessary financial levers to deliver public financial management.

2. The Practical Impact of Additional Fiscal Powers

- 2.1 Tax powers will give the Scottish Government more control over the amount of revenue they raise (although this will be offset from the block grant from HM Treasury) and make them more financially accountable to Scottish taxpayers.
- 2.2 Borrowing powers will enable greater flexibility to spread the costs of infrastructure investment, and so service provision, over financial years, but will result in an accompanying commitment to repay the debt in future years.
- 2.3 The majority of Scotland's income will still be in the form of the block grant, with the accompanying restrictions and limitations on financial planning and management, such as no end of year flexibility and the lack of ability to decide reserves.
- 2.4 From April 2015 (when Land and Buildings Transaction Tax and Scottish landfill tax are devolved), the Scottish Government will be able to borrow up to £200 million in any one year, with a cumulative limit of £500 million to manage differences between forecast and actual tax revenues. Such revenue borrowing will have to be repaid within a maximum of four years, and will impact on the financial position of the Scottish public

¹ Charter for Budget Responsibility, Autumn Statement Update 2014: HM Treasury
<https://www.gov.uk/government/publications/charter-for-budget-responsibility-autumn-statement-2014-update>

sector, counting as a liability on the Scottish Government's balance sheet.

- 2.5 The *Scotland Act 2012* also provides new capital borrowing powers from April 2015 for investment in infrastructure. The Scottish Government will be able to borrow up to 10% of their capital budget² in any one year, with a cumulative limit of £2.2 billion over ten years.
- 2.6 The Scottish Government has set out that capital borrowing powers available in 2015-16 will be £304 million³, and the Scottish Government has indicated that it intends to utilise the full £304 million of available borrowing in the 2015-16 financial year to maximise its capital investment.
- 2.7 The Scottish Government will not only be able to borrow from the National Loans Fund and Commercial Banks, it will also be able to issue bonds. This will not alter the levels of borrowing available, but provides an additional source of borrowing, allowing the Scottish Government to directly access the capital markets and issue its own debt.⁴
- 2.8 This capital borrowing power will impact on Scotland's balance sheet, both in terms of increased assets (the infrastructure investment) and increased liabilities (the obligation to repay debt). This power will also impact significantly on the financial sustainability of public services for the future, and imposes a significant level of responsibility and stewardship on the Scottish Government to ensure that such debt is affordable and appropriately managed, and does not represent an unmanageable tax burden on future generations.
- 2.9 To manage this risk and level of accountability it is appropriate to have a formally updated fiscal framework in place as outlined in the Command Paper.⁵ However, CIPFA believes this provides a real opportunity to consider what strategic fiscal policies and framework should be in place over the longer term that meet the obligations and responsibilities outlined in paragraph 2.8 and provide real accountability to the Scottish Electorate.

3. Mechanisms for Fiscal Policy Management

- 3.1 The recommendation from the Command Paper is that an updated fiscal framework for Scotland should be consistent with the overall UK fiscal

² Capital departmental expenditure limit (DEL)

³ Scottish Budget – Draft Budget 2015-16 <http://www.gov.scot/Resource/0046/00462296.pdf>

⁴ HM Treasury and Scotland Office, News Story, [Scotland to be given powers to issue its own bonds](#), 19 February 2014.

⁵ Scotland in the United Kingdom: An Enduring Settlement, Chapter 2

<https://www.gov.uk/government/publications/scotland-in-the-united-kingdom-an-enduring-settlement>

framework.¹ However, consistency does not necessarily mean that the content has to exactly reflect the UK fiscal policy objectives or the current UK government's fiscal mandate. Therefore the Scottish Parliament should consider modernising and updating the Fiscal Framework to be appropriate for Scotland.

3.2 It is important that any updated fiscal framework reflects the responsibilities and accountabilities that the Scottish Government has to the population of Scotland and; provides a basis to cope with any future increase in the level of devolved powers, given that all the major UK parties are making commitments to devolve further powers across the UK. We consider that the necessary fiscal levers include:

- Borrowing powers
- Power to hold reserves
- Improved financial reporting, including a Scottish public sector balance sheet, which provides an opportunity to scrutinise performance of Scotland's public services

3.3 Currently the UK's fiscal framework is underpinned by legislation in the form of the Budget Responsibility and National Audit Act 2011. This provides a basis under which the UK government sets out its objectives for fiscal policy, its directive (or fiscal mandate) to HM Treasury for fiscal policy and how it intends to operate fiscal policy.¹ This legislative basis also sets out the statutory remit for the Office of Budget Responsibility which has the role of providing the Government with authoritative analysis of the UK's public finances.

3.4 Applying this structure on a consistent basis to Scotland would require the Scottish Government to consider a legislative basis for the Scottish Government to review and put in place a fiscal policy framework, including how it is operated.

3.5 We note the Scottish Government's current consultation on the Scottish Fiscal Commission and its expanded remit. CIPFA welcomes confirmation of its independent status and its functions of assessing and reporting on Scottish Ministers plans, projections and forecasts of Taxes and Borrowing.

