

<b>Institution:</b> University of Glasgow (UofG)		
<b>Unit of Assessment:</b> UoA 17 Business and Management Studies		
<b>Title of case study:</b> Establishing the Scottish Fiscal Commission		
<b>Period when the underpinning research was undertaken:</b> 2001–2018		
<b>Details of staff conducting the underpinning research from the submitting unit:</b>		
<b>Name(s):</b> (1) Campbell Leith (2) Tatiana Kirsanova (3) Ioana Moldovan (4) Charles Nolan	<b>Role(s) (e.g. job title):</b> (1) Professor of Macroeconomics; (2) Professor; (3) Lecturer; (4) Bonar MacFie Chair in Economics	<b>Period(s) employed by submitting HEI:</b> (1) 1999–present (2) 2011–present (3) 2006–present (4) 2010–present
<b>Period when the claimed impact occurred:</b> 2014–2020		
<b>Is this case study continued from a case study submitted in 2014?</b> No		
<p><b>1. Summary of the impact</b></p> <p>Professor Leith and colleagues have developed an extensive body of research on fiscal policy and its institutions in response to fiscal policy failures. They have used this research to develop principles and practice that have had a threefold impact on the redesign of Scottish arrangements:</p> <ol style="list-style-type: none"> <li>1. The formation and design of the Scottish Fiscal Commission (SFC) in June 2014.</li> <li>2. The Scottish Government's bargaining position over the rules which support Scotland's newly devolved fiscal powers following the independence referendum of 2014.</li> <li>3. The development (with Leith and Nolan as Commissioners) of the SFC's remit as it became a statutory body in April 2017.</li> </ol>		
<p><b>2. Underpinning research</b></p> <p><b>2.1. Exploring the design and implementation of macroeconomic stabilisation policy</b></p> <p>Between 2001 and 2011 Professor Leith was the Principal Investigator (with co-investigator Simon Wren-Lewis of the University of Oxford) on 3 ESRC-funded projects exploring the design and implementation of macroeconomic stabilisation policy, especially fiscal policy. The research, particularly papers [3.1–3.5], combined an analysis of public finances with Keynesian business cycles to describe how a benevolent policy maker should use fiscal policy over the business cycle. A key insight, in a variety of contexts, is that it is optimal to use government debt as a shock absorber and that following adverse economic events the policy maker needs to trade off the short-run costs of fiscal austerity against the long-run benefits of lower debt. One striking result from this analysis is that this balance is very fine—it is optimal to use fiscal policy to stabilise debt following a recession, but returning debt to its pre-recession level should be undertaken only very slowly.</p> <p>However, this policy recommendation assumes that the policy maker is both benevolent and able to make credible promises about their own future behaviour. In the absence of such an ability to commit, the government may be tempted to use inflation to reduce the real value of that debt. Moreover, in the real world, fiscal policy is typically implemented by governments subject to the constraints of the political process. For numerous reasons this may result in a 'deficit bias'—a tendency for governments to run sub-optimally high fiscal deficits—which can account for the rising government debt levels in many advanced economies over recent decades. Recognising the costs of such biases, many politicians have sought to tie their own hands by adopting some form of fiscal rule, which often requires debt and deficits to be stabilised over relatively short time horizons. However, possibly since such rules clearly violate the gradual fiscal adjustment implied by descriptions of optimal policy, they have often been broken at the point where they start to bite. This has happened so often that it is difficult to see such rules now having any credibility.</p> <p><b>2.2. Proposing the creation of independent fiscal councils</b></p> <p>An early statement of the policy implications of this research is [3.1], which built on the work-in-progress subsequently published in [3.2, 3.3]. The research [3.1] proposed the creation of independent fiscal councils to help bring policy closer to the optimal one of gradual fiscal correction without resorting to excessive inflation or preventing the use of government debt as a</p>		

shock absorber over the business cycle. The argument is that the adoption of a fiscal rule which is gradual and recognises the need to respond to the business cycle (unlike the overly aggressive rules often adopted in practice) may lack credibility, which the monitoring of outcomes relative to the rule by an independent fiscal council can help provide. Subsequent research, for example [3.4, 3.5], has confirmed this insight in richer settings.

