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FINANCING UK DEVOLUTION IN PRACTICE

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Financing UK Devolution in Practice

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This paper was written for an International Symposium, organized by the Québec Commission sur le Déséquilibre Fiscal, which would have been held in Québec City on 13-14 September 2001, but for the terrorist incidents in the United States. The paper analyzes UK experience with financing devolved government two years after the landmark events of 1999. Attention is first paid to the territorial structure of the United Kingdom, showing how a highly centralized fiscal system had previously allowed substantial administrative devolution in Scotland, Wales and Northern Ireland. The devolved funding system is then carefully explained, before certain real and imagined problems are discussed. Four sets of issues are identified: the lack of transparency; weak fiscal accountability; the scope for policy variation and policy leadership; and the absence of institutional machinery. Topical questions are addressed: for example, the future of the Barnett formula (a key mechanism in determining changes in devolved expenditure); and the debate about fiscal autonomy (notably, proposals during the 2001 General Election campaign that the Scottish Parliament should have more control over its revenues). Contrasts and comparisons are drawn between the United Kingdom and Canada, a long-standing federation.

Key Words: financing devolution; intergovernmental fiscal relations; Barnett formula; fiscal autonomy; Scotland; United Kingdom; Canada.

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I INTRODUCTION

The United Kingdom differs from many of the countries discussed at this symposium because it is a unitary state characterized by Executive-dominated Parliamentary government and a highly centralized system of public finances. Nevertheless, it is embarking on a process of asymmetric internal devolution at exactly the same time as European Union (EU) developments are raising far-reaching questions about future economic, monetary and fiscal arrangements.

Inevitably, this paper cannot be fully comprehensive in its coverage.[1] However, it seeks to explain and analyze contemporary UK developments. The paper is structured in the following way. After this brief Introduction, Section II sets the context. Section III describes the devolved funding system in 2001. Section IV considers real and imagined problems. It sets out possible developments, paying particular attention to current policy debates about the present funding system and about fiscal autonomy (regarding which there was much coverage in Scotland during the 2001 UK General Election). Section V discusses similarities and differences between the United Kingdom and Canada, with regard to territorial public finance. Section VI provides brief conclusions.

The focus of this paper is upon the fiscal implications of devolution for the United Kingdom as a whole, as much as upon the devolved territories of Scotland, Wales and Northern Ireland. Given that such devolution has been in place for only two years, predictions about the wider implications for the United Kingdom must necessarily be tentative. In these circumstances, it is appropriate to note that the present author has been a longstanding proponent of devolved government, particularly – but not exclusively – for Scotland. As such, he has been a participant observer for more than a quarter of a century.[2]

[1] The pre-devolution and post-devolution arrangements are explained, respectively, in Heald (1994) and Heald et al. (1998).
[2] See, for example: Heald (1976, 1980, 1990) and Heald and Geaughan (1996).

II CONTEXT

A brief setting of context inevitably involves over-simplification and matters of interpretation which are themselves controversial. Nevertheless, this Section is vital to establishing the political and constitutional context of the technical financial arrangements.

Firstly, there are matters of geography. In the initial symposium programme, this paper was titled “Grande-Bretagne” or “Great Britain”; the paper itself now carries the correct title of “United Kingdom” (“Royaume-Uni”). A publication by the Foreign & Commonwealth Office (2000, inside cover) contains the following clarification: ‘The term “Britain” is used informally to mean the United Kingdom of Great Britain and Northern Ireland. “Great Britain” comprises England, Wales and Scotland’. It is hardly surprising that there is confusion when Great Britain is smaller than Britain! More seriously, there is resentment and touchiness in Scotland, Wales and Northern Ireland at the way ‘England’ is often used to describe the whole.

Secondly, history is important and influences attitudes and governmental arrangements. Wales was conquered in 1277 and its incorporation into England was fully completed by the *Laws in Wales Act 1535*. Scotland’s history was different: the Union of the Crowns occurred in 1603, when James VI of Scotland assumed the English throne as James I. This was followed, more than a century later (and after a brief union under Oliver Cromwell), by the *Acts of Union 1707*, when the two Kingdoms came to be governed by a single Parliament in one Kingdom, with the same monarchy and succession, and equal trade and economic rights. Ireland was conquered in 1649 but not fully incorporated until, following a major rebellion in 1798, the *Act of Union (Ireland) 1800* created the United Kingdom of Great Britain and Ireland. The *Government of Ireland Act 1920*, which provided for separate devolved Parliaments in Belfast and Dublin, was implemented only in the north. The south of Ireland seceded in 1922 as the Irish Free State (and changed its name to the Republic of Ireland in 1937), being formally recognized as an independent Republic by the United Kingdom in the *Ireland Act 1949*. Northern Ireland remained part of what had therefore become, in 1922, the United Kingdom of Great Britain and Northern Ireland. There was devolved government in Northern Ireland from 1921 to 1972, when civil disorder brought about direct rule from Westminster.

Thirdly, since the election of the Labour Government in May 1997, constitutional reform has received much attention. Devolution is just one aspect; others are the incorporation of the European Convention of Human Rights into Scottish and then English law, and the removal of much of the hereditary element in the House of Lords (the upper chamber of the UK Parliament). In 2001, Scotland has a devolved Parliament with legislative and some tax-varying powers; Wales has an Assembly with executive powers and responsibility for secondary legislation, but not for primary legislation or taxation; and Northern Ireland has a devolved Assembly with legislative but not taxation powers. There have been many fewer developments in England, though London (itself a region for statistical purposes) now has an elected Mayor with executive responsibility for, *inter alia*, strategic planning and transport, supported by an elected Assembly. Significantly in a UK context, all these bodies have been elected by a form of proportional representation. Overall, there has been a significant injection of a democratic element accountable to territorial electorates; these reforms have largely built upon and modified existing territorial structures of government.[3] An important point – to which attention will return – is that, long before recent devolution, Scotland and Northern Ireland exhibited distinctive features of governance and civil society which indicated that they had not been fully assimilated to the English model.

Two aspects of the UK political system also merit comment. First, UK citizens seem to expect that they can have EU levels of public service provision at US levels of taxation. Among the consequences of this illusion is that genuine policy failures go unaddressed and evidence of success is dismissed as data manipulation (eg improved school exam performance is attributed to exams being easier). Second, the United Kingdom combines a highly centralized fiscal apparatus dominated by the Treasury with a substantial degree of expenditure decentralization to local authorities.[4] However, central government has long dominated local government, which is heavily dependent on transfers from central

[3] Full information on powers and responsibilities is available from the respective websites: http://www.ni-assembly.gov.uk; http://www.scottish.parliament.uk; http://www.assembly.wales.gov.uk.

[4] In 2000-01, local authorities accounted for 24.7% of Total Managed Expenditure (TME), the Treasury's principal control aggregate (Treasury, 2001c). King (1999) analyzed the structure, functions and financing of local authorities in Great Britain.

government and operates under its direction in many areas. This was exacerbated by the taxation and expenditure limitation measures of the 1979-97 Conservative Government. Though still big spenders, UK local authorities suffered a loss of confidence and own revenues[5] during this period, a trend unlikely to be reversed under the centralizing tendencies manifest in 'New Labour' at the UK level.[6]

Asymmetric devolution is, in part, a response to the inherent asymmetry of the United Kingdom. First, 84% of the UK population live in England, and this preponderance is likely to increase. Second, there has long been asymmetrical machinery of government, with the Secretary for Scotland (upgraded to Secretary of State in 1926) and the Scottish Office dating from 1885. These increasingly undertook, especially after the Second World War, functions separately from the 'UK' Ministers and Departments. Northern Ireland has been distinctive at least since 1921 (when it secured devolved government under the *Government of Ireland Act 1920*); and Wales has tended to follow Scottish developments with a long lag. These governmental arrangements have played as much a part in sustaining separate senses of identity, as have the separate religious, legal and educational systems which Scotland maintained after 1707. Leruez (1983) perceptively titled his book on Scotland: *Une Nation Sans Etat*.[7] In practice, distinctive arrangements perceived to be important in Scotland were hardly noticed in London. Those now deploring asymmetry in devolution should recognize that symmetry never existed; full integration into the English administrative system was never attempted with Scotland, though it was much further advanced for Wales. Third, there is deep ambiguity about Scottish attitudes towards the Union. This was recognized by John Mackintosh, Professor of Politics, Labour MP and a major figure in the failed 1970s' devolution campaign; not least, the decline of the British Empire, which had offered many opportunities, made the Union seem less relevant (Mackintosh, 1969). Since that period, the semi-detached status of the United Kingdom within the EU has encouraged the periphery, especially Scotland, to become pro-European, in part as a weapon against the then UK Conservative Government, though probably also against UK centralism more generally.

[5] Local governments in England, Wales and Scotland may only raise a domestic property tax (council tax), and then only within parameters set by central government. Non-domestic property taxes (Non-Domestic Rates), although still collected by local governments, are set centrally; and the revenue is remitted to the central authorities, who redistribute them as part of the transfers but not on the basis of derivation.

[6] For an interim assessment of the 1997-2001 Labour Government, see Seldon (2001).

Speculatively, one would expect a higher pro-Euro vote in the territories[8] than in England should there be a referendum. Nevertheless, the conflicting pulls on individual Scots are clear: whether to concentrate on running Scotland or to play in the bigger field that the United Kingdom constitutes. London's dominance over all aspects of British economic, political and cultural life reflects its role as business, commercial, financial, governmental, political and scientific capitals; this combination of roles in a single city is one of the differentiating aspects of the UK case.[9]

Nevertheless, it would be a fanciful view that contemporary developments represent a 'long march of historical inevitability' towards Scottish devolution or restored independent statehood. In reality, recent history might have turned out quite differently (Taylor, 1999). For example, until the death in a car accident of HRH Princess Diana on 31 August 1997 took over the news agenda, the Yes campaign in the Scotland referendum was looking vulnerable on the second question of whether voters supported the proposal that the Scottish Parliament should have tax-varying powers (the 'tartan tax').[10] Moreover, the carrying of the Labour Government's proposals for Wales was still in doubt right up until the declaration of the last local authority, in the referendum deliberately held one week after Scotland's. Several of the technical problems identified in this paper are much more easily understood if this context is taken into account.

