

# Fiscal opportunities

**David Heald<sup>1</sup>**

**V**iewed from Scotland, where the constitutional-reform agenda was promoted by the broadly-based Scottish Constitutional Convention throughout the 90s,<sup>2</sup> the pace of developments in Northern Ireland has been spellbinding. Thus the month between the constitutional referendum and the election of the Northern Ireland Assembly should be compared with the corresponding 20-month gap in Scotland and Wales.

Yet it is essential to set political developments in Northern Ireland within the context of constitutional developments across the United Kingdom. Having elected devolved bodies in all three territories will be of enormous practical significance: for example, a Scottish Parliament on its own would have been much more vulnerable to interventions from Westminster and Whitehall.

Despite different forms of devolution

in Scotland, Wales and Northern Ireland, the common feature of elected territorial bodies will alter the calculus of electoral competition: a UK party which alienated all three could only win a UK election on the back of a landslide majority in England. Consequently, a broad swathe of political opinion will seek to make the new institutions work, with the result that parties and voters in Great Britain will have to adapt to the direct and indirect consequences of proportional representation. The cumulative effect will be that the new constitutional arrangements will be able organically to mature, not necessarily frozen as they stand after the 1998 bout of constitutional legislation.

There are, however, interesting differences between the three territories. First, the run-up to devolution in Scotland is proving fraught: Scottish Office ministers are simultaneously condemned for lack of policy dynamism *and* for pre-empting

David Heald sets the fiscal context straight



the Parliament. The situation in Northern Ireland is quite different, not least because direct-rule ministers will not have careers in the Assembly.

Secondly, challenges to the devolution settlement can be expected to come

from different directions. The Scottish referendum was decisive enough to end the system of administrative devolution, but the issue of devolution versus independence was not tested. The referendum in Wales dramatically highlighted its east-west divide, with vocal opponents decrying even non-legislative devolution as a step too far. In Northern Ireland, at the time of writing, it remains unclear whether those opposed to the establishment of the Assembly will seek to make it work.

Thirdly, there are some important differences in financial context. It seems likely that both Scotland and Northern Ireland have fared well out of the Barnett formula arrangements—their expenditure relatives probably having been kept at a higher level than their needs relatives. In comparison, Wales may have done less well.<sup>3</sup>

Fourthly, only the Scottish Parliament has an explicit tax-varying power (the ‘tartan tax’<sup>4</sup>); the Northern Ireland Assembly has legislative powers without revenue-raising powers, while the Welsh Assembly has neither. There is a broad academic consensus that elected bodies should be fiscally responsible at the margin, especially when they have legislative powers.<sup>5</sup>

The key qualifier is ‘at the margin’: after the fiscal equalisation system has

compensated for differences in needs and resources (that is, taxable capacity), the cost of additional expenditure (and the benefit of lower expenditure) should fall on 'local' taxpayers. There are powerful economic factors, including globalisation and membership of the European Union, which mean that sub-national governments cannot be fully self-financing.<sup>6</sup> There are encouraging signs that the decisiveness of the Scottish referendum result has persuaded some of those hitherto opposed to devolution to abandon 'tax-horror' stories and now support (more extensive) tax-varying powers.<sup>7</sup>

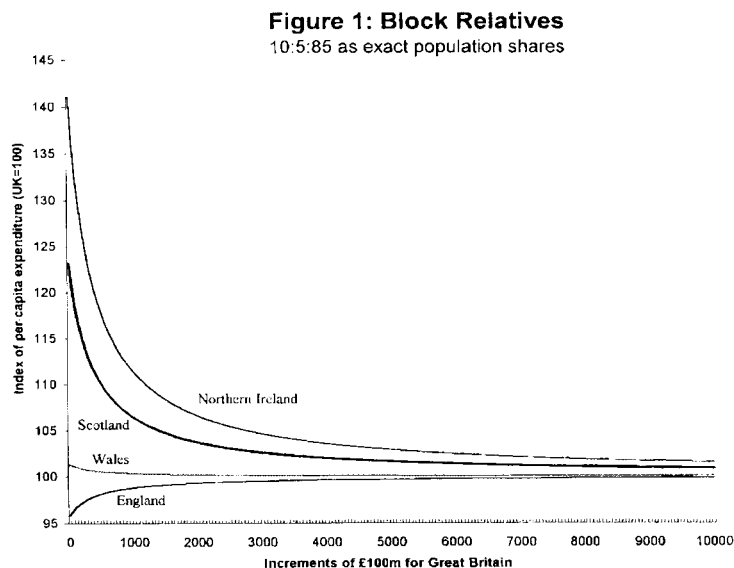
Fifthly, local authorities and their expenditure constitute a large claim on the Scottish and Welsh blocks, whereas their limited role in Northern Ireland means that a much larger proportion of its block will be under the direct control of the Assembly. Nevertheless, there remain important connections with the local-government finance system in Great Britain which will affect public expenditure in Northern Ireland (see below).

