FISCAL AUTONOMY UNDER DEVOLUTION: INTRODUCTION TO SYMPOSIUM

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INTRODUCTION

How Fiscal Autonomy Came on the Agenda

'Full fiscal autonomy' is a term used in media and political debate without any great precision as to its meaning. This is often accompanied by confusion about the fiscal powers presently available to the Scottish Parliament, which is characterised as having no fiscal powers and as being wholly dependent on grants from the UK government. Neither of these statements is true. The Scottish Parliament has, for example, more decision-making power over taxes than has any of the German Länder, and about 15% of spending comes from taxes under its control.

Nevertheless, important issues have been raised in recent controversies under the fiscal autonomy umbrella. It is certainly true that the Scottish Parliament is more dependent than intermediate levels of government in mature...
federations (ie states and provinces) on grants from the centre, and there are those who argue that this makes the Scottish Parliament less 'accountable'.

The debate was brought to life during last year's General Election campaign when 12 economists signed a letter to the Scotsman (Cross et al 2001) arguing for 'fiscal autonomy' (without defining what was meant by that term), asserting that this would improve Scotland's economic prospects.

During the subsequent acrimonious exchanges, it became clear that those calling for full fiscal autonomy started from different preconceptions: some believed that this would allow the Scottish Parliament to spend more with unchanged tax levels, whereas others expected – perhaps welcomed – severe expenditure retrenchment. The first group started from the belief that Scotland raises more in taxation than is spent on public services, so that fiscal autonomy would allow either higher levels of public services or lower taxation. The second group consisted of those with the opposite belief, namely that Scotland spends more than it raises. Within this second group, there were two sub-groups: those outside Scotland who want to see an end to what they perceive as subsidy; and those within Scotland who believe that having to cut the cloth will lead to a reduction in the size of the public sector, which will in turn bring economic benefits (Jamieson 2001).

Although the term 'full fiscal autonomy' might not again enjoy the profile that it had in May 2001, certain issues have been placed on the political agenda and seem likely to stay there. There is some evidence that Scottish public opinion has been influenced. For example, the Herald reported on 7 October 2002 that 57% agreed with the proposition 'that the Scottish Parliament rather than Westminster should be responsible for raising taxes to cover public spending'; 30% disagreed and 12% were undecided (Dinwoodie, 2002).

The language may evolve over time. Recently, the SNP has switched from 'full fiscal autonomy' or 'full fiscal freedom' to 'fiscal independence', though

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3 There is much appeal by commentators to the concept of 'accountability', though the meanings attached to accountability are often imprecise and inconsistent. This issue is briefly addressed in the 'Assessment' section.
there remains a lack of precision as to what this means in the context of devolution.

**Alternative Meanings of Fiscal Autonomy**

If Scotland were independent, its public finances would be entirely separate from those of the remaining part of the UK. There would be no more link than there presently is between the public finances of the UK and those of the Republic of Ireland. If a member of the EU, Scotland would have the same powers, and be subject to the same constraints on taxation policy, as any other member state. Economic analyses of independence will focus primarily on whether Scottish economic performance would improve or deteriorate, and, if improvement, whether this would be sufficiently marked and rapid for the structural deficit (analysed in Goudie, in this issue) to be manageable.

The topic of this Symposium is 'Fiscal autonomy under devolution', thereby excluding discussion of the case of Scottish independence (see Murkens et al. 2002).

The concept of fiscal autonomy under devolution is much more blurred than its counterpart under independence. In practice, devolved financial arrangements are likely to be assessed on multiple criteria; Goudie (2002, p. 76, in this issue) lists seven dimensions on which to analyse fiscal activity at sub-national and local levels. There is a wide range of possibilities and that range is illustrated by three examples.

At one extreme is what might be termed 'spend what you raise in revenue'. The Scottish Parliament would have the power to raise whichever taxes it liked, whether or not the UK government raised similar taxes; it would have the power to borrow; social security would be devolved (and funded from Scottish taxation); and there would be no UK-wide equalisation. This would leave the UK to provide 'national' services from a separate system of taxation and borrowing. Although systems of separate taxation do exist elsewhere (eg in Canada and the USA), such a system would be more difficult to operate in an asymmetric situation such as occurs in the UK.