[7] There is a substantial political science literature on 'stateless nations', with Catalonia, Quebec and Scotland being cited in this category (Keating, 1997). Further discussion on Scotland can be found in McCrone (1992) and McCrone et al. (1998).

[8] There is much political sensitivity concerning how Scotland, Wales and Northern Ireland are described: nation; country; region; and many loaded terms specifically used in respect of Northern Ireland. For that reason, this paper usually adopts the Treasury's bland terminology of 'territories', understood to refer to Scotland, Wales and Northern Ireland (which have had territorial Secretaries of State and now have devolution), but not usually to England (which is managed by London-based departments which have a mixture of UK, GB and English responsibilities).

[9] This observation is not new. Davies (1999, p. 689) refers to the complaints of Sir Andrew Fletcher of Saltoun, who vigorously opposed the passage of the Act of Union through the Scottish Parliament: 'Fletcher was clearly in favour of an equitable balance between England, Scotland, and Ireland. He did not believe that an equitable solution could be found in a centralized state inevitably dominated by the strongest of the three partners. "That London should draw the riches and government of the three kingdoms to the south-east corner of this island", he wrote, "is in some degree as unnatural as for one city to possess the riches and government of the world"'. Fletcher thought of Wales as part of England just as did Lord Goschen, Chancellor of the Exchequer, when announcing the Goschen formula for territorial expenditure allocation in 1888.

[10] The Labour Government's plans for Scottish devolution were tested in a pre-legislative referendum held on 11 September 1997; the second question, (about the tartan tax), was carried by 63.5% to 36.5% on a 60.4% turnout (Heald and Geaughan, 1997)

III DESCRIPTION OF THE DEVOLVED FUNDING SYSTEM

There are many complexities to the UK devolved funding system, but the basic outline can be readily explained. First, the devolved bodies are financed through an unconditional block grant (‘assigned budget’) from the Treasury paid via the territorial offices (the Scotland Office, Wales Office and Northern Ireland Office) which, as UK departments, account to the Westminster Parliament for the total. Accountability for the spending of the assigned budget rests with the devolved Executives, accountable to the devolved Parliament and Assemblies, with the audit being undertaken by the public official (Auditor General for Scotland, Auditor General for Wales and Comptroller & Auditor General for Northern Ireland) who heads the respective territorial audit offices. Subject to the qualifications below, the devolved Executives do not control budget size, but have total discretion over expenditure composition.

Second, changes to the levels of the assigned budgets are determined primarily through the mechanism known as the ‘Barnett formula’, established in 1978.[11] This formula operates only on increments, not on the base, allocating to each territory a population-based percentage of the increase in comparable expenditure in England. Heald (1990) set out the advantages of using a broad-brush formula such as Barnett, in the traditions of the Goschen formula (announced in 1888 and of which some use was still made in the late 1950s). There are powerful arguments against drawing the territories into a UK-wide annual needs assessment exercise, such as that used for the distribution of Revenue Support Grant in England. In the territorial context, needs assessments should be periodic, and then used to inform the calibration of the territorial formula for the next period. This pre-devolution mechanism has so far survived the transition from being an internal mechanism within one government to being the basis of transfers between governments. There has not been any formal equalization scheme across the United Kingdom, though highly complex systems exist, for example, for National Health Service funding allocations and Revenue Support Grant distribution to local authorities within each territory.

Applied systematically, the Barnett formula would bring convergence to the UK average per capita level of public expenditure (ie expenditure relatives converge asymptotically on 100).[12] Figure 1 provides a representation of this process, with the initial relatives for each territory being estimates of the position circa 1981. In Figure 1's simulation, it is assumed that the original 10:5:85 proportions reflected exact population shares, and relative populations remain unchanged. Crucially, the speed of convergence depends upon the nominal increase of public expenditure.

Figure 2 breaks the assumption that the original 10:5:85 proportions reflected exact population shares, but keeps the assumption that relative populations are unchanged. In this case, the relatives converge to different values for each territory, though not far from 100. This result is less important, of itself, since the annual updating of population proportions was implemented in 1998. Nevertheless, it serves as a convenient reminder that, when population relatives do change through time, there are separate limits for each territory. On plausible assumptions about Scotland, Cuthbert (2001) proves this result mathematically for Scotland (which converges on a value above UK = 100).

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[11] Briefly, the non-statutory formula provides that increases in public expenditure in Scotland and in Wales for specific services within the territorial blocks would be determined according to the formula consequences of changes in equivalent expenditure in England. Initially, Scotland received 10/85ths and Wales 5/85ths of the change in England. A parallel formula allocated 2.75% of the change in equivalent expenditure in Great Britain to Northern Ireland. The essential distinction is between base expenditure, whose current levels are carried forward, and incremental expenditure, which is determined by the formula (Heald, 1994). Under this arrangement, block expenditure relatives would in the long run converge on the UK per capita average. However, the intention was to seek a better alignment of expenditure and needs relatives, not full convergence (Mackay, 1996). It was understood that a territorial Secretary of State would have the right to call for a Needs Assessment should convergence go 'too far'. In practice, convergence has been substantially frustrated by formula bypass, and in Scotland by relative population decline. In 1992, the formula was recalibrated (10.66:6.02:100.00 and Northern Ireland 2.87%) in recognition of the results of the 1991 population census. In 1997, it was announced that the population figures would be updated annually. The effects of annual upratings of population are likely to be minimal, as these will affect only the increment. The significance of Scotland's relative population decline is that it offsets the convergent properties of the Barnett formula. Throughout this paper, an expenditure relative denotes the index for a particular territory or region of per capita expenditure relative to the UK per capita average.

[12] This is an oversimplification, as is noted in the discussion on relative population change. A mathematical analysis appears in Heald (1996).

Figure 3 shows graphically the automatic result that such a formula, which delivers equal per capita increments to each territory, delivers smaller percentage increases to those territories with highest starting values of the relative. In consequence, Scottish expenditure rises faster than Northern Ireland's expenditure, whilst it rises slower than English expenditure. Whilst Figure 3 makes the same assumptions as Figure 1, a comparable diagram can be produced on the assumptions of Figure 2. The Barnett formula is therefore a population-based mechanism to allocate increments of public expenditure, not a needs-based formula as it is sometimes described. Contrary to some claims, it was never intended to drive the territorial public expenditure relatives to 100: the territorial Secretaries of State understood that they could call for a successor needs assessment to that published in 1979 (Treasury, 1979), should they feel it necessary. Revealed preference suggests that they made a calculation that such a needs assessment would not be in their interests. Furthermore, the longevity of the Barnett formula, initially seen as a temporary measure, is to be noted.

Although there is now much more detail about the operation of the Barnett formula in the public domain (Treasury, 1999, 2000a), it is still not possible to replicate the calculations. The crucial point is that there are no published data for comparable English expenditure relative to the Scottish, Welsh and Northern Ireland assigned budgets. Because of different functional responsibilities, three separate series of data are needed. The Treasury takes a proprietary view of its public expenditure database and denies access to this even to the pre-devolution territorial departments and the post-devolution Executives. There has been so much recent change to the definition and measurement of public expenditure aggregates that do-it-yourself calculations are likely to be misleading.

Third, the formula-driven assigned budget is the major, but not sole, part of the funding available to the devolved Executives. Figures 4, 5 and 6 refer to Scotland, Wales and Northern Ireland, respectively. These Figures show that there is a common structure to the funding system in the three territories. Moreover, they are also useful as lists of the kinds of functional expenditure which are devolved. These are broadly the same, though with some important differences: for example, Scotland alone has 'Law and order' (though this could be devolved to the Northern Ireland Assembly should the security situation make this possible); and the Northern Ireland Assembly alone has responsibility for the social security system (though this is best seen as an agency arrangement, as there is no policy discretion).

What is also highlighted is how the devolved bodies are integrated into the UK public expenditure system.[13] When the devolution funding scheme was determined in 1997, it was not known that the Treasury would, in 1998, revamp public expenditure control aggregates or move to a biennial survey. Changes to the assigned budget are controlled by the Barnett formula, with the costs of running the territorial offices top-sliced in the case of Scotland and Wales. The assigned budget is classified as Departmental Expenditure Limit (DEL), as are certain other items of expenditure which, for various reasons, are not formula-controlled. Examples are Hill Livestock Compensation Allowances and Welfare-to-work (a programme financed out of the windfall tax on privatized public utilities). At the time of a Comprehensive Spending Review (CSR), namely in 1998, 2000 and 2002, DELs are set three years ahead. In contrast, Annually Managed Expenditure (AME) is set one year ahead, largely on the ground that these items are more difficult to control and forecast. Examples of AME are Common Agricultural Policy expenditure and Local Authority Self-Financed Expenditure (LASFE). If the Scottish Parliament were to levy the tartan tax, the expenditure funded in this way would be scored as AME.

Although there is greater transparency post-devolution about the *system*, largely thanks to the block rules guidance having been published (Treasury, 1999a, 2000a), there is not transparency about the *numbers*. In consequence, it is not possible to place values in each cell of Figures 4, 5 and 6. An indication of the predominance of Barnett formula-determined DEL is that, for 1999-2000 plans, this accounted for 79% (Scotland), 87% (Wales) and 84% (Northern Ireland).[14]

In the absence of better and more relevant data, interterritorial comparisons fall back on the figures for 'Identifiable General Government Expenditure' (GGE) published annually by the

[13] The 1998 CSR saw the introduction of a new public expenditure control system, focusing upon Total Managed Expenditure (TME), itself composed of Departmental Expenditure Limits (DELs) and Annually Managed Expenditure. From 2001-02, government accounting has switched from a cash basis to an accruals basis, under the project known as Resource Accounting and Budgeting (RAB) (Treasury, 2001a).
[14] The calculation for Northern Ireland excludes social security benefits.