3.6 The Scottish Parliament will need to consider its fiscal policy aims. This should take account of the powers it now has and the likelihood for further devolved powers. The fiscal objectives should include clear principles and promote good practice in delivering sustainability,

affordability and prudent public financial management⁶ over the medium to longer term. Also, that the Scottish Governments interventions, through taxation and borrowing, promote economic growth and stabilise the economy over the course of the Economic Cycle.⁷

3.7 Appendix 1 to this document sets out an approach to the Scottish Fiscal Framework that correlates with the UK Government's approach.

4. The Opportunity to Enhance Fiscal Accountability and Management of Public Finances

4.1 Alongside the need to review and update the Scottish Government's fiscal framework, there is also a requirement to ensure that the supporting monitoring, review, reporting and general scrutiny and governance processes are fully supporting a system of robust public financial management. Only through ensuring that this is in place will the Scottish Government be confident of its ability to manage the operational aspects of its new powers.

4.2 We noted in our Executive Summary, paragraph 1.2, that there are four key questions that the Scottish Government must be able to answer. In order to achieve that, it is essential to have in place robust and timely reporting of the financial position and state of public finances in Scotland.

4.3 The current position provides an opportunity to review the current policies practices and enhance or revise those where appropriate. This includes the overarching fiscal policy framework, operation and supporting fiscal mandate for Scotland. Clear principles should be included in that statement and it should include a statement on a balanced approach to the current budget⁸ over the Economic Cycle. Principles would include:

- Affordability
- Prudence
- Sustainability

4.4 These principles would refer to the medium to longer-term nature of public finances in Scotland and encompass the current budget and investment in capital projects, the capital budget. Supporting measures

⁶ Public Financial Management – a whole system approach <http://www.cipfa.org/policy-and-guidance/reports/whole-system-approach-volume-1>

⁷ 'Evidence on the Economic Cycle', HM Treasury, November 2008

⁸ Resource departmental expenditure limit (DEL)

should be based around the implementation of a prudential management regime. This would support and further develop the recommendations from the Smith Commission⁹ and we believe will provide a flexible and accountable approach for management of Scotland's public finances.

- 4.5 There is flexibility in this approach as the overall fiscal policy can set the principles to be employed. This is supported by the fiscal mandate that ensures that the appropriate set of prudential measures are developed for the budget annually and reviewed in year as necessary.
- 4.6 The accountability of the Scottish Government is enshrined in the fact that it is the Scottish Parliament that decides on the affordable level of borrowing within the prudential regime and sets the measures of affordability, prudence and sustainability.
- 4.7 The robustness of the estimates can be checked, independently reviewed by the Scottish Fiscal Commission and approved by the Scottish Parliament as part of the budget and funding allocation cycle.

5. Independent Review

- 5.1 Consistent with the approach and role that the Office of Budget Responsibility¹⁰ performs for the UK Government, we believe that there is an enhanced role that the Scottish Fiscal Commission can perform and welcome the proposed legislation outlined in the Scottish Governments consultation on the Scottish Fiscal Commission.
- 5.2 Their role should be enhanced to providing an independent review of the estimates and assessments made in the Scottish Governments medium to long-term planning. It can also provide the Scottish Parliament with a view on the robustness of the Scottish Government's estimates and measures of prudence, sustainability and affordability.
- 5.3 We acknowledge the Scottish Governments consultation on the Scottish Fiscal Commission. We support the proposal that the Commission should provide independent economic and fiscal forecasts to the Scottish Government in order to support decisions by Government on budgets and plans, official financial statements and published measures.

⁹ The Smith Commission Report, paragraph 95 (5) (b) http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf

¹⁰ Role of the Office of Budget Responsibility - <http://budgetresponsibility.org.uk/about-the-obr/what-we-do/>

Appendix 1. – Scotland’s Fiscal Framework Outline:

Framework Area	Purpose	Basis	Operation
Fiscal Policy Framework	This sets out the Scottish Governments overall objectives for fiscal policy.	Requires annual review under a legislative basis.	Would be updated following agreement of the Budget by the Scottish Parliament.
Fiscal Mandate	Provides a mandate for the Finance Directorate and Deputy First Minister.	Set out in the Annual Budget Statement, including appropriate prudential measures.	Underpins allocations of funding and the parameters within which funding and investment decisions are made.
Framework Operation	To provide the mechanisms for parliamentary scrutiny of public finances.	Set out in Deputy First Ministers Budget Statement. It would also be incorporated into any revised budget approval, reporting and funding allocation cycles.	Covers the duty to publish a budget each year. Complete in year monitoring and review and importantly covers the operation of independent review of the Scottish Governments forecasts and projections.
Independent Fiscal Review	To establish the role and duties that provides the basis of independent review of the policy framework and its outcomes.	Memorandum of understanding between the Scottish Government and the Independent Review Body, functions of which are set out on a legislative basis.	Establishes the relationship between the Scottish Government and its independent fiscal review body. This body can also link into the UK Government on issues of block grant adjustment and the position on no detriment to the respective budgets as a result of devolved powers.