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4 A possible variant is to leave social security as a central government function.
A variant of this scheme is that Scotland would retain all the tax revenue generated in Scotland and meet all its own public expenditure requirements, including a payment to Westminster for reserved services, effectively modelled on the Imperial contribution of the Government of Ireland Act 1920.

At the other extreme all decisions on tax structures, bases and rates would be taken by the UK government, with the Scottish Parliament receiving as its revenue the estimated tax yield in Scotland. Alternatively, the proceeds of certain taxes might be treated as Assigned revenues, attributed on some basis such as estimated yield (ie derivation basis) or on population or needs-weighted population (ie equalisation basis).

A middle formulation would involve there being UK-wide equalisation, either limited to differences in taxable capacity or extended further to allow for differential needs. There are a large number of possible arrangements, both of how much devolved control there is over taxes and of how much equalisation takes place.

The public debate is often confused, with little explicit statement of either equalisation or tax-setting policies. Some proponents of fiscal autonomy appear to imply that the Scottish Parliament would determine tax bases and determine tax rates; others that the revenue accruing to the Scottish Parliament would be an incidental consequence of decisions on tax bases, structures and rates taken by the UK Treasury. In addition, the practicalities arising from membership of the EU (and perhaps of the single currency) are often ignored.

Whatever the precise detail, a fundamental counterpart to a revenue-based system must be extensive borrowing powers. Otherwise, the Scottish Executive could not balance expenditure and revenue at the time of a cyclical downturn, especially if Scotland were differentially affected. It would be difficult to forecast Scottish revenue, because of both macroeconomic uncertainties and the effects of UK Treasury decisions when these affected the Scottish yield. On the latter point, there has been much discussion of the
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micro-management of the tax system during Gordon Brown's Chancellorship.

Later in this article, we examine the reasons why a supposed revenue basis for financing devolved government can quickly be transformed into a non-transparent expenditure basis.

The Motivation of the Symposium

The purpose of this Symposium is to allow authors holding different views to develop their arguments at length. These articles will inform the debate on fiscal autonomy, by clarifying the issues involved and by clearly marshalling the arguments which underpin different policy positions.

In this introductory article, we set the scene for the other articles and offer our own interpretation of the present position and of the available policy choices. The next section summarises the key features of the financial structure of devolution, concentrating upon the revenue-raising side. Then attention turns to what we regard as the fundamental policy issues: the choice between a revenue or expenditure basis for financing devolution; the form

5 An excellent example of the implications for devolved finance of UK tax policy is provided by the changes to the income tax structure made in the March 1999 Budget. This restructured tax bands, replacing the existing 20% band (£0-£4,300 of taxable income) with a starting band of 10% (£0-£1,500), with the net effect that the basic rate (23% in 1999-00) started at a taxable income of £1,500. Treasury (1999, p. 99) stated: 'Effects on the Scottish Parliament's tax varying powers – statement regarding Section 76 of the Scotland Act 1998: After the changes..., a one penny change in the Scottish variable rate in 2000-01 could then be worth approximately plus or minus £230 million, compared with plus or minus £180 million prior to these changes. In the Treasury's view, an amendment of the Scottish Parliament's tax-varying powers is not required as a result of these changes'. These UK changes increased the potential yield of the tartan tax, yet arguably made it more difficult to levy because its starting point is now lower down the income scale. The Treasury (2002a, p. 159) estimate that a 1p change in 2002-03 would still be worth approximately £230m, giving a potential variation of £690m in either direction.

6 We do not discuss the Barnett formula, though we have written about it elsewhere (Heald and McLeod 2002). In this Symposium, sharply divergent views on the merits of the Barnett formula are advanced by Midwinter (2002, in this issue) and Bell and Christie (2002, in this issue).
and extent of equalisation; and the constraints on operating a revenue basis in the UK. A brief assessment then examines the issue of accountability and fiscal responsibility. The final section provides a brief discussion of the coverage of each of the other five articles.