Treasury in a document now known as 'Public Expenditure Statistical Analyses' (PESA).[15] Taking data primarily from the 2000 issue (Treasury, 2000b), Figure 7 shows public expenditure relatives for Scotland, Wales and Northern Ireland, relative to England = 100 (rather than the published indexes with UK = 100). For each of these three territories, there is a line representing Identifiable GGE (solid line) and another representing Identifiable GGE excluding Social Security (dashed line). Although these are very imperfect proxies for devolved expenditure (data for which are unavailable), the striking point is that the relative (England = 100), when social security expenditure is excluded, is much higher for Scotland and Northern Ireland, but not Wales.

There have been longstanding complaints about the poor quality of expenditure data for the English regions, notably a large amount of expenditure identified to England but not to individual regions. There are better data in the 2001 issue of PESA for 1998-99 and 1999-2000, the latter of which are tabulated in Figure 8. When interpreting the relatives on individual programmes, attention should be paid to the UK weight, indicating the percentage of total expenditure accounted for by this programme. The entries for Totals in each column are weighted averages. These figures show marked variations in levels and compositions among territories and regions. Certain figures should be interpreted with great caution, as, for example, the figures for 'Housing' in some prosperous regions are clearly affected by the proceeds from council house sales being netted off. Much greater expenditure disaggregation is a precondition for analytical work on these differences.

Fourth, the UK Treasury controls, directly or indirectly, all borrowing on programmes controlled by the devolved Executives: they themselves can only borrow temporarily for timing reasons; and the 'consent' counterpart of (borrowing for) capital expenditure by local authorities is scored against the assigned budget. Total UK control of all borrowing would now be justified primarily in terms of UK commitments under the EU Stability & Growth Pact, though experience of past practices suggests that this would have happened in any case. One of the reasons why the Private Finance Initiative (PFI) - a Treasury programme to

[15] The data on identifiable expenditure should always be read with awareness about the impact of non-identified expenditure on services such as defence. Debates about the territorial pattern of defence expenditure are a telling reminder that political concerns are as often about inputs (hence employment effects) as about outputs. When the focus is upon both expenditure and revenue, tax expenditures (eg on owner-occupied housing) cancel out because regional revenue is correspondingly depressed. However, they do affect the comparability of expenditure measures.

bring private finance and management into asset provision in transport, education and health - has been embraced in Scotland is that it is an approved route to evade borrowing restrictions. This is despite the fact that there remain ideological and Value-For-Money (VFM) doubts. The standard justification offered politically for the adoption of the PFI route is one of capital starvation and the non-availability of public funds; this sits uncomfortably with concerns that the Barnett formula will in future bring convergence.

Fifth, contrary to the purposes of various EU programmes of regional support to less prosperous regions, the award of funds from the European Regional Development Fund (ERDF) generally does not bring additional resources to the beneficiary UK territory or region. Despite EU pressure, the UK Government has consistently argued that there is additionality in aggregate, namely that public expenditure as a whole is higher than could have been afforded in the absence of ERDF receipts. The most politically dramatic event connected with devolution was when Alun Michael, having been parachuted into the Welsh Labour leadership by the Blair Government to stop Rhodri Morgan being elected First Secretary, had to resign because he failed to deliver extra money following the acquisition by West Wales (a strange geographic construction covering 63% of the area and 65% of the population of Wales) of Objective 1 status.[16] Subsequently, Rhodri Morgan became First Secretary; the Treasury allowed funding ‘above Barnett’;[17] and the minority Labour administration in Wales followed the Scottish precedent and went into coalition with the Liberal Democrats.

Sixth, the generation of revenues plays only a small role in the devolution funding system. Alone, the Scottish Parliament has the power to vary the basic rate of income tax, by 3p in either direction; this ‘tartan tax’ and the local authority taxation system is discussed in Section IV.

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[16] Objective 1 is the classification which brings eligibility for the highest level of European Regional Development Fund financing. On the role of EU funding in Wales, see Blewitt and Bristow (1999).

[17] This provoked outrage in the Scottish media, always keen to spot offence, until someone pointed out that an extension of this concession to Scotland (which was losing ERDF funds) would have meant a reduction in the Scottish Parliament’s Budget.

IV REAL AND IMAGINED PROBLEMS

The new arrangements in the United Kingdom exhibit some real problems, whereas others are imagined. Notwithstanding that some of the problems which appear in public debate are imagined, this does not mean that they have no influence on the evolution of the system.

Lack of Transparency

There is a lack of transparency about both processes and data.[18] The territorial fiscal mechanisms originated in the context of the territorial deconcentration of UK central government, with the territorial Secretaries of State being members of the UK Cabinet. Typically, they were relatively junior members of that Cabinet, but acquired constrained autonomy over the operation of public policy in their territory, in part as a reward for their loyalty to the Prime Minister of the day. Neither the Treasury nor the territorial departments had any interest in transparency: the Treasury culture naturally disposes itself to secrecy; and the territorial ministries thought that they could best protect territorial interests behind a veil of secrecy (Midwinter et al., 1991). A continuing consequence is that UK territorial data are generally of poor quality, arguably deteriorating during the 1980s and 1990s when the Conservative Government categorically ruled out devolution. In the UK system, most official statistical work is geared to the needs of UK policy, and requests for data which might have been taken to imply support for devolutionary policies were suspect. These effects reach far beyond territorial public expenditure data; for example, Cameron and Muellbauer (2000, Abstract) noted that ‘The historical unreliability of the Regional Accounts has implications for economic research on regional consumption and convergence and may have caused the poorest regions to miss out on EU Structural Funds’.

Given the technical problems of producing regional data, and the political context within which they are produced, all regional data are likely to be challenged politically. The best

[18] Although it is not fashionable to have public doubts about the desirability of transparency, it is clear that attitudes in practice are ambivalent. There seems to be a presumption in some Finance Ministries, most notably in the New Zealand Treasury, that greater transparency will lead to lower spending. Moreover, it is difficult to take the UK Treasury’s new-found enthusiasm for transparency at face value when there is so much pressure to use the PFI as a vehicle for off-balance sheet finance. Furthermore, the effect, so far, of the Comprehensive Spending Review has been to bring even more obscurity to public expenditure numbers. Some of the calls for greater transparency, whether with regard to interpersonal or interregional transfers, may implicitly or explicitly be calls for less redistribution or fiscal equalization. However, these observations should not be taken as a defence of fiscal opaqueness.

data about a constituent part of the United Kingdom appear in the series 'Government Expenditure and Revenue in Scotland' (*GERS*),[19] originally published by the Scottish Office and now continued by the Scottish Executive. However, this series is regularly abused by governments. Michael Forsyth, Conservative Secretary of State for Scotland, 1995-97, released one issue on the eve of a Scottish Conservative & Unionist Party Conference, at which he used its contents to denounce the devolution plans of the Scottish Constitutional Convention. Since 1997, Labour ministers, first at the Scottish Office and more recently at the Scottish Executive, use this document to pronounce unrealistic the SNP's plans for independence. In turn, the SNP attack the integrity of *GERS*, and always make reference to a celebrated written Parliamentary answer from 1997 given by the then Chief Secretary (William Waldegrave).[20] The media constantly recycle figures for Scottish fiscal deficits or surpluses relative to England, many of which reports are incompetent and/or malevolent. A classic error is to interpret the Scottish fiscal deficit as a measure of the subsidy from England, even when the United Kingdom as a whole incurs a fiscal deficit. Some of the inflammatory language is so outrageous as to be humorous.[21] Although Scottish Executive economists must feel battered by this exposure, they deserve credit for persisting with *GERS*; no counterpart exists for Wales or Northern Ireland. In this political context, it will be quite difficult to achieve transparency and agreement upon regional flows of income and expenditure.[22]

[19] The most recent issue of *GERS* relates to 1998-99 (Scottish Executive, 2000) and is available on the Scottish Executive's website at http://www.scotland.gov.uk/library3/government/gers.pdf.

[20] Historically, North Sea oil revenues (which are attributed to the UK Continental Shelf which is part of the United Kingdom but not part of any region) have been large. The Scottish National Party's argument that Scotland subsidized the United Kingdom by £28 billion during the years 1978-79 to 1994-95 is discussed in Heald et al. (1998) Whatever view is taken about the past, oil revenues have less significance for the future.

[21] One example is Heffer (1999): 'For the English…, the road to Scottish independence is paved with gold (p. 67).'; '… every English taxpayer and every English business will be better off if England no longer has to subsidise Scotland (p. 71); 'If the English can make a four pence in the pound tax cut out of Scotland's deciding to become independent, that is a cause for rejoicing rather than shame (p. 73)'. His calculations (p. 71) take the *GERS* measure of Scotland's fiscal deficit in 1994-95 as a subsidy from England to Scotland. Another example is the way in which the condition of the London Underground is routinely blamed on Scotland (McLean, 1998), a tactic which found much favour during the 2000 Mayoral election campaign in London. Before the referendum, there were suggestions that, unless it accepted the *status quo*, Scotland should be evicted from the Union (McLean, 1997a,b), in the manner in which it is claimed that Slovakia was evicted from the Czechoslovak federation.

[22] 'Recent' discussion of the Scottish fiscal position goes back to McCrone (1969).

Weak Fiscal Accountability

There is weak fiscal accountability, in part because of the extent of Vertical Fiscal Imbalance (VFI). However, public finance economists sympathetic to UK devolution have stressed that, in the UK context, attention should focus on fiscal accountability at the margin (Blow et al., 1996, Smith, 1996, Bell et al., 1996). This would allow devolved bodies to vary total budget size, as well as to vary expenditure composition. For the reasons explored elsewhere in this paper, there is not much likelihood either of full revenue decentralization or of a recourse to the principle of derivation (public expenditure in a region depends solely on taxes raised in that region). The twin dangers of blaming the devolved bodies, both for UK fiscal centralism and for the genuine constraints imposed by context, should be avoided.

Quite apart from the Labour Party's explicit electoral commitment not to use the tartan tax in the first term of the Scottish Parliament,[23] there have been other considerations pointing in the direction of caution. There was always a case for caution, in that the first step for the newly elected Parliament and Assemblies was to assess the expenditure situation, notably composition and the possibilities for greater VFM. Moreover, contrary to all expectations prior to devolution, the devolved Executives have been awash with money in financial years 2000-01 and 2001-02.[24] Rather than a shortage of cash, the problem has been mobilizing real resources, as manifest in high levels of underspend across both the devolved Executives and UK central government more generally (Treasury, 2001b).