**T**he Barnett formula has often been misrepresented and even more frequently misunderstood. Briefly, as described in the previous chapter, the formula has provided that changes 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 comparable expenditure in England.<sup>8</sup>

Having previously been recalibrated in 1992, the formula proportions will now be updated annually, in line with revised estimates of relative populations, with effect from 1999-2000 (the first year to be affected by the results of the Comprehensive Spending Review). The revised ratio of comparable expenditure changes (based on mid-1996 population estimates) is England: Scotland: Wales = 100: 10.45: 5.95, with Northern Ireland adjusted to receive 2.91 per cent of the change in Great Britain.

Figure 1 demonstrates how the



internal dynamic of this formula, when implemented over a period in which all increments of expenditure pass through the formula, will bring about convergence of *per capita* expenditure in all four territories.<sup>9</sup> But this conclusion depends on the assumptions that the initial formula proportions exactly match relative populations, that relative populations do not change through time and that there is no formula bypass.

Figure 2 modifies the assumption of exact matching, introducing instead the historical fact that the original formula proportions were advantageous to Scotland (10/85 rather than 9.57/85.31 as at mid-year 1976) and disadvantageous to Wales (5/85 rather than 5.12/85.31). Even though the Northern Ireland formula was expressed to two decimal places (2.75) in relation to its base of Great Britain, there was an adverse rounding as the population percentage at mid-year 1976 was 2.79.<sup>10</sup> As a result of the population rounding in the formula, Scotland's relative in Figure 2 does not fully converge, while Wales' overshoots and falls below 100.

Taken together, the 1992 recalibration (which moved the GB component of the formula to two decimal places) and the 1997 modification (annual population updating) have eliminated rounding as an inhibitor of long-run convergence.

Nevertheless, there remains the issue of relative population change.

The contrast between Scotland and Northern Ireland is particularly marked. The population ratio of Scotland to England has changed from 11.24 per cent in 1976 to 10.45 per cent in 1996. In contrast, Northern Ireland's population ratio to Great Britain has risen from 2.79 to 2.91 per cent. Therefore, the convergence effect of application of the Barnett formula on *per capita* expenditure relatives has been attenuated in Scotland but accentuated in Northern Ireland.

Figure 3 illustrates for Northern Ireland the inevitable downside of a formula which does not challenge the base but allocates incremental expenditure on a population basis. Arithmetically, it must be the case that, starting from a higher *per capita* base, expenditure in Northern Ireland will rise more slowly (expressing, that is, each increment as a proportion of existing expenditure) than expenditure elsewhere in the United Kingdom.

At the beginning of the convergence process, started by the adoption of the Barnett formula in the context of then actual expenditure relatives, the increase in expenditure in Northern Ireland would be approximately 70 per cent of that in Great Britain. The growth relatives with England and Wales are little different from that with Great Britain. In contrast,

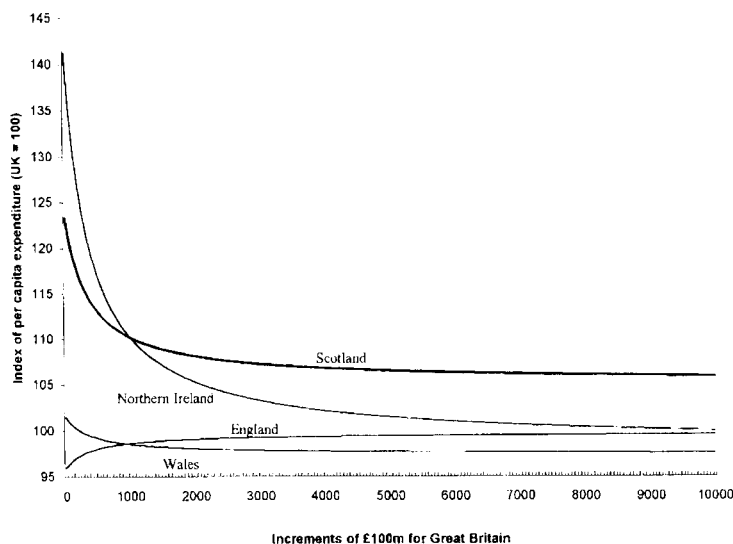
the comparable initial figure for Northern Ireland with Scotland would be about 85 per cent—a result of Scotland's own convergence process. Naturally, the more expenditure has gone through the formula (the further right one goes along the horizontal axis), the closer these relatives tend to 100.