**FUNDING STRUCTURE OF THE DEVOLUTION SETTLEMENT**

Satisfactory data on the funding system of the Scottish Parliament are missing, particularly comparable data for a run of years. Figure 1 represents best estimates for 2002-03, drawing upon various sources. Central government transfers, via the Scotland Office, are the principal means by which devolved expenditure, including that of local authorities, is financed. Own taxes (15%) would include the tartan tax, if levied. The 2002-03 composition of Own taxes is: Non-Domestic Rate Income (50%); Council tax paid by taxpayers (40%); and Council tax paid by benefits (10%). Unlike many intermediate-level counterparts, the Scottish Parliament has full legislative and executive control over local taxation, and this is a significant part of the funding system.

There are three smaller items. First, there are some Assigned revenues (3%), principally in connection with the attribution of a proportion of National Insurance contributions from the National Insurance Fund to the National Health Service in Scotland. Second, borrowing, principally by local authorities, constitutes 3%. There is also some EU funding (2%), in connection with both the Intervention Board and the European Regional Development Fund.

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7 Figure 1 does not take account of the funding of capital projects via the Private Finance Initiative when projects are off-balance sheet. This has rapidly acquired significance since 1999, for example in connection with funding school replacement and renovation (Accounts Commission 2002). Treasury (2002a) gives the Scotland figure for capital spending under signed PFI deals as £118m in 2002-03 (Table C17), with a further £33m at preferred bidder stage (Table C18).

8 The percentage in Figure 1 for Central government transfers and non-cash items includes £1.376m of non-cash items (eg cash to accruals adjustments) in the total of £17,932m.

9 Borrowing within Scotland, such as by Non-Departmental Public Bodies and public corporations from the Scottish Ministers, is ignored.
Future developments must start from the present position, and therefore we first discuss the prospects for the revenue sources under devolved control before turning to the question of Assigned revenues. Then there is a brief discussion of an important feature of the present system, namely the lack of conditionality attached to central government transfers.

Revenue Sources under Devolved Control

Taxes under the control of the Scottish Parliament account for 15% of its revenue. If it were to levy the tartan tax at the full rate, without offsetting reductions in other Own taxes, this would increase to 17%; and if it were to apply the full reduction, it would reduce to 12%. Regrettably, it may prove difficult, certainly in the short to medium term, to sustain this proportion of own revenues. The principal own sources are briefly considered.

First, the existence of the tartan tax power focused minds at the 1997 devolution referendum on the issue of revenue-raising. Despite the impressive 'Yes' vote on the second question (63.5% as against 74.3% on the first question), the reluctance of the Labour Party, especially its London leadership, to contemplate using this power became evident. With Labour having ruled out recourse during the first Parliament (ie 1999-2003), it became part of political folklore that the allegedly poor SNP performance in the 1999 elections was due to the 'Penny for Scotland' policy – a promise to offset in Scotland the promised 1p reduction of the basic rate at the UK level.
At the same election, the Liberal Democrats continued their UK-wide policy of an additional 1p on income tax. Both the SNP and Liberal Democrats dropped these policies in Autumn 2002, in part to protect themselves from criticism by Labour in the 2003 elections. Furthermore, there are now large sums of money gushing through the Barnett pipeline into the Assigned Budget, coupled with the associated problem of substantial underspending. In consequence, the tartan tax is unlikely to be used in the medium term. The fear expressed by Heald and Geaughan (1997) that the tartan tax power might atrophy, administratively as well as politically, through non-use remains highly relevant. This is troubling when Darby, Muscatelli and Roy (2002, in this issue) and Bell and Christie (2002, in this issue) emphasise taxes on income as playing an important role in securing greater fiscal autonomy.

Second, the recent history of Non-Domestic Rates is illuminating. In 1989, the Conservative Government introduced a policy of reducing the poundage of Scottish Non-Domestic Rates progressively to a common level with England. Rather than each local authority setting its own poundage, there would, by the end of a transitional period, be a single rate for the whole of Scotland consciously set at the level for England. This objective was achieved in 1995-96, when the Uniform Business Rate was set at 43.2p, and the common poundage with England was maintained until 1999-2000. An important factor easing the way to the common poundage was that the 1995 revaluation resulted in a greater increase in valuations in Scotland than in England. Subsequently, however, the 2000 revaluation worked in the opposite direction. A differential in poundages was therefore re-established in 2000-01, with the Scottish poundage being raised to maintain the real-terms yield on the relatively lower valuations. If the Scottish poundage were constrained to the English level, the loss of revenue would now be approximately £150m per year. In response to heavy criticism from Scottish business, the Scottish Executive undertook in September 2002 to freeze the poundage for a year and restrict the future rate of growth of the Scottish poundage to the change in the RPI. This means that the proportion of spending financed by Non-Domestic Rate Income will fall over time.