A movement to greater fiscal accountability at the margin, if it occurs, is likely to be gradual. The combination of unexpected fiscal plenty[25] and expected political hesitation

[23] This commitment, widely believed to have been imposed upon the Scottish Labour Party by the London leadership, was accompanied by a campaign against the SNP's 'Penny for Scotland' (ie the use of 1p of the 3p power), which forecast economic doom and mobilized business persons and celebrities (eg football managers), in a way highly reminiscent of the No campaign during the 1997 Referendum.

[24] In order to establish its economic credentials before the 1997 General Election, the Labour Party promised to hold to the pre-existing public expenditure plans for 1997-98 and 1998-99, which it would inherit from the Conservative Government. The public expenditure process was moved from an annual Survey (looking three years ahead on a rolling basis) to a biennial Comprehensive Spending Review (looking three years ahead, but with some reconsideration of the third year at the next CSR). The public expenditure settlements announced in July 1998 and July 2000 (Treasury, 1998, 2000c) were unprecedentedly generous, especially to public services such as health and education. These fed through the Barnett formula into the assigned budgets of the devolved bodies.

[25] Timmins and Beattie (2001a,b) reported that the Institute for Fiscal Studies has calculated that the Treasury has funds within its plans which would allow public spending in 2001-02 to increase by more than 10% in cash terms (the forecast GDP deflator is 2.5%).

runs the risk that the tartan tax machinery, carefully developed between 1997 and 1999, will atrophy (Heald and Geaughan, 1997). There will be a long-term issue of how the tartan tax mechanism, whether restricted to Scotland or extended to Wales and Northern Ireland, interrelates with changes to central government taxes. After a period dating from the 1980s when considerable importance was attached by the Treasury to the stability of the personal income tax structure, the Treasury under Gordon Brown has engaged in a great deal of micro-management of tax bands, credits and rates. One such change considerably increased the potential yield of the tartan tax, but did this by taking its threshold lower down the income distribution, thereby making it more difficult to levy.[26] At the 1999 Scottish Parliament elections, there was a mistaken but widely accepted view that the tartan tax is regressive because it only applies to the basic rate, not extending to the higher rate.[27] The difficulty in using the tartan tax is essentially political, and there would be much manoeuvring regarding whether the Scottish Executive or the UK Government took the blame. One practical concern is that, given the Treasury's control over data and scoring, recourse to the tartan tax might be neutralized by a reduction in the assigned budget. However, transparency about the assigned budget calculations would be the best safeguard.

Perhaps one of the most significant aspects of the tartan tax is that this proposal explicitly linked the legislative and executive power of the Scottish Parliament to revenue raising. Although the referendum on the basis of two questions (one about the Parliament, one about the tartan tax) was widely interpreted as an attempt by the Labour Government to backslide on the revenue-raising power, the practical impact was to highlight the link in a way which had not previously been done, despite the commitment of the (Scottish Constitutional Convention, 1990, 1995) to this proposal. Subsequent to the referendum, some of those who had forecast dire economic consequences arising from a modest proposal then switched to a position advocating that the Parliament should raise all its own money.

[26] The March 1999 Budget restructured tax bands, replacing the existing 20% band (£0-£4,300 of taxable income) with a starting band of 10% (£0-£1500), with the net effect that the basic rate (23% in 1999-00, 22% in 2000-01) started at £1,500. Treasury (1999b, p. 99) stated: 'Effects on the Scottish Parliament's tax varying powers – statement regarding Section 7b 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'.

[27] The Institute for Fiscal Studies (1999) showed that, until the top decile, the tartan tax would be progressive. On the considerations which led to the tartan tax not being applied at the higher rate, see Heald and Geaughan (1997).

It is important not to underestimate the significance of the Scottish Parliament having full legislative control over local government structure, finance and taxation.[28] As shown in Section III, local government revenues implicitly finance a part of devolved expenditure. The positions are less developed in Wales (where the National Assembly for Wales controls the operation of the Welsh system but relies upon Westminster for primary legislation) and in Northern Ireland (where most local government functions were taken into central government under direct rule, and where the comparable taxes are lower); however, these positions might change. The constraint on change is political, not technical, echoing the earlier observation that UK citizens have more enthusiasm for public services than for paying taxes. The quickly reversed implementation of the community charge (ie poll tax) has accentuated political nervousness about local authority taxes, business as well as personal, and more specifically about differences between tax *rates*[29] in Scotland, Wales and England.[30] Two examples illustrate this point. Council (ie domestic property) tax valuations are still based on April 1991 values. In September 2001, there was newspaper coverage of business opposition to the intention of the Minister for Finance and Local Government in the National Assembly for Wales to go ahead with a proposal for a supplementary (ie local authority) business rate in Wales, even though such a proposal, discussed in a September 2000 Green Paper (Department of the Environment, 2000), has been abandoned in England.

Control of the entire local government financing system is a major asset for the Scottish Parliament, especially when it is noted that the Autonomous Communities in Spain are bypassed by the central government in Madrid which deals directly with local authorities. In contrast, central government taxation (here referring to the direct activities of the Scottish Executive) is not devolved, but central government charging policy is devolved.

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[28] The limitations on this power were spelled out in the 1997 White Paper: 'Should self-financed expenditure start to rise steeply, the Scottish Parliament would clearly come under pressure from council tax payers in Scotland to exercise its [capping] powers. If growth relative to England were excessive and were such as to threaten targets set for public expenditure as part of the management of the UK economy, and the Scottish Parliament nevertheless chose not to exercise its powers, it would be open to the UK Government to take the excess into account in considering the level of their support for expenditure in Scotland' (Scottish Office, 1997, para 7.24). There is no guidance on what would constitute 'excessive' growth.

[29] Much less attention is paid to differences in valuation practices and levels.

The line between taxes and charges is an elusive one. Congestion-type taxes, such as motorway tolls, are those least likely to provoke a reaction from the UK Treasury, which may even like the idea of the devolved bodies taking the lead in such a policy area. Nevertheless, the withdrawal by the Scottish Executive of its own motorway toll proposals re-emphasizes the political sensitivity of these matters.

The 2001 UK General Election, the first to take place with devolution in place, was remarkably dull until enlivened by a fractious and confused controversy about 'fiscal autonomy'. The trigger was a letter urging fiscal autonomy (Cross et al., 2001), published in the *Scotsman* newspaper. The problem is that several meanings could be attached to this term. First, the meaning is clear if Scotland were an independent state, though that was not generally the context of this discussion. Second, fiscal autonomy could mean that the devolved Scotland would receive all the tax revenue collected by the UK revenue departments and identified as having emanated from Scotland, with there being no power to vary UK rates. In such a case, a crucial question is whether there would be fiscal capacity equalization and/or needs equalization; the letter itself condemned equalization as inefficient and unfair, and stated that the direction of transfer runs from Scotland to England. Third, fiscal autonomy could mean that Scotland would have power to vary all or some tax rates, in which case questions of whether there would be equalization of fiscal capacity and/or for needs, whether there would be separate tax administrations, and whether such rate variation would be admissible within a EU member state, all arise. It became apparent that those in the media and politics advocating fiscal autonomy in the second or third meanings included some, hitherto opposed to devolution and the tartan tax, who believed that such an arrangement would bring large and welcome reductions to devolved

[30] It is part of the received political mythology that the poll tax was Prime Minister Margaret Thatcher's revenge upon Scotland for its lack of enthusiasm for the policies of her Government, a view often now repeated by those sympathetic to her programme. In fact, the poll tax emerged as a Scottish proposal in response to a bitterly contested rating revaluation in 1985, and this was the reason why implementation took place in Scotland in 1989-90, one year ahead of England. This episode in GB fiscal history (the poll tax was never implemented in Northern Ireland) has been described as 'fiscal anarchy' (Besley et al., 1997).

expenditure because of a revenue shortfall, as well as those who supported fiscal autonomy as a means of securing higher devolved expenditure.[31]

The focus in the United Kingdom should be upon fiscal accountability at the margin, not upon the proportion of expenditure which is financed from own resources. To concentrate upon the latter is to misjudge the UK fiscal system. Even without the traditionally centralized fiscal psychology of the Treasury and the desire of the present Chancellor of the Exchequer to micro-manage functional spending departments, the growing extent of international (IMF) and supranational (Ecofin) surveillance of general government-based indicators means that a high level of own resources would not be any guarantee of autonomy at the margin.

Policy Variation and Policy Leadership

Leaving aside the issue of the relationship between expenditure and needs, the evidence indicates that per capita expenditure on devolved services is higher in Scotland, Wales and Northern Ireland than it is in England. Especially since the implementation of Barnett in 1981-82, the territorial offices had considerable scope to vary the composition of their expenditure from that in England, though the fact that the respective Secretaries of State were members of the UK Cabinet of a Conservative Government, with a well-defined policy agenda, limited how much deviation might be expected. During this period, the Secretary of State’s expenditure-switching power within the block seems to have been used more for tactical public expenditure management than for policy variation. Nevertheless, even through the periods when the 1979-97 Conservative Government regarded reducing public expenditure as a priority, successive territorial Secretaries of State and their civil servants defended territorial programmes.

Under the devolved system, policy divergence seems more likely, as the factors which generated alignment are now much weaker. Midwinter (1997) has stressed that one of the reasons why the Treasury has not challenged the Barnett system is that any reductions of expenditure secured in the territories would spread very thinly over the much larger England. Moreover, the system allowed the Treasury to exercise control over the main Whitehall spending departments, and then quickly calculate the formula consequences which bore a predictable relationship to totals. Treasury staffing levels could not have coped with involvement in the particularities of territorial public policy (Thain and Wright, 1995), especially in cases where there was political leverage. Policy leadership, especially that which might be expensive, remained in London in Whitehall departments. Devolution changes this picture. From the Treasury's viewpoint, policy initiatives in the territories might now generate expensive policy spillovers to England[32] if there is pressure for matching policy.