The Barnett formula has not, however, been operated on this 'clean' basis. First, there appears to have been considerable formula bypass: not all incremental expenditure has gone through the formula. Several examples have been instanced, confirmed by the Treasury in evidence to the Treasury Committee.<sup>11</sup> The extent of bypass has not been quantified, though it now occurs less frequently than in the 80s. Most of the identified cases seem to have benefited, rather than disadvantaged, the territories.<sup>12</sup>

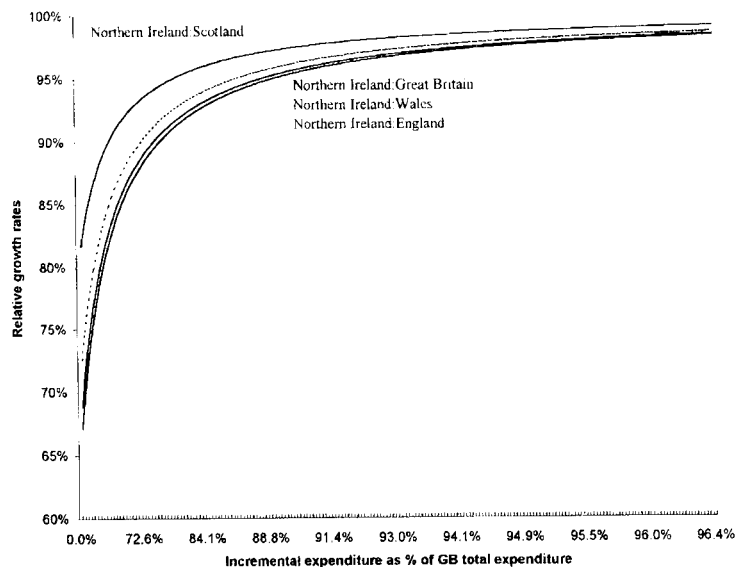
Secondly, and much less publicly documented, the Treasury has on at least one occasion implemented an across-the-board percentage reduction in departmental baselines, before applying the formula. Whether by accident or design, this procedure allows ministers to state that the Barnett formula has been implemented, even though it erodes the protection afforded by the formula to inherited expenditure.<sup>13</sup>

Thirdly, the metropolitan domination

**Figure 2: Block Relatives**  
10:5:85 as rounded population shares



**Figure 3: Relative Block Growth Rates**  
10:5:85 as rounded population shares



of UK politics should never be underestimated. The territorial fiscal system is of asymmetrical importance: it is crucial for the territorial departments and their ministers but often fairly invisible to their counterparts at the centre. Joel Barnett's memoirs of his experiences as chief secretary to the Treasury (1974-79)<sup>14</sup> never mention the eponymous formula—an omission to which his attention was drawn during the high-profile Treasury Committee hearing on November 13th 1997.<sup>15</sup> Similarly, Roy Jenkins' 22-page chapter on George Goschen, one of his predecessors as chancellor of the exchequer (1887-92), never mentions the Goschen formula; the present Scottish secretary, Donald Dewar, noted this omission in his book review.<sup>16</sup>

Nevertheless, while sometimes feeling slighted, the territorial departments have appreciated the advantages of their expenditure constituting a relatively small proportion of the UK total—not least because the Treasury's focus on the 'big numbers' keeps their programmes out of view most of the time. This is one reason why having a territorial formula has long been viewed as mutually beneficial.<sup>17</sup>

**D**evolution will markedly alter the context in which the formula is operated. First, the Barnett formula will become a mechanism for transferring

money *between tiers of government*, not a mechanism *internal to one government*.<sup>18</sup> The intensity of political and media interest over the last 18 months gives some indication of what the future holds. The lack of transparency characterising the past use of the formula will be unsustainable. (The Treasury did not publish figures for expenditure comparable to the territorial blocks until March 1998, and even then the form of publication was singularly uninformative.<sup>19</sup>)

Secondly, the effects of the formula can be modified by unconnected changes in the technical detail of public-expenditure management.<sup>20</sup> For example, the switch from volume to cash planning in 1982-83 increased the expenditure which would in principle pass through the formula. Previously, the territorial blocks had been revalued by specific price factors each year before the formula was applied to the growth component; subsequently, both the growth and inflation components would pass through the formula. Other things being equal, this would speed up convergence.