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10 ‘For next year, we will freeze the business rate poundage at the current level... For the rest of the Spending Review, we will stick to our commitment to limit rate
Third, the most important tax relevant to devolved finance and affecting individuals is the Council tax, which replaced the community charge in 1993-94. Notwithstanding much criticism, local property taxes are a suitable means of raising revenue for local governments.\(^\text{11}\) They are highly visible, cheap to administer in relation to yield, and difficult to avoid. The potentially regressive impact can be moderated by a reasonably generous rebate system. Additional revenue from this source is constrained by: the visibility of the Council tax, which makes above-inflation increases politically sensitive; the explicit provision in the Treasury (2002c) funding policy document to reduce the Assigned Budget in the case of excessive growth of locally financed expenditure;\(^\text{12}\) and the likelihood that the long-delayed revaluations will result in significantly lower average valuation increases in Scotland than in England. The Scottish Socialist Party has proposed that Council tax be replaced by a Scottish Service Tax, levied on a banded basis in relation to income. This raises issues of judicial interpretation of the Scotland Act 1998,\(^\text{13}\) as well as about the substantive merits of the proposal.

Fourth, Figure 1, which analyses net expenditure, does not take account of the possibility of reducing net expenditure, whilst holding gross expenditure increases to the rate of inflation, with – as previously stated – the obvious caveat that there are no dramatic changes in economic circumstances' (Kerr 2002).\(^\text{11}\) King (1984) provides a comprehensive analysis of the relevant considerations when choosing sub-national or local taxes. More generally, one reason for taxing the occupation of property and for using consumption taxes is that there are concerns about the avoidance and evasion of income tax, thus adding to the attraction of taxing visible assets and consumption.

\(^\text{12}\) The ability to vary local authority taxation is qualified by the UK government reserving the right 'to take into account levels of self-financed expenditure in each country when determining the assigned budget where: i. levels of self-financed spending have grown significantly more rapidly than equivalent spending in England over a period; and ii. this growth is such as to threaten targets set for the public finances as part of the management of the UK economy' (Treasury 2002c, para 5.2).

\(^\text{13}\) Excepted from the general reservation of fiscal, economic and monetary policy including taxes are 'Local taxes to fund local authority expenditure (for example, council tax and non-domestic rates)' (Scotland Act 1998, Schedule 5, Part II, section A1). The question is whether these two named local taxes (though Non-Domestic Rates are no longer local) are merely exemplars or whether they qualify the apparent breadth of the exception in some way.
constant, by increased use of fees and charges. Such recourse is not easy, nor necessarily desirable, on a scale that would impact on the aggregate numbers. There are possibilities, for example in the field of transport, but congestion charging and road tolling would undoubtedly attract political controversy. There is likely to be some relaxation of the system for controlling local authority capital expenditure, mirroring proposals for a prudential borrowing regime in England. However, such borrowing has to be subsequently repaid, and a crucial issue is whether and how such additional borrowing would be scored against the Assigned Budget. Extensive use is now being made in Scotland of the Private Finance Initiative (PFI), both directly by the Scottish Executive and by local authorities, though the facilities made possible by the PFI subsequently have to be paid for on contracts stretching up to 30 years.