### 3. References to the research

3.1. Kirsanova, T. , Leith, C. and Wren-Lewis, S. (2007) [Optimal debt policy, and an institutional proposal to help in its implementation](#). *European Economy Economics Papers*, 275, pp. 269–296. (doi: [10.1057/9780230271791\\_12](#))

3.2. Leith, C. and Wren-Lewis, S. (2011) [Discretionary policy in a monetary union with sovereign debt](#). *European Economic Review*, 55(1), pp. 93–117. (doi: [10.1016/j.eurocorev.2010.11.007](#))

3.3. Leith, C. and Wren-Lewis, S. (2013) [Fiscal sustainability in a new Keynesian model](#). *Journal of Money, Credit and Banking*, 45(8), pp. 1477–1516. (doi: [10.1111/jmcb.12060](#))

3.4. Leith, C. , Moldovan, I. and Wren-Lewis, S. (2018) [Debt stabilization in a Non-Ricardian economy](#). *Macroeconomic Dynamics*, 23(6), pp. 2509–2543. (doi: [10.1017/S1365100517000797](#))

These papers were all cited in evidence given to the Finance Committee relating to both the creation of the Scottish Fiscal Commission and the design of the Fiscal Framework governing the extended fiscal powers granted to Scotland following the independence referendum. However, the body of work undertaken by colleagues at the UofG, informing Professors Leith and Nolan’s input in both the creation and development of the Scottish Fiscal Commission, is greater than this. Much of this work is reviewed and extended in:

3.5. Leeper, E. M. and Leith, C. (2016) [Understanding inflation as a joint monetary-fiscal phenomenon](#). In: Taylor, J. B. and Uhlig, H. (eds.) *Handbook of Macroeconomics Volume 2*. Elsevier, pp. 2307–2417. ISBN 9780444594884

The application of the principal insights of this research can be seen in the detailed analysis contained in:

3.6. Leith, C., Nolan, C. & Rice, S. (2016) [Report on Draft Budget 2017-18](#), Scottish Fiscal Commission.

The following three ESRC grants generated the research which underpinned the impact. For each grant Professor Leith was the Principal Investigator (all were rated ‘outstanding’):

- 1) ESRC Grant (2001–2004) GBP50,000 for research on “Interactions Between Monetary and Fiscal Policy” joint with Simon Wren-Lewis (University of Exeter).
- 2) ESRC Grant (2005–2008) GBP147,000, for research on “Reinstating Fiscal Policy as a Stabilisation Device” joint with Simon Wren-Lewis (University of Oxford).
- 3) ESRC Grant (2008–2011) GBP150,000 for research on “New Directions in Monetary and Fiscal Policy Analysis at the Macroeconomic Level” joint with Simon Wren-Lewis (University of Oxford).

### Evidence of the quality of the underpinning research

Outputs [3.1], [3.2], [3.3] and [3.4] are published in international double-blind peer-reviewed economics journals. Output [3.5] is a chapter in a peer-reviewed edited Handbook from a high-reputation publisher. Output [3.6] is a report written in the researchers’ capacities as Scottish Fiscal Commissioners.

#### 4. Details of the impact

##### 4.1. Pathway to impact

Through a long-term consistent strategy of engagement with communities of policy making, economic forecasting and institutional design, Professor Leith and colleagues forged three principles from the underpinning research to shape policy and practice. First, the Scottish Fiscal Commission should be fully independent from the Scottish Government. Second, it should support fiscal sustainability. Third, the SFC, and its operating Fiscal Framework, should enable policy makers to respond flexibly to shocks. This third principle is the key insight from the underpinning research: the point of fiscal councils is to ensure unbiased fiscal forecasting and enhanced credibility in support of policies which mimic what we believe to be optimal policy. This is in contrast to the non-credible fiscal rules which have been adopted and, just as quickly, abandoned in the past.

##### 4.2. The creation and evolution of the Scottish Fiscal Commission

Ahead of the SFC being established, Scottish Government forecasts and their underlying methodologies were not independently scrutinised. Initially, that scrutiny was the central role for the SFC when it was created as a non-statutory body in June 2014. However, following the independence referendum of the same year, additional borrowing and fiscal powers were granted to Scotland. As a result, the remit of the SFC expanded and its status changed from non-statutory to statutory body in 2017. This change was acknowledged by the SFC becoming a member of the OECD's group of recognised Independent Fiscal Institutions (IFIs). At this point the SFC assumed the role of official forecaster for Scotland. This marked a step change in Scotland's economic policymaking.