Examples of this are now widely discussed. First, the Labour Government's UK reform of student finance began to unravel when the coalition Scottish Executive adopted a package involving the abolition of up-front student fees. This was substantially less expensive than the proposals of the Cubie Report (1999), which had been commissioned by the Scottish Executive as part of the coalition agreement between Labour and the Liberal Democrats. Subsequently, pressure has built up for policy changes in England which, because of relative populations, would be expensive for the Treasury.

Second, the Labour Government appointed a Royal Commission on the financing of long-term care for the elderly (Sutherland, 1999). To the Government's discomfort, the majority report favoured the government paying for personal care as well as nursing care for dependent elderly persons, irrespective of means. Although the proposals were initially rejected by the UK Departments and by the Scottish Executive, one of the first actions of the new First Minister (Henry McLeish MSP) was to announce that the majority report

[31] Another aspect of this debate is the proposal that the Scottish Parliament would take all revenues generated in Scotland and then pay the UK Government for the services it provided. Such a system in principle operated in Northern Ireland from 1921 to 1972, but in practice it quickly degraded and the payment became negative (Gibson, 1996). A practical issue is that such an arrangement would generate much controversy about non-devolved matters, with the Scottish Parliament being likely to object to certain components of such UK expenditure, definitely complaining about the geographical distribution of defence bases and perhaps threatening to charge rent for the location of the UK's nuclear capability in the Clyde estuary.

[32] This discussion refers to the financial effects of horizontal policy spillovers, not to vertical financial spillovers. The published rules (Treasury, 2000a) for operating the devolved financial system specify that there would be adjustments to the assigned budgets in cases where devolved policy, for example higher council taxes or higher council house rents, leads to higher benefit payments from UK funds.

proposals would be implemented in Scotland. This was partly under pressure from the Liberal Democrats, but also to assert his independence from the London Labour leadership, which had become involved in the Scottish leadership election, occasioned by the death in October 2000 of First Minister Donald Dewar. Subsequently, pressure is building up for policy modifications in England. Moreover, the implementation of this policy raises financial issues concerning the way the non-devolved social security system interfaces with devolved expenditure; in this case, the devolved policy will bring savings to the UK programme.

A third example relates to teachers' pay, on which topic the Scottish Executive commissioned the McCrone Report (2000) which recommended considerable restructuring and substantial pay increases. Again, these Scottish developments have affected debates about teachers' pay in England (though there is some evidence that teachers' pay in Scotland has lagged behind that in England).

These Scottish initiatives have provoked much comment in England, largely to the effect that Scotland must be overfunded if these can be afforded from within the assigned budget. Several questions arise. First, there is the question of the respective merits of the Scottish and English policies, a topic well beyond the scope of this paper. Second, there is the question of how much these initiatives will cost, both in Scotland and then if extended to England. There are many figures in circulation about potential costs, though the basis of calculation, the original source and even the time period are often not made explicit. For example, with regard to Scotland, £800 million has been cited for the McCrone proposals; £110m a year for Sutherland; and £50m a year for Cubie. Moreover, a huge amount of media attention has been attracted by the mismanagement and cost overruns of the buildings for the Scottish Parliament at Holyrood and for the National Assembly for Wales at Cardiff Bay. These overspends have to be met from within the assigned budget. Third, even where a Scottish policy initiative does not involve future expenditure commitments, the method of funding via the assigned budget means that the way in which the Treasury scores particular transactions can be highly technical and immensely important. There has been newspaper coverage, probably leaked to damage the new First Minister, regarding negotiations between the Scottish Executive and the Treasury as to how the transfer of Glasgow City Council's housing stock to a housing association will be scored.[33]

Nevertheless, policy spillovers do not all run the same way. First, pressure has been put upon the devolved administrations because of the headlining, particularly at the times of the 1998 and 2000 CSRs, of the percentage increases awarded to health and education in England. Because of the operation of the Barnett formula, the devolved administrations could not match these percentages, without massively distorting internal priorities within their assigned budgets. The so-called 'Barnett squeeze' has been measured as the amounts Scotland, Wales and Northern Ireland have not received because the same percentage increase as in England was not applied to their own expenditure base (Cuthbert and Cuthbert, 2001). Although there is something bizarre in such calculations,[34] the media and political attention they attract are undoubtedly causing problems for policy-makers in the devolved administrations.[35]

Second, there are considerable differences in the structure of government in the four territories of the United Kingdom, and in the conduct of central-local relations. Scotland now has a single-tier local authority system and, even before 1997, there has been considerably less conflict over education policy and schools management. Local government is highly marginal in Northern Ireland, with many functions, including schools, managed directly by the Executive or by quangos. In England, the highly centralized inclinations of the Department for Education and Employment (now Education and Skills) have combined with the desire of Westminster politicians to gain credit for 'new money', leading to the announcement of direct payments to schools which bypass the block grant

[33] Traditionally, Scottish local authorities have owned a large stock of 'council housing'. Over the past 20 years, a substantial proportion has been sold to sitting tenants. Some local authorities, like the City of Glasgow Council, with a large proportion of its remaining stock in poor condition, see the transfer to a housing association as a means of renovating the stock. Housing associations, though heavily dependent on public funds, are treated by the Treasury as private sector bodies which can borrow in the capital market without that scoring against public expenditure aggregates. The technical issue is presumably that, at the time of the transfer, the local authority would seek a writing-off of that part of its debt relating to the now-transferred housing stock, with the Scottish Executive accepting responsibility for servicing that debt. However, newspaper coverage suggests that a write-off of housing debt across the United Kingdom at the time of transfer might avoid the Scottish Executive taking over this debt.

[34] These calculations imply that each territory should have the same percentage increase, irrespective of the present expenditure relatives and of relative needs.

local authority financing system. The knock-on effect, probably felt more intensely in Northern Ireland, where there seems to be more awareness of English developments, is that schools in Northern Ireland believe they have been missing out.

Thirdly, there is the curious situation when the Barnett formula is widely criticized, albeit for diametrically opposite reasons. It is primarily exceptionally high rates of nominal public expenditure growth which has brought the convergence issue on to the policy agenda in the territories. There has also been extensive media attention to changing patterns of relative GDP, usually focusing on Scotland moving much closer to the UK average and Wales dropping much further below. However, this focus on relative GDP is largely misguided, as the drivers relevant to differential needs for devolved expenditure are demography, geography and participation rates in publicly provided services such as health and education.

The so-called 'devolution backlash' has been relatively subdued. In part, this is because the territories receive little attention from the UK media. However, there is undoubted resentment, particularly in the North East of England (adjacent to Scotland), about the higher expenditure levels and greater policy autonomy of the territories, now much more widely known. So far, resentments have been fuelled, without there being real transparency in how the territorial expenditure system operates.[36]

Thus far, the expectation of many strongly supportive of devolution that the budget constraints would be highly restrictive has not come about, because of broader UK developments. A key issue is whether the system, which theoretically embodies a hard

[35] 'We have a formula that, every time a big headline increase is announced by the Chancellor in England, it can't actually be repeated here because our Barnett consequences don't give us enough. There are serious difficulties there. For every pound extra that has been announced for education, per school child in England, it's only 76p per pupil here' (Mark Durkan MLA, Minister for Finance in the Northern Ireland Executive, quoted in the *Belfast Telegraph* on 14 January 2001).

[36] Newspaper comment suggests that there is considerable resentment at the prominence in the UK Labour Cabinet of MPs representing Scottish constituencies: out of 23, five are Scottish MPs, and three others (one a member of the House of Lords, two representing English constituencies) were born in Scotland. An important factor behind this prominence was that Labour was much more successful in Scotland in 1983 and 1987 at retaining its seats. One of the provisions of the *Scotland Act 1998* is that, with effect from the General Election to be held not later than 2006, the number of Scottish MPs will be cut from the present level of 72 to a number based on the same population quota as applies in England. Gay (1997) calculated that a strict *pro rata* basis would give, out of 659 MPs, England 549 (presently 529), Scotland 59 (72), Wales 33 (40) (where there are no proposals for reduction), and Northern Ireland 18 (18).

budget constraint, can withstand the inevitable political pressures when money becomes genuinely tight.

Absence of Institutional Machinery

UK government has been very top-down, with a hierarchical relationship between central government and local authorities, even before the 1980s saw a removal of functions, the imposition of compulsory tendering, and the diminution and restriction of revenue raising. Even within the territories, with their separate territorial administration, political authority came through the Secretary of State from the Prime Minister and the UK Cabinet.

On a constitutional level, devolution does not necessarily change this, because the Scottish Parliament was established by Westminster legislation, which any future government can repeal, and the funding basis is only contained in the devolution White Papers (Scottish Office, 1997, Welsh Office, 1997) and non-statutory Treasury guidance (Treasury, 1999, 2000a). There can be no such thing as a constitutional assignment of powers. Nevertheless, the political reality is quite different. Devolution 'all around' fundamentally alters the politics; between them, the three territories elect a considerable proportion of the UK Parliament. Withdrawing devolved powers is unlikely to be attempted by a UK Government unless it enjoyed significant support for this policy in that territory. Although the UK Government can exercise the power to suspend the Northern Ireland Assembly, it is far less likely that this could be done in the case of Scotland and Wales. There are now credible alternative political mandates, with devolved administrations looking to their own electorates who may behave differently in UK and devolved elections. A further complication arises from proportional representation to the devolved bodies, together with coalition government which is a likely consequence. In Scotland and Wales, this has facilitated a revival of the respective Conservative Parties, making UK commitments to roll back devolution highly problematic for a UK Conservative leader.

What is obviously lacking is institutional machinery within which intergovernmental relations can be conducted. The devolved Executives are remote from the UK level of decision-making, relying both on internal party links and on the operation of the Scotland

and Wales Offices, whose heads at present retain UK Cabinet Minister status. There is no clarity as yet as to how this machinery might develop.