The Question of Assigned Revenues

Under a scheme of Assigned revenues, all, or part, of the revenue from a particular national tax or taxes is given automatically to a sub-national government. The sub-national government has no power to vary the tax rate, or exemptions. It will carry the risks associated with the variability of the revenue. The claimed advantages are that they reduce dependence on central transfers and may register the link between spending by sub-national governments and taxation. In principle it should be possible to use any tax, but there can be difficulties in apportioning the revenue from some taxes amongst sub-national areas, and it may be necessary to distribute on the basis of a proxy, such as population, rather than of estimated yield.\footnote{The distribution of Assigned revenues on a per capita basis can have a powerful equalisation effect.}

Assigning tax revenues does not, of itself, increase fiscal autonomy. Moreover, it is debatable whether importing tax-sharing arrangements would substantially alter the position in the UK.\footnote{While the previous policy of the Scottish Constitutional Convention (1990) included the use of Assigned revenues, its 1995 policy (Scottish Constitutional Convention 1995), at the insistence of the Labour Party, excluded them. Writing before devolution, Heald (1990, p. 23) noted the possible advantages of Assigned revenues as part of the funding package: ‘A key advantage of assignment, recognised in both the Belgian and West German systems, is the sense of entitlement which is thereby generated. Assigned VAT would not be a “gift” of the UK Treasury to the Scottish
for example, have to be interpreted in the context of the composition and powers of the Bundesrat, and the desire, deriving from historical considerations, to limit the power of the Federal government. Complex systems of revenue assignment can damage transparency about territorial transfers.

The Lack of Conditionality Attached to Central Government Transfers

Except for those expenditure items where the relationship between the Scottish Executive and the UK government has agency characteristics (e.g., NHS and teachers’ pensions), the lack of conditionality on central government transfers is a marked feature of the devolution scheme. This has been particularly important given the post-1997 assertion by the Treasury of its control rights over departmental expenditure, in particular through the vehicle of Public Service Agreements. These do not extend to Scotland and there has so far been no attempt to put conditions on the formula consequences which arise from the operation of the Barnett formula (Heald and McLeod 2002). This lack of conditionality, inherited from the pre-devolution system, is a feature that needs to be protected against possible erosion.

FUNDAMENTAL ISSUES OF SYSTEM DESIGN

Revenue versus Expenditure Basis

Discussion of a revenue basis can quickly become confused unless the question of equalisation is explicitly treated. This issue does not arise on the ‘spend what you raise’ model, though the previous analysis has shown why such a system is unlikely in the UK. It has to be explained what happens if there is a shortfall of revenue. For example, does the central government effectively guarantee the yield of a standard level of sub-national taxation? Moreover, does the central government operate with an explicit or implicit target expenditure for each sub-national government, which it is willing to support with grants if there is insufficient revenue? A revenue basis can

Parliament (or other devolved Assemblies), but simply a recognition that the nature of VAT makes it imperative to maintain a unified tax administration which acts on behalf of the various recipient units of government.
quickly degenerate into an implicit expenditure basis if the level of expenditure affordable by a sub-national government is determined by these revenue guarantees and expenditure floors rather than by the revenue it raises.

The modern welfare state necessarily implies that there will be territorial transfers of resources, except in the unlikely case that households with different resources and needs are spread evenly across all jurisdictions. If this unlikely condition does not hold, full fiscal autonomy for a sub-national government cannot be combined with interpersonal redistribution, unless there is a clear separation between central (redistributive) and devolved (non-redistributive) functions. Although this might have been possible in the context of the Gladstonian minimal state, it is not consistent with the existing European model of welfare states.

Nevertheless, it should be recognised that there is a different vision of territorial fiscal relationships, strongly represented in the distinctive US tradition of fiscal federalism. This view (Weingast 1995; McKinnon 1997) treats territorial equalisation with suspicion and emphasises the role of market forces in equilibrating regional incomes and public service standards. Riker (1996) concluded that the great benefit of federalism is that it imposes limits on government size. One of the specific characteristics of UK devolution is that pressure for constitutional change has come primarily from countries and regions that have been recipients of territorial fiscal transfers. With devolution in place and proposals for England on the agenda, it can be expected that the prosperous regions, which are net contributors, will become more vocal.