The initial link in the chain of impact was the involvement of Professor Leith in calls for a fiscal council to be created for Scotland. The body of research explicitly underpinned Leith's written evidence [5A] to the Finance Committee of the Scottish Parliament, which was relied on in supporting their recommendation that the SFC be created (confirmed by the official report and transcript of Leith's oral evidence [5B]). For example, the report relies on Leith's definition of the role of the SFC, 'The objective of an independent fiscal body is summarised by Professor Campbell Leith as being "...to allow for short-run flexibility in a way that adherence to fiscal rules may not allow, but to ensure that this does not jeopardise long-run fiscal solvency."'

Upon the formation of the SFC, Leith was then invited by the Finance Minister to be one of three founding members (Commissioners) of the SFC (confirmed by the Committee's assessment of Leith's nomination [5C]). The fact that Leith was appointed as a founding Commissioner provides evidence that his vision for the role of the SFC was accepted by the Scottish Government (confirmed by final report and transcript of oral evidence [5D]). Leith was then joined by UofG colleague, Professor Nolan, who became a Commissioner in 2016, following the resignation of one of the original Commissioners.

##### 4.3. Informing the Scottish Government's negotiating position

Professor Leith was also involved in providing evidence to the Scottish Parliament on the appropriate form of fiscal rules for Scotland, which informed their negotiating position in agreeing the Fiscal Framework governing the implementation of further fiscal powers following the Scottish independence referendum of 2014. This written evidence again cited and drew on the published research of the UofG researchers named above [5E]. The final report of the Finance Committee relied heavily on this evidence in formulating its recommendations, which were broadly accepted by the Scottish Government as its bargaining position (confirmed by official report [5F]).

For example, the report cites Leith's view on fiscal rules, "Professor Campbell Leith suggests that 'fiscal targets should facilitate the use of debt as a shock absorber.' If the 'borrowing limit is too low, the effective use of government debt as a shock absorber will be compromised.' These fiscal targets 'should apply over a sufficiently long time horizon to allow gradual adjustment to the target and the time horizon should be rolling. The targets should also be set in terms of deficits and not debt'" [5E]. This was used to justify the Committee's recommendations, "The Committee's view is that it is clear that the level of borrowing powers for current spending will

need to be significantly increased and should be commensurate with the risks faced by the Scottish Government post-Smith. The Committee notes that the precise types of risk Scotland may be exposed to will be determined by the block grant adjustment method which is intended to insulate Scotland from UK-wide economic shocks. At the same time there will also be a Scotland-specific cyclical risk and the Scottish Government will require substantial new borrowing powers to manage this volatility” [5F].

#### 4.4. The design and ongoing development of Scotland’s fiscal framework

In light of the further devolution of fiscal powers, the provision of evidence on how the SFC’s remit should evolve was an ongoing aspect of Professor Leith and Nolan’s roles as Commissioners. This was done formally in both closed and open sessions of Committees of the Scottish Parliament, particularly the Finance Committee (confirmed by official reports [5G][5H][5I]). However, Commissioners were also regularly briefed on, and able to influence, the drafting of the legislation which formalised the SFC’s status and remit as a statutory body. Leith and Nolan were also heavily involved in designing the structure of the SFC, as well as its way of operating, as it expanded to a staff of approximately 20 people. Moreover, Professor Nolan represented the SFC on a parliamentary committee, The Budget Progress Review Group, which sought to change the budget process to enhance both the Scottish Parliament and SFC’s scrutiny of the Scottish Budget following the creation of the SFC (confirmed by official report [5J]).

The initial evidence Professor Leith gave to the Scottish Parliament made the general case for fiscal councils, but also included specific recommendations for the Scottish context (confirmed by written evidence [5A]). In particular, it stressed the need to ensure cooperation rather than conflict with the UK sister body, the Office for Budget Responsibility (OBR). For example from the Finance Committee’s Report [5B], “The matter of the relationship between an independent fiscal body and the OBR was commented on by Professor Leith [...] an independent Scottish Fiscal Council could enhance the policy making process by making independent forecasts of variables of sole interest to Scotland. For other items which impact on both Scotland and the rest of the UK, a formal working relationship between the Scottish Fiscal Council and the OBR which aims to produce a single consensus forecast would facilitate the gains from cooperation, without undermining the credibility of either body.” To this end, upon being appointed as a Commissioner, Professor Leith promoted the holding of regular meetings with the OBR to ensure there was a shared reconciliation of their respective forecasts, thereby preventing any differences being exploited politically. Thereafter, Professors Leith and Nolan were in regular contact with the OBR.