Thirdly, the financial arrangements for devolution are being devised at a time when there is substantial flux in UK public-expenditure planning. Until the new contours are more clearly visible, it is almost impossible to establish the detailed implications for the territorial

expenditure system. One such change is resource accounting and budgeting in central government. This will bring both accruals accounting (in which capital assets are valued and depreciated) and resource budgeting, under which the planning system will be operated in accruals terms, and supply will be voted at a disaggregated level in accruals and at a more aggregated level in cash.<sup>21</sup> Formula consequences could in future be worked out in accruals, in cash or both.

Another change is that the Treasury has established a new fiscal framework as from 1999-2000, involving a three-year plan,<sup>22</sup> the replacement of the control total by two new aggregates (departmental expenditure limits and annually managed expenditure)<sup>23</sup> and the promulgation of fiscal rules as part of a statutory *Code for Fiscal Stability*. The necessary modifications to the territorial expenditure system have not yet been agreed between the Treasury and territorial departments, but experience suggests not all the implications will be fully anticipated.

Despite attracting little attention at the UK level, the pre-devolution system of territorial government embodied extensive devolution of expenditure responsibilities.<sup>24</sup> The essence of contemporary constitutional reforms is to transfer these responsibilities from members of the UK

cabinet to those who owe their position and legitimacy to the elected territorial assemblies. The issue of 'local' fiscal accountability has naturally acquired more salience.<sup>25</sup> The devolved bodies should eventually have more responsibility for raising revenue at the margin.

This judgment should not be taken as encouragement to the Northern Ireland Assembly to think in terms of spending more. *Per capita* expenditure in Northern Ireland exceeds the UK average by a large margin.<sup>26</sup> Revenue-raising should be regarded as a means of securing fiscal accountability at the margin, and of securing proper attention to the full range of allocative and distributional effects of public-expenditure programmes. Given the likelihood of downwards pressure on the expenditure relative in the medium term, greater awareness is needed in Northern Ireland of the relevant opportunity costs of public-sector activity.

Some financing issues are highly technical but others have constitutional and political importance. It is useful to distinguish them at three levels: the United Kingdom as a whole, most notably in the financing of local government; those arising as a consequence of devolution in the three territories; and those specific to Northern Ireland.

Fiscal accountability at the margin can only be secured for the devolved

bodies following a thorough review of sub-national taxation. Indeed, the financing of devolved assemblies is intricately interwoven with questions about the financing of local authorities.<sup>27</sup> This is more obvious in Great Britain than in Northern Ireland, where local authorities are less important spenders because of their much narrower functional responsibilities. Northern Ireland is nevertheless affected by these interconnections through the operation of the Barnett formula.

For reasons which were entirely predictable and understandable, the pre-referendum debate in Scotland about financial aspects of devolution concentrated heavily upon the 'tartan tax' and its possible repercussions on the formula. Even the 1998 Scotland Bill contains little about many important financial issues, preferring to leave them to be tackled administratively or by legislation by the new Parliament. The priority of the devolved bodies should be to review systematically the value for money secured from existing programmes. Nevertheless, the Scottish Parliament needs to use the tax-varying power in the medium term, as it will otherwise atrophy.

The budgetary procedures of the devolved bodies should take account of those taxes and charges which, because of netting off, reduce the amount of

expenditure scored against the block. Naturally, this highlights the importance of establishing a good working relationship with local government. In Scotland, the term 'concordat' has been used; the Commission on Local Government and the Scottish Parliament has been tasked to report to the Scottish first minister when that person is elected.

There was a warning in the Scottish devolution white paper that 'excessive growth' in local-authority self-financed expenditure, relative to England, might be scored against the assigned budget—though there was no guidance on what 'excessive' might be: "Should self-financed expenditure start to rise steeply, the Scottish Parliament would clearly come under pressure from council-tax payers in Scotland to exercise the 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."<sup>28</sup> This seems likely to be an area of delicate negotiation between the UK government and the devolved executives. There would only be scope for a sustained switch of



the burden of financing a given level of sub-national expenditure if there were a UK-wide consensus about the desirability of such a change.<sup>29</sup>

Moreover, UK-wide rules are urgently required on a series of technical issues which have considerable potential for generating political conflict. Obvious examples relate to the treatment of European Union funds, National Lottery grants, assets financed through the Private Finance Initiative and tax expenditures granted by the UK government which touch upon devolved programme areas. Each opens up scope for budgetary gamesmanship and poor value for money, suggesting regulation by the Territorial Exchequer Board proposed below.