The Form and Extent of Equalisation

The UK territorial fiscal system can be considered to have two levels: the country level, whereby expenditure in Scotland, Wales and Northern Ireland is regulated by the Barnett formula with reference to changes in comparable public expenditure in England; and the various formal equalisation systems within each country, which allocate resources for the National Health Service and local authorities. Equalisation of both implicit and explicit forms is thus deeply embedded in UK public finances. Proposals for devolution in the UK typically assumed that the principle of territorial equalisation would not be challenged.
Equalisation systems naturally raise questions about the incentives they create, particularly whether they stimulate or hinder economic development. It is often alleged that they generate perverse incentives. When equalisation relates to taxable capacity, economic developments leading to a higher tax take will result in equalisation taking away the benefit, either of higher public expenditure or the scope to reduce tax rates. The same is true of a needs-based scheme, where successful policy initiatives that reduce relative need may lead directly to reductions in relative public expenditure. Nevertheless, there are powerful incentives on politicians to improve economic conditions and the health of their citizens, though the design of detailed equalisation systems needs to be alert to these issues.

**Constraints on a Revenue Basis in the UK**

All proposals to shift the financing basis of devolution from an expenditure basis to a revenue basis are confronted by a number of constraints, some specific to the UK. First, there has been a long history of implicit territorial equalisation, with the consequence that there are large, but poorly mapped, inter-regional transfers (Heald and Short 2002). The available data are typically of poor quality and not comparable through time. Moreover, the economic and population dynamics, which lead to differential economic prosperity within the UK, are not well understood, and the disparities may be becoming more pronounced. Even if the political circumstances favoured a switch to a revenue basis, with modest equalisation, the withdrawal of public expenditure from certain countries and regions could have a damaging macroeconomic effect (McCrone 1999; Ferguson et al. 2002).

Second, commentators on the public finances of the 1921-72 Stormont period of devolved government regularly made the point that Northern Ireland could not afford the British welfare state from its own resources (Lawrence 1965; Green 1979). Its extension to Northern Ireland further undermined the viability of the 1920 funding scheme; the attempts to circumvent these difficulties led to complexity and non-transparency. There is a current parallel. If the Scottish Parliament were to be financed on a strict
revenue basis, Scotland could not afford the surge in public expenditure arising from Spending Reviews 1998, 2000 and 2002.16

Third, experiences in Northern Ireland and Spain are also informative about the problems of managing a system in which all Scottish tax revenues would be received by the Scottish Parliament, which would then pay the UK Parliament for UK functions. In Northern Ireland, this calculation rapidly became a fiction (Gibson 1996). In Spain, historic rights under the 'foral' regime are recognised in the 'concierto económico' which provides that the three Basque provinces and Navarra collect all tax revenues and then pay the 'cupo' to Madrid for services supplied by the Spanish government (Keating 1999). However, the cupo is not an objective economic calculation, but non-transparent and manipulable. A grievance of the Catalan government is that prosperous Autonomous Communities (ACs) within the 'common' regime implicitly make contributions towards redistribution to the poorer Spanish ACs, whereas the Basque provinces and Navarra make no such contribution.

In the Scottish context, such a system would lead to disputes between the two Parliaments about reserved matters, notably the size, purpose and location of UK defence expenditure. The popular debate would therefore shift from the appropriateness of the Barnett formula to that of the 'Westminster contribution'. It would be open to politicians at the devolved tier to claim that the level of taxes was not the result of their policies or their quality of management of public services, rather a consequence of the rapacious demands of central government. Moreover, some mechanism would be required for joint decision-making on UK fiscal policy, an improbable concession by Treasury ministers since even other UK Cabinet ministers are excluded.

Fourth, there are significant differences between the way EU constraints affect variations in taxes within a member state and between member states. For example, much of the tax policy discretion which would be enjoyed by

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16 The transformation of the public expenditure climate at the UK level is illustrated by the following Treasury data for real-terms changes in Departmental Expenditure Limits: -2.2% (1995-96); -1.0% (1996-97); -2.3% (1997-98); 0.4% (1998-99); 2.1% (1999-00); 4.5% (2000-01); 5.0% (2001-02); 5.4% (2002-03); and 4.6% (2003-04). The figures for outturn years have been affected by underspending.
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an independent Scotland would not be available to a devolved Scotland. Membership of the EU involves acceptance of strict limits on the extent of variation in consumption taxes, which the European Commission has been attempting to standardise across member states.