For example, the aborted devolution plans of the 1970s produced an Expenditure Needs Assessment conducted by an interdepartmental committee chaired by the Treasury (1979). This work provided the context within which the Barnett formula was adopted. Although nothing has ever been published, the Treasury has periodically updated its assessments of the relative needs of Scotland, Wales and Northern Ireland. Understandably, the devolved Executives do not trust either the Treasury's ownership of public expenditure data or the potential uses to which such calculations might be put. Such concerns will have been magnified by the Deputy Prime Minister's promise during the 2001 General Election campaign that there would be 'blood on the carpet' about the Barnett formula (Hetherington, 2001).

Given this context of suspicion and of poor data, only a body independent of the UK Treasury would command consent in the context of any future needs assessment. There is presently a remarkable amount of confusion about even basic facts, stemming in part from an apparent failure to understand the difference between relative and absolute changes. The Barnett formula is characterized in Scotland, Wales and Northern Ireland as a means of depriving them of equal percentage increases to those in England, whilst in England it is synonymous with feather-bedding of the territories. Territorial politicians and media work themselves up into a lather, sometimes about things which are unimportant or irrelevant. To what extent this is playing political games, and to what extent there is genuine ignorance, is sometimes difficult to assess.

What the United Kingdom will need is some kind of forum for minimizing areas of conflict over factual matters, and a mechanism for resolving disputes. Different federations deal with this matter in various ways: for example, the Australian Grants Commission plays an important role in the operation of fiscal equalization among the states, and the Supreme Court has regularly been involved in taxation disputes. In Germany, the Fiscal Equalization Law is currently under revision after the Federal Constitutional Court deemed certain aspects of the present scheme unconstitutional, in a judgement delivered on 11 November 1999.

Thus far, intergovernmental conflict over resources has been minimal, probably because of the lubrication of unexpected real expenditure growth. This is one of the factors which have, thus far, falsified Midwinter and McVicar's (1996a,b) apocalyptic predictions of conflict which would destabilize the Union.

Those supporting devolution recognized the strains on the Barnett formula-controlled assigned budget which might arise. These concerns operated at two levels. Firstly, a collapse of public service quality in some parts of inner London might take opinion formers and the middle class further out of public provision and reduce the need, and weaken political support, for the higher expenditure in England which generates formula consequences. Second, a fundamental shift in UK policy towards tax expenditure support for private health and education would automatically mean that there were fewer formula consequences.[37]

V COMPARISON BETWEEN CANADA AND THE UNITED KINGDOM

Certain differences and similarities between Canada and the United Kingdom can usefully be summarized. Firstly, Canada became a federation in 1867 whereas the United Kingdom is not a federation, and probably never will be. Nevertheless, recent UK developments are quasi-federal in character and reflect the fact that, in both countries, there is a real possibility of break-up. Quebec has had referendums on separation, and the break-up of the United Kingdom began in 1922. But for World War I, devolution might well have been implemented in Scotland in the 1910s when 'Home Rule All Round' was a vibrant rallying cry in the periphery. To a considerable extent, devolution, which had been strongly supported by the Labour Party, went off the agenda because Labour, both in office and in opposition at Westminster, attached great importance to the centralized UK welfare state. The existence of potentially insoluble conflicts, which federalism is seen as a way of

[37] This issue, of there being no English counterpart to generate formula consequences, already arises in the case of water and sewerage, privatized in England and Wales but not in Scotland and Northern Ireland.

managing, distinguishes both Canada and the United Kingdom from a federation like Germany, where federalism is more a governance concept than a mechanism for assuaging deep conflicts or facilitating marked policy divergence.

Secondly, in both Canada and the United Kingdom there are markedly different patterns of political support in different area, a feature that has been accentuated by the first-past-the-post electoral system. Its effect was particularly pronounced during the 1979-97 Conservative Government, which relied upon majorities from England to pass legislation concerning Scotland and Wales. The Labour Party's revival in southern England in the 1997 General Election, sustained in 2001, has modified this picture, though provoking new complaints that New Labour's preoccupation with 'Middle England' is leading it to neglect its heartlands. The electoral system thereby amplifies fluctuations in political support.

Thirdly, Scotland often defines itself in relation to England, its much larger neighbour, which – for most of the time – is unconcerned about, and ignorant of, developments in Scotland. There are parallels in that Canadian nationalism is, in part, defined relative to the United States (Helliwell, 2001). There is some similarity between the economic pressures from the North American Free Trade Area (NAFTA) and those from the EU, though a bigger difference is to be found in that increased economic integration is not presumed to involve either monetary or fiscal integration. The fiscal history of Canada and, especially, that of the United States, where federalism has been explicitly viewed as a restraint on government size, has led to much less concern about the fiscal viability and health of sub-national governments (Riker, 1996). There is much more willingness to leave fiscal discipline to the capital market, rather than the surveillance which has been adopted by Ecofin.[38] Although the United Kingdom, unlike Canada, does not have a constitutional commitment to fiscal equalization, there is a deeply embedded political commitment to the principle of broadly equal standards of public service provision across the United

[38] There has been considerable conflict between the UK Chancellor of the Exchequer (Gordon Brown MP) and Ecofin concerning the UK's conformity with the EU Stability and Growth Pact (which applies to the United Kingdom even though it is not a member of the Euro). The deficits and debt of sub-national governments are scored within the general government measures monitored by Ecofin.

Kingdom.[39] The differences in provision which are now attracting increased attention are partly a consequence of political compromises and partly a reflection that the UK fiscal system has been non-transparent. Whereas Canada exhibits a high degree of revenue decentralization (Boadway and Watts, 2000), the United Kingdom will remain highly centralized. Indeed, the UK Government will simultaneously resist EU pressures for tax harmonization (arguing the case for tax competition) and devolved pressure for modest measures of tax decentralization (arguing that these would be distortionary). Even without EU pressures for tax harmonization, the UK Exchequer's loss of revenue from tobacco and alcohol excises, together with the criminalization of parts of the distribution system, will lead to major reductions in excise levels, which are currently much higher than in the relevant parts of continental Europe. Distance provides less protection than in Canada for differentiated excise systems.

Fourth, the UK Government has no power to spend its own money on devolved functions, so that, in this respect, the devolved bodies are more effectively protected from UK government intervention than are the Canadian provinces, which have long complained about the Federal Government's use of its 'spending power' (Boadway and Watts, 2000) to override provincial policy preferences. An obvious caveat is that a UK government has control over the tax/transfer system and there might well be circumstances in which this could be used to override the policy preferences of devolved bodies.

[39] This manifests itself in unresolved tensions in public attitudes to centralization. First, territorial variation in cash benefits is deemed intolerable, even when strong cases could be made in terms of regional variations in the cost of living. Second, though centralized bureaucracies are viewed as suspect, attempts to decentralize public sector decision-making (eg purchaser-provider separation in health, with local determination of some priorities) quickly face bitter complaints about 'postcode lotteries'. Paradoxically, if devolution brings greater transparency about in-kind provision, this might revive pressures for uniform provision.

VI CONCLUSIONS

In conclusion, four final observations will be made. Firstly, it is essential to recognize where the UK devolved system of government is coming from and not to criticize it on the grounds that it would not have been invented in that form had there been a clean slate. Devolved government in Scotland and Wales is only two years old and the restoration of devolved government in Northern Ireland, itself two years old, suffered a 24-hour suspension on 10 August 2001 for reasons unconnected with the subject matter of this paper. The start has undoubtedly been shaky, but the show is on the road.

Secondly, the conceptual framework of the economic theory of fiscal federalism is most helpful in constructing an analysis of a particular country in terms which resonate elsewhere. However, prescription ought to proceed with great caution. The mainstream literature on fiscal federalism has a strongly normative orientation, relating to the optimal tiering and spatial design of government. Much of its development predated the influence of public choice theorists, a factor which probably explains the relatively optimistic view of government characteristic of this tradition. Clearly, those who start with a Leviathan model of government are likely to reach different conclusions from those making more benevolent assumptions. Moreover, the trade-offs between efficiency, equity and broader political considerations (such as sustaining territorial integrity) will crucially depend on context. In some cases, the units of a devolved or federal structure are themselves open to negotiation, in others they are historically and culturally determined. Similarly, traditions about the extent of fiscal equalization can be deeply embedded.

Thirdly, one possible line of constitutional development would see Wales and Northern Ireland converge on the Scotland model, at the same time as the Scottish Parliament sought to expand its fiscal power. By far the greatest uncertainties attach to developments in England, where the Labour Government's commitment in principle to regional government did not produce much action between 1997 and 2001. In its 2001 General Election Manifesto, Labour undertook that elected regional assemblies could be established in those cases where a double condition was satisfied: there is majority support in a referendum; and there is a predominance of single-tier local government (a condition satisfied in the North

East, North West, Yorkshire and Humberside, and, marginally, the West Midlands). A White Paper has been promised, though that would have to be followed by primary legislation to authorize such referendums. This leisurely approach is indicative of contrasting views within the Government, in relation to, *inter alia*: the interface with local authorities; the electoral system; the possible effect on the Government's centralized approach to public service delivery (perhaps the most high profile priority of its second term); and the interface with the business-led Regional Development Agencies (the highest profile English regional measure of its first term). It remains unclear whether the response to devolution in the territories will be a new emphasis on England as a unit, or a focus on at least some regions.

Fourthly, there is an urgent need for the United Kingdom to be open to learning from other jurisdictions, though this would be contrary to inclination and history. There is clearly relevant experience in countries such as Canada and Australia (where there is a shared institutional heritage) and Germany and Spain (where EU membership provides common context). As the literature shows, policy transfer and lesson-drawing are not simple matters (Dogan and Pelassy, 1990, Rose, 1993). However, that difficulty does not justify insularity. When commenting on a draft of Heald's (1980) monograph, the late Russell Mathews, a prominent figure in Australian policy and practice on fiscal federalism, observed that the British were characteristically obsessed with re-inventing the wheel. Fortunately, such attitudes will be more difficult to sustain in a more integrated world and with devolved institutions in place.