Whereas finance was rightly seen as crucial to debates about Scottish devolution, the main issue in Northern Ireland was a lasting peace settlement. The inevitable consequence is that several issues have not received a public airing.

There has been considerable media discussion of the distributional effects of peace in Northern Ireland. In the long run, there would be downwards pressure on the real incomes of middle-class households (especially those currently benefiting from GB-pegged wages and low house prices), although in the short run this would be masked by windfall capital gains as house prices rose in response to

stronger GDP growth.

Given the macro-economic importance attached to house-price inflation by Muellbauer<sup>30</sup>—who believes that residential property is too lightly taxed under the council-tax system in Great Britain—the Assembly should consider carefully the desirable path of regional and district rates. As a result of the Comprehensive Spending Review, there has been an important change in the public-expenditure treatment of the regional rate.<sup>31</sup> Whereas hitherto it has only been a financing matter—in the sense that its level did not affect expenditure totals—variations upwards or downwards will in future directly affect how much can be spent.

**U**nquestionably, there will be difficulties ahead as public expenditure will be tight and considerable adjustment will be needed. The publicity attached to these difficulties, however, should not obscure the opportunities.

Starting with the difficulties, greater transparency of territorial fiscal arrangements is inevitable. The most likely outcome is some compression of expenditure relatives, particularly from levels which seem higher than (likely) needs relatives. This convergence needs to be accomplished in a gradual, non-disruptive way.

The possibility of this being achievable has been greatly enhanced by the

favouring through the Comprehensive Spending Review of those functional areas which will be devolved.<sup>32</sup> For example, the substantial boosts to education and health expenditure in Great Britain have generated formula consequences for Northern Ireland.

Nevertheless, the 'managed block' (see below) will be unable to cope with the up-front costs of the retrenchment of 'law and order' expenditure; there will have to be non-formula supplements for this purpose. These will undoubtedly raise the question as to whether a proportion of subsequent savings on 'law and order' should be returned to the Treasury, rather than transferred to other programmes.

The Assembly should embrace transparency (as indeed should its counterparts in Scotland and Wales). It will provide the best long-run protection of its autonomy and educate the public. This naturally entails risks, though these already exist.<sup>33</sup> The finance ministries of the devolved executives should commence advance planning for a UK-wide needs assessment in the medium term.

The ineffectiveness of the Northern Ireland Joint Exchequer Board,<sup>34</sup> though a warning of the dangers to be avoided, should not discourage the establishment of a Territorial Exchequer Board on the Australian model.<sup>35</sup> Despite the obvious

temptation in Scotland and Northern Ireland to postpone any discussion of expenditure relatives, it will be safer for the territories to see such machinery in place while the constitutional-reform agenda still enjoys a fair wind at Westminster.<sup>36</sup>

Turning to the opportunities, a key issue in Northern Ireland will be better value for money from block expenditure. Notwithstanding the problems of comparing expenditure levels, there can be no doubt, as remarked above, that *per capita* expenditure is well above the UK average. An observer would speculate that sustained peace should help improve value for money, as the security problem must have complicated public-service delivery across the board.

An urgent priority must be a review of the entire machinery of government, the complexity of which—for example, the education and library boards and the health and social services boards—suggests a use of quangos to legitimise direct rule. Once devolved government has been restored, there would seem to be potential savings from layering.

This will not be painless: relatively well-paid jobs will disappear, with substantial, up-front redundancy costs. Moreover, the deflationary macro-economic impact of a reduction in security-related expenditure—including that within the defence budget rather than

the Northern Ireland programme—needs to be offset by strong private-sector performance. Clearly, much depends on the performance of the UK and Republic of Ireland economies during this transition.

Secondly, there is an excellent opportunity for constructing a more open budget process, in which well-researched information is available about programme performance and expenditure options. It should be possible to avoid the excesses of executive domination and news management which have characterised the UK Public Expenditure Survey in recent years.