Fifth, there are a large number of issues concerning the practicality of particular devolved taxes (Heald, Geaughan and Robb 1998). These relate, inter alia, to: the constraints imposed by globalisation, deregulation and economic integration on the taxation of mobile factors; the remarkable changes over the last 20 years in the technology of consumption and in the organisation of retailing, reinforced by problems of avoidance and evasion (e.g. cross-Channel shopping and smuggling); and macroeconomic constraints arising from the Maastricht Treaty and the EU Growth and Stability Pact. Sub-national and local governments have been expected to contribute to fiscal consolidation, with implications both for their freedom to borrow and for their use of tax powers.

ASSESSMENT

In addition to scene-setting and introducing the Symposium, this article has drawn attention to some of the factors that have to be clarified by those wishing to propose full fiscal autonomy, or indeed any alternative scheme for funding the Parliament. Designers have to address the following questions. What are the equalisation policies? To what extent does the scheme increase fiscal responsibility? How far is it transparent to voters? Is it consistent with EU law? Does it provide sufficient incentives for efficiency in government; and does it hinder economic development?

We have here used the term 'fiscal responsibility' because there is great difficulty with the term 'accountability'. Lack of accountability is rather like sin: everyone is against it, but there are many different perceptions of what it entails. Sometimes, 'lack of accountability' is merely a convenient insult to throw when disagreeing with a particular policy. The Scottish Executive is accountable for its spending, both in the formal sense that it must produce audited accounts and in the political sense that it has to defend the spending choices it makes to the Scottish Parliament.

That is not to say that there is not a serious issue. Pressures for fiscal responsibility can only be effective if there is a clear link in voters' – and
commentators’ – minds between the taxation choices made by politicians and the level of public services. The more complex the system, the easier it is to deflect criticism to external factors. This problem is accentuated when there is equalisation (as we consider there always will be in the UK) or payment for central services (as there would be if all Scottish tax revenues went first to the Scottish Parliament).

The funding of devolution in the UK is further complicated by the existence of asymmetry and a lack of transparency. Unlike Darby, Muscatelli and Roy (2002, p. 51, in this issue), we consider that some degree of asymmetry in devolved arrangements in the UK is inevitable for historical, cultural and demographic reasons. However, transparency could certainly improve and the obstacles to this are poor territorial data (which can in time be remedied) and a political nervousness on the part of governments about exposing the detailed operation of territorial transfers.

We agree with the view that having to raise some taxation increases the fiscal responsibility of politicians, and that, in an ideal world, Own taxes would constitute a higher proportion of the funding of the Scottish Parliament. The so-called 'flypaper effect' carries a degree of conviction: governments adjust their behaviour when they are responsible for raising revenue. There is a broad academic consensus that elected bodies should be fiscally responsible at the margin, especially when they have legislative powers (Bell et al. 1996; Blow et al. 1996; Constitution Unit 1996; King 1984; Smith 1996).

In that respect, equalisation, and indeed Barnett or a variant, are not necessarily incompatible with further fiscal autonomy. The key qualifier is the phrase 'at the margin', meaning that, after the fiscal equalisation system has compensated for differences in needs and resources (ie taxable capacity), the cost of additional expenditure (and the benefit of lower expenditure) should fall on 'local' taxpayers. That is broadly the position of the Scottish Parliament: it has the power to vary the basic rate of income tax by up to 3p, and it has control over local authority taxation (unlike the German Länder and the Spanish Autonomous Communities).

The centralised UK fiscal system is unlikely to change fundamentally. Priority should therefore be given to making the present system work as effectively as possible, nudging it in the right direction (more fiscal
responsibility) and resisting drift in the wrong direction (Own taxes accounting for a smaller proportion of total expenditure).

THE CONTRIBUTIONS TO THIS SYMPOSIUM

This final section introduces the other papers in this Symposium, highlighting key issues and discussing some interrelationships.

Darby, Muscatelli and Roy provide an up-to-date survey of the internal fiscal arrangements of a large number of OECD countries, skilfully exploiting the available data. In doing so, they illustrate the difficulty inherent in international comparisons. Not only is there a huge variety of arrangements, but an assessment is complicated by the extent to which the federal/central government may effectively direct the management of particular services through financial (eg grant conditionality) and administrative means. Two broad conclusions emerge. First, there are marked differences in country positions, attributable in part to history and culture; the outlier position of Switzerland in Figure 2 (p. 35) is an excellent example. Second, the UK is an outlier in terms of the dependence of sub-national and local governments on central transfers, as opposed to formal tax-sharing arrangements, such as those used in Germany.