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Figure 1: Block Relatives

10:5:85 as exact population shares

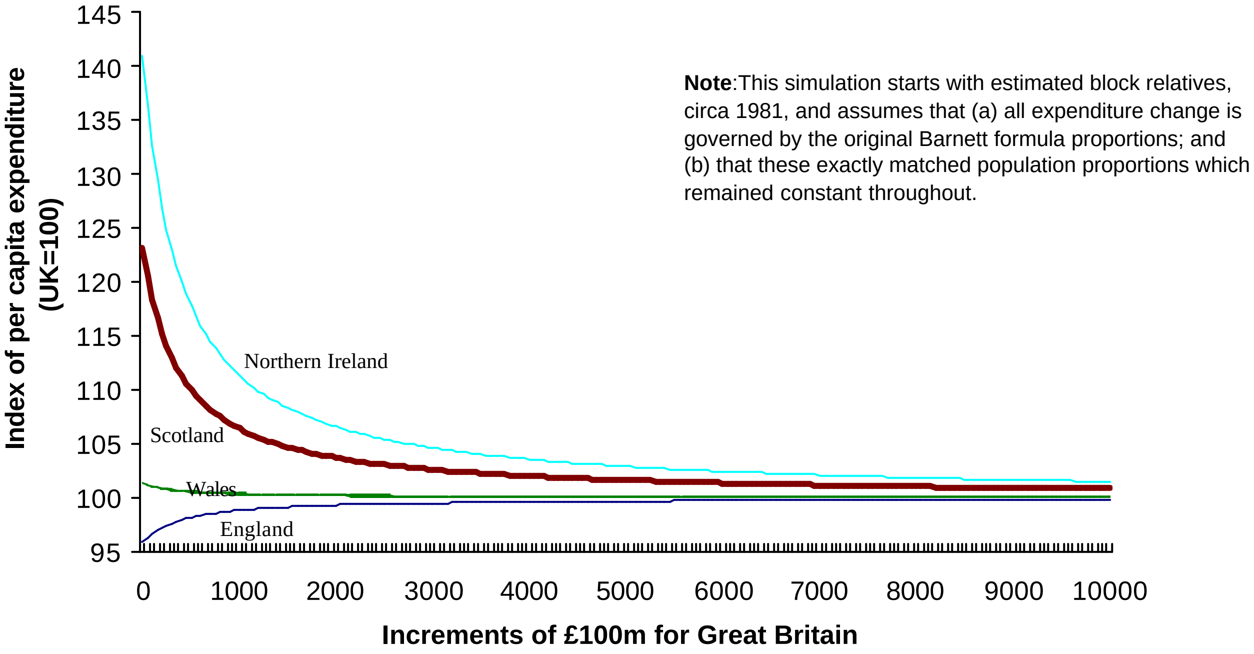
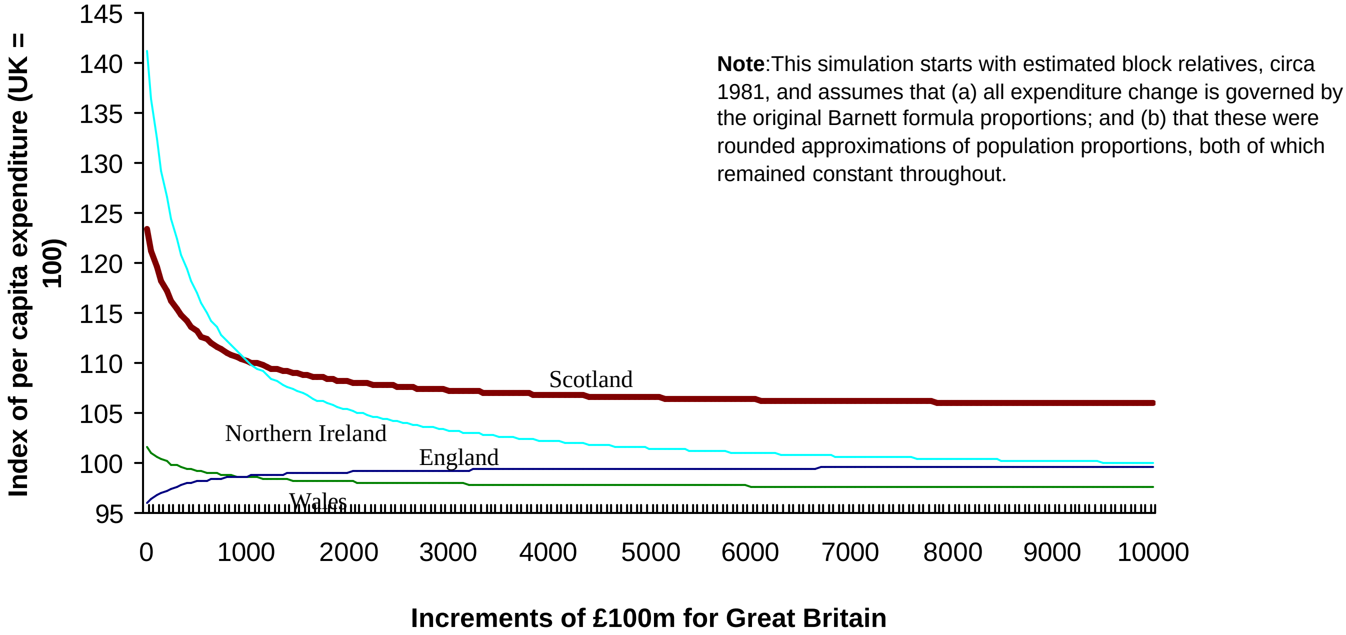


Figure 2: Block Relatives

10:5:85 as rounded population shares



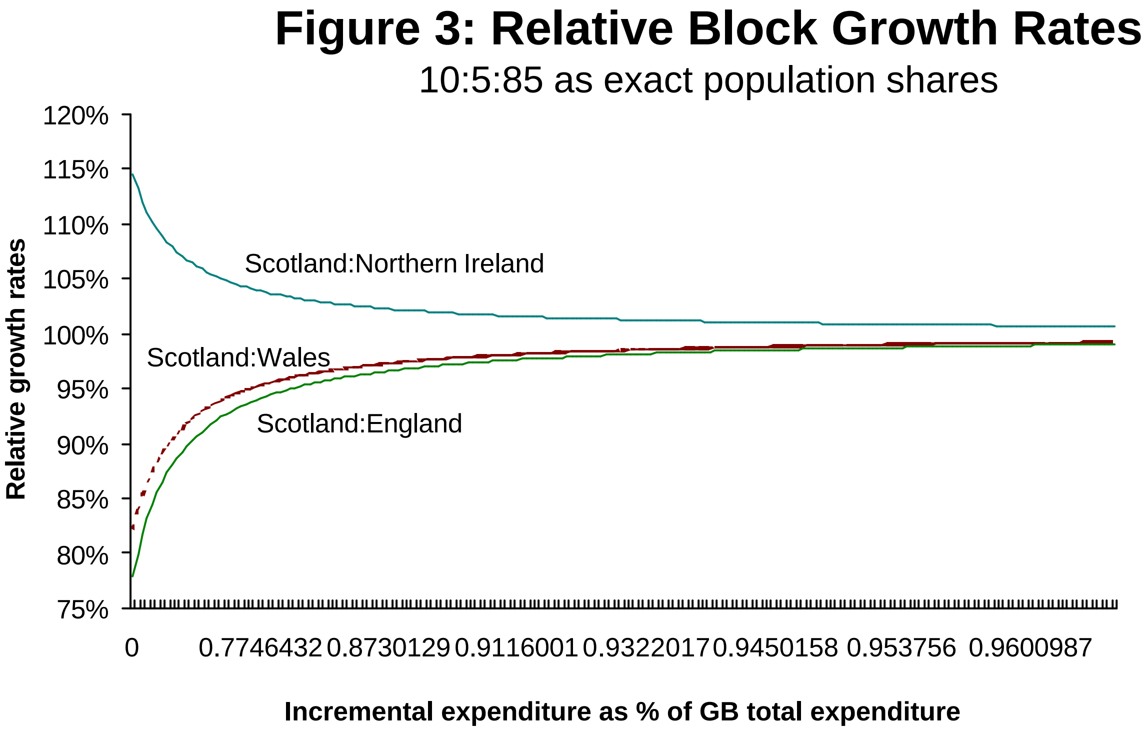


Figure 3: Relative Block Growth Rates
10:5:85 as exact population shares
Relative growth rates
120%
115%
110%
105%
100%
95%
90%
85%
80%
75%
Scotland:Northern Ireland
Scotland:Wales
Scotland:England
0
0.7746432
0.8730129
0.9116001
0.93220017
0.9450158
0.953756
0.9600987
Incremental expenditure as % of GB total expenditure

Figure 4: The Case of the Scottish Parliament

<table>
<tr><th colspan="3">Public Expenditure Regime</th></tr>
<tr><td colspan="3">1999-2000 onwards</td></tr>
<tr><td>Assigned Budget</td><td>Non-assigned Budget</td><td></td></tr>
<tr><td colspan="2">Departmental Expenditure Limit (DEL):</td><td>Annually Managed Expenditure (AME):</td></tr>
<tr><td>Barnett Formula determined</td><td>Non-Barnett determined</td><td>Main programme spending:</td></tr>
<tr><td>Secretary of State’s/Advocate General’s office</td><td></td><td></td></tr>
<tr><td rowspan="7">Education and arts,
Health and social work
Industry, enterprise and training,
Transport and roads,
Housing, Scottish Homes external finance,
Law and order,
Crown Office
Domestic agriculture
Environmental services,
Forestry
CalMac and HIAL’s External Finance Requirements
Student Loans: implied subsidies and provision for bad debts
Capital Receipts Initiative
Trust Debt Remuneration
Scottish Renewables Obligation
Bus Fuel Duty Rebates</td><td>HLCAs</td><td>CAP</td></tr>
<tr><td rowspan="2">Welfare to Work</td><td>Housing support grant</td></tr>
<tr><td>NHS and teachers’ pensions</td></tr>
<tr><td></td><td>Other AME:
Certain accrual items such as capital charges and depreciation charges</td></tr>
<tr><td></td><td>Local Authority Self Financed Expenditure (LASFE)</td></tr>
<tr><td rowspan="2"></td><td>Scottish Non-Domestic Rates</td></tr>
<tr><td>Scottish Variable Rate of Income Tax</td></tr>
<tr><td colspan="3">Other expenditure outside DEL: Police Loans charges</td></tr>
</table>

Source: Treasury (2000), p. 27.
Other abbreviations: CAP = Common Agricultural Policy; HIAL = Highlands & Islands Airports Limited, a public corporation which runs certain small airports; and HLCAs = Hill Livestock Compensation Allowances.