#### 4.5. Beneficiaries

The establishment of the SFC has reduced suspicion of politically influenced forecasts, generated trust in its work and enhanced fiscal transparency. An OECD review of the SFC (2019) confirms that, “[it] has been successful in establishing constructive relationships with key stakeholders and has quickly developed a reputation for delivering independent and credible forecasts. The SFC’s independence is underpinned by strong enabling legislation ... The SFC has become a voice of authority, and is credited with enriching the fiscal policy debate in Scotland. It has significant engagement with the Scottish Parliament and receives broad media coverage” [5K]. Chapter 5 of the OECD review further evidences the positive impact of the SFC. As Scotland’s official forecaster, it has a direct influence on the parameters of the annual budget and informs MSPs (who between April 2017 and May 2019 made 62 references to the SFC in parliamentary questions). In addition, the OECD found that through its reports, website, social media, press conferences and regular interactions with journalists, the SFC has established significant media impact [5K]. Thus, the ultimate beneficiaries of this impact are the people of Scotland and the evolving devolved governance of the country.

### 5. Sources to corroborate the impact

#### Creation of the SFC:

[5A] Professor Leith’s initial written evidence (which cites the underpinning research) on the desirability of creating the SFC can be found in the [official papers](#) for the Finance Committee’s meeting of 27 November 2013 [PDF Available].

[5B] [The official report and transcript of the associated oral evidence](#) *[PDF Available]*.

[5C] [The Committee's assessment of Leith's nomination](#), which includes further written evidence from Leith on how he envisions the SFC operating. The fact that Leith was subsequently appointed as a founding Commissioner provides evidence that his vision for the role of the SFC was accepted by the Scottish Government *[PDF Available]*.

[5D] Prior to being formally appointed, Professor Leith's nomination was further scrutinised, which gave him the opportunity to reiterate exactly how he would see the SFC operating in light of his research in this area. This took place in the Finance Committee meeting of 28 May 2014: [Final Report and Transcript of Oral Evidence](#) *[PDF Available]*.

#### **Design of Scotland's Fiscal Framework:**

[5E] Professor Leith gave written evidence on the desirable form of the fiscal rules (again citing the underpinning research) to be adopted as part of Scotland's Fiscal Framework and how these can be complemented by the activities of the SFC. The Finance Committee's report (Leith's written evidence is included in Annex A) on the Fiscal Framework which cites and draws heavily on this evidence can be found [here](#) *[PDF Available]*.

[5F] [The Scottish Government's response](#), which accepts many of the recommendations, can be found in Annex A of the official papers for the Finance Committee's meeting of 2 March 2016 *[PDF Available]*.

#### **Ongoing Development of the SFC's Remit:**

Professors Leith and Nolan gave evidence to the Finance Committee in both closed and open sessions on many occasions. Videos, transcripts and reports of this testimony can be found on the Finance Committee's website. While some of these sessions relate to the scrutiny work of the SFC, some relate to the debate as to how the SFC should develop as Scotland obtained additional fiscal powers following the Scottish independence referendum, for example in the meeting of the Finance Committee of 25 November 2015.

[5G] [Official Papers](#) (including submissions from Leith) *[PDF Available]*.

[5H] [Official Report](#) (including transcript of oral evidence) *[PDF Available]*.

[5I] [The Stage 1 Report](#) on the development of the SFC's remit, which includes correspondence between the Committee and the SFC (including Leith and Nolan) *[PDF Available]*.

[5J] Professor Nolan also represented the SFC in his membership of the Budget Progress Review Group of the Scottish Parliament, which sought to strengthen parliamentary scrutiny of the Scottish Budget process in light of the creation of the SFC. The report of this Committee can be found [here](#) *[PDF Available]*.

#### **Beneficiaries:**

[5K] [OECD Independent Fiscal Institutions Review: Scottish Fiscal Commission \(SFC\)](#) (2019) (Quote from 'Highlights', p. 2; additional information from Chapter 5 on the impact of the SFC, p. 59–70) *[PDF Available]*.