Their article draws out important tensions which characterise intergovernmental fiscal arrangements – between equity and accountability; between complexity and transparency; and between equity and incentive. They are critical of the asymmetry of the UK arrangements.

Goudie builds upon the series of annual Government Expenditure and Revenue in Scotland publications, starting in 1992, to build up a comprehensive picture of Scottish public finances over the last two decades. This empirical work demonstrates that, notwithstanding the inevitable estimation process, Scotland has a structural deficit problem. The tables and figures provide hitherto unpublished data on the evolution of this deficit. In order to persuade those who are doubtful of such data, there is a range of sensitivity testing of the net fiscal deficit, including assumptions about the treatment of North Sea oil.

The Scottish Executive and its economists are to be congratulated on persisting with the GERS exercise, which has no published counterpart
elsewhere in the UK. In the past, the GERS exercise has been damaged by the spin which ministers have placed upon it, initially as an anti-devolution message and more recently as an anti-independence message. In the context of this Symposium, the Goudie article is invaluable in terms of informing the debate of the likely implications of switching the funding of a devolved Scottish Parliament from an expenditure basis to a revenue basis. Naturally, it does not resolve the question of what Scottish public finances would look like under independence, because that would bring policy levers which do not exist under devolution.

The article by Cuthbert and Cuthbert seeks to address what they view as the chronic underperformance of the Scottish economy. Explicitly, they consider the question of fiscal autonomy only in the context of devolution. They contrast the attitude of the UK government on taxation in its dealings with the EU with its attitude towards its own sub-national governments. Moreover, they identify as a central problem in economic underperformance the subordination of Scottish policy interests within the UK monetary union. They doubt whether what is advanced as fiscal autonomy under devolution would generate improved economic performance. They identify a need for selective reductions of taxation in Scotland, especially the taxation of business. They reach the conclusion that what is required in this context is central control over taxation so that there can be fiscal compensation for those countries and regions disadvantaged by the UK monetary union. Hitherto, territorial fiscal transfers have taken the form of higher public expenditure, with potentially damaging economic consequences, whereas the stimulation of economic performance requires downward adjustment of relative tax levels.

The last two papers offer contrasting perspectives on the present funding system. Midwinter approaches these issues from the perspective of a political scientist, noting that economists are loquacious about the desirability of greater fiscal autonomy but silent when it comes to specific proposals. He is critical of those who claim that Scotland has a net fiscal surplus. He considers that the real test of the present funding system will come when there are governments of markedly different political persuasions in Scotland and the UK. He expects the structural weaknesses of the funding system to persist, as claims about the benefits of greater fiscal autonomy in terms of either economic efficiency or political accountability are unlikely to persuade the major parties to implement change. He warns of the problems
inherent in a needs assessment and defends the Barnett formula, which 'provides both stability and flexibility' (p. 117).

The final article, by Bell and Christie, adopts a more critical view of the Barnett formula. These authors conclude that 'there is no convincing economic case that can be made in its defence' (pp. 136-37). They are also more favourable towards a needs assessment than is Midwinter. They raise the option of switching 'from the Barnett formula to a needs assessment at a time when the Barnett squeeze has reduced the gap in expenditure per head between Scotland and the Rest of the UK to broadly the same level that might be implied by a needs assessment exercise' (p. 138). This might begin the process of moving to a new fiscal settlement for devolution. This article's examination of the prospects for greater fiscal autonomy notes the problems arising from Scotland's fiscal deficit. Another issue addressed is whether there are sufficient differences in fiscal preferences between Scotland and England to warrant further fiscal autonomy.

Collectively, the articles in this Symposium represent a major effort to advance understanding of the strengths and weaknesses of the present funding system for devolution, and to set out the possibilities for reform. There are obvious disagreements among contributors and no attempt has been made to forge a consensus. However, the reader of the Symposium will probably find more agreement about facts than expected, even when the interpretations placed on those facts differ. One conclusion can be safely drawn: over the years ahead, there will be continuing debates in Scotland on how to resolve the fiscal dilemmas covered in this Symposium.

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