Figure 5: The Case of the National Assembly for Wales

<table>
<tr><th colspan="3">Public Expenditure Regime</th></tr>
<tr><td colspan="3">1999-2000 onwards</td></tr>
<tr><td>Assigned Budget</td><td>Non-assigned Budget</td><td></td></tr>
<tr><td colspan="2">Departmental Expenditure Limit (DEL):</td><td>Annually Managed Expenditure (AME):</td></tr>
<tr><td>Barnett Formula determined</td><td>Non-Barnett determined</td><td>Main programme spending:</td></tr>
<tr><td>Secretary of State’s office</td><td></td><td></td></tr>
<tr><td rowspan="5">Economic development, industry and training,
education and arts,
transport, planning and environment,
local government,
housing and social services and health
Domestic agriculture
Forestry (from 1 April 2000)
Capital Receipts Initiative
Trust Debt Remuneration
Bus Fuel Duty Rebate</td><td>HLCAs</td><td>CAP</td></tr>
<tr><td rowspan="2">Welfare to Work</td><td>Housing Revenue Account Subsidy</td></tr>
<tr><td>Other AME:
Certain accrual items such as capital charges and depreciation charges</td></tr>
<tr><td></td><td>Local Authority Self Financed Expenditure (LASFE)</td></tr>
<tr><td></td><td></td></tr>
</table>

Source: Treasury (2000), p. 29.
Other abbreviations: CAP = Common Agricultural Policy; and HLCAs = Hill Livestock Compensation Allowances.

Figure 6: The Case of the Northern Ireland Assembly

Public Expenditure Regime		
1999-2000 onwards		
Assigned Budget	Non-assigned Budget	
Departmental Expenditure Limit (DEL):		**Annually Managed Expenditure (AME):**
Barnett Formula determined	**Non-Barnett determined**	**Main programme spending:**
Agriculture, trade and industry, employment, energy, roads and transport, housing, environment and water, fire, education, health, social security administration, public corporations and other public services, Student Loans: implied subsidies and provision for bad debts Capital Receipts Initiative Trust Debt Remuneration Fossil Fuel Obligation Bus Fuel Duty Rebate	Housing Loan Charges	CAP
	EU Peace and Reconciliation Programme	Social security benefits
	ERDF gas link and electricity interconnector	NHS and teachers' pensions
	HLCAs	**Other AME:** Certain accrual items such as capital charges and depreciation charges
	Welfare to Work	District Councils' self-financed expenditure
		Regional Rates

Source: Treasury (2000), p. 31.
Other abbreviations: CAP = Common Agricultural Policy; ERDF = European Regional Development Fund; and HLCAs = Hill Livestock Compensation Allowances.
Note: Under direct rule, the Northern Ireland Office and the Northern Ireland Departments were effectively managed together, in the name of the Secretary of State for Northern Ireland, a member of the UK Cabinet. Since devolution which was restored on 2 December 1999, there is a complete separation between the Northern Ireland Assembly (to which the above scheme applies) and the Northern Ireland Office, still headed by the Secretary of State for Northern Ireland, though now treated as a Whitehall department which negotiates bilaterally with the Treasury. In consequence, the Social security programme is devolved (as it has been since 1921) but the Law, order and protective services programme is not (though this could be done if the security situation was fully normalised) .

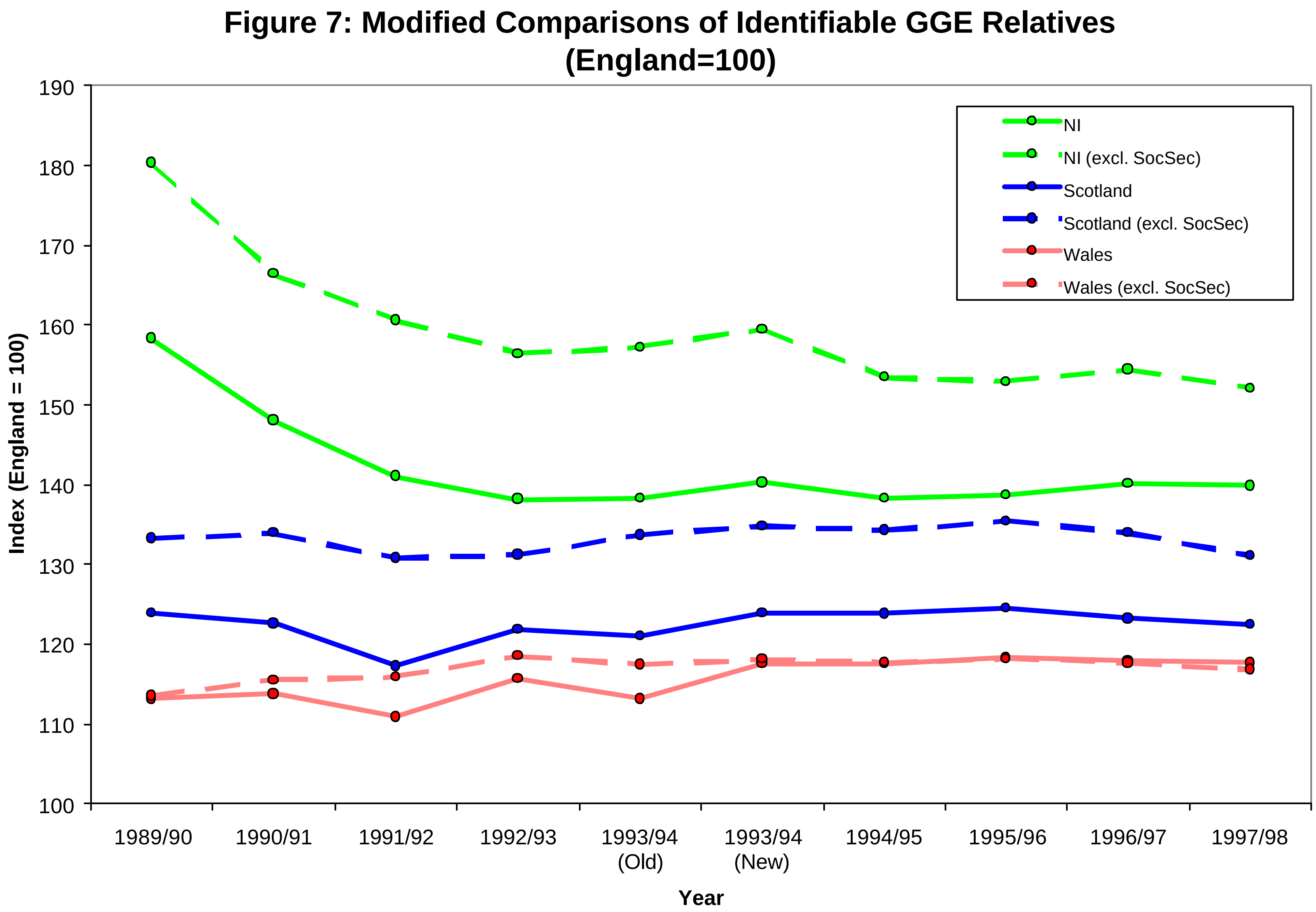


Figure 7: Modified Comparisons of Identifiable GGE Relatives
(England=100)
Index (England = 100)
190
180
170
160
150
140
130
120
110
100
NI
NI (excl. SocSec)
Scotland
Scotland (excl. SocSec)
Wales
Wales (excl. SocSec)
1989/90
1990/91
1991/92
1992/93
1993/94 (Old)
1993/94 (New)
1994/95
1995/96
1996/97
1997/98
Year

Figure 8: Identifiable General Government Expenditure Per Head, By Territory, Region and Function

	UK weight	Scotland	Wales	Northern Ireland	England
Education	15.4%	126	100	136	96
Health and personal social services	24.1%	119	110	111	97
Roads and transport	3.1%	130	112	89	96
Housing	1.1%	176	145	325	82
Other environmental services	3.2%	131	168	106	93
Law, order and protective services	7.1%	96	96	206	97
Trade, industry, energy and employment	2.6%	149	113	255	90
Agriculture, fisheries, food and forestry	1.7%	267	155	283	73
Culture, media and sport	2.0%	99	157	60	99
Social security	38.7%	108	115	120	98
Miscellaneous expenditure	1.0%				
Total	**100.0%**	**118**	**113**	**133**	**96**
Total excluding Social Security		**125**	**112**	**142**	**95**

	North East	North West	Yorkshire & Humberside	East Midlands	West Midlands	South West	Eastern	London	South East
Education	100	101	96	93	101	92	96	108	82
Health and personal social services	102	100	98	88	92	91	92	121	85
Roads and transport	96	97	74	85	89	88	95	122	105
Housing	57	90	71	35	37	35	4	304	25
Other environmental services	117	106	45	90	92	79	76	126	94
Law, order and protective services	104	101	93	90	88	85	75	144	83
Trade, industry, energy and employment	103	94	91	96	90	87	86	94	76
Agriculture, fisheries, food and forestry	75	73	75	73	69	75	73	72	73
Culture, media and sport	143	88	87	81	82	83	75	176	76
Social security	119	112	101	94	99	97	89	97	84
Miscellaneous expenditure									
Total	**109**	**104**	**95**	**90**	**94**	**92**	**88**	**113**	**84**
Total excluding Social Security	**102**	**99**	**91**	**88**	**92**	**88**	**87**	**123**	**84**

Source: Treasury (2001a), Tables 8.6B and 8.12
Note: An index of miscellaneous expenditure is not calculated since the administration costs of departments other than in territories are not separated from functional expenditure. Such an index would be misleading.

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