For example, the Department of Finance & Personnel (DFP) should be obliged to provide costed options to Assembly committees. In the case of Scotland, the budgetary timetable has to be consistent with the practicalities of the Inland Revenue implementing the ‘tartan tax’ on a cost-effective basis. Across the United Kingdom, local authorities and a wide range of other public bodies need to be able to take their own budgetary decisions in the light of information about grant levels.

The principles governing the UK territorial fiscal system can be made accessible, notwithstanding the technical complexity of its detailed operation. The prevailing opacity has owed much to obsessive secrecy and limited institutional

memory.

Thirdly, in comparison with Scotland and Wales, Northern Ireland possesses some advantages and some disadvantages—both rooted in its institutional and financial history. On the positive side, it already has much of the necessary financial framework and institutional infrastructure—for example, a separate estimates system and the Northern Ireland Audit Office, headed by the Comptroller and Auditor General for Northern Ireland. On the negative side, the frozen inheritance of provisions contained in, or originating from, the Government of Ireland Act 1920 has created something of a time warp.

In particular, a gulf has developed between the formal financial system and the reality of expenditure planning (which has increasingly become like that in Scotland and Wales). This effect has been reinforced by the suspension of ‘normal’ politics: for almost 25 years decisions have been taken by direct-rule ministers with no ‘local’ accountability, rendering the financial system opaque and little discussed. One indication is that the Northern Ireland Affairs Committee’s recent inquiry into Northern Ireland programmes explored ground that Scotland had begun to traverse in 1980.<sup>37</sup>

One reason for such a lack of transparency may have been the sensitivity

attached to Northern Ireland's relationship with the Republic. Repealing outdated provisions in the Government of Ireland Act 1920 could have raised unwelcome diplomatic and domestic complications.<sup>38</sup> The co-existence of statutorily required documents (reflecting continuing provisions from the period of devolved government) and Treasury-mandated documents (reflecting Northern Ireland's position within the UK public-expenditure system) has rendered the financial system inaccessible.

For example, it is difficult to see the relationship between the annually published *Public Income and Expenditure* (DFP), the *Finance Accounts of Northern Ireland* (ditto), the *Northern Ireland Appropriation Accounts* (Northern Ireland Audit Office) and the *Northern Ireland Departmental Report* (DFP & Treasury). The departmental report, which covers the Northern Ireland Office and Departments, is considerably less helpful than its Scottish and Welsh counterparts in explaining the territorial expenditure system.

Most notably, there is serious terminological confusion. What is described in the published documents as the 'Northern Ireland block' is not comparable to the Scottish and Welsh blocks. The best way to explain the structure of the Northern Ireland programme is to think in

terms of three levels.

The first is the Northern Ireland programme, which corresponds to expenditure within the responsibility of the secretary of state; this is the focus of the departmental report. The second excludes expenditure on 'national' agricultural and fisheries support (these being greatly influenced by UK and EU policies); this is what is described in the departmental report as the 'Northern Ireland block'. The third level is described internally as the 'managed block', though there is no explicit reference to it in the 1997 or 1998 departmental reports; this is the aggregate corresponding to the Scottish and Welsh blocks, fed by the Barnett formula, and over which the secretary of state holds expenditure-switching discretion.<sup>39</sup>

The managed block thus includes expenditure by the Northern Ireland Office—predominantly on 'law and order'—as well as by Northern Ireland departments. The favourable security situation at the time of the 1994 Survey allowed the previous secretary of state to switch expenditure from 'law and order' into other programmes; the reverse occurred in 1996. There remain substantial uncertainties about how the system will operate under devolution: 'law and order' expenditure is 'reserved', remaining the responsibility of the secretary of state.

There should therefore be a thorough rationalisation of Northern Ireland public-finance documentation, including the preparation of a comprehensive overview along the lines already established for Scotland and Wales.<sup>40</sup>

A major educational exercise is also required, to improve the understanding of Assembly members and public servants of how the territorial fiscal system operates. Moreover, each of the major political groups in the Assembly should designate someone to develop the specialist expertise needed to engage in technical discussions with the financial managers of the Northern Ireland programme, most notably in the DFP. Senior civil servants involved in finance are likely to acquire much higher public exposure than during direct rule.

**T**here is so much political capital tied up in making a success of the Assembly that the opportunities should outweigh the difficulties. And the developing UK context should reinforce the sense that much can be achieved.

MacKay and Audas admirably capture the need for decentralisation in their discussion of Wales: "Where government is has economic as well as political effects. In a centralised State, career structures develop which require location in or close to the national capital. That capital

draws strength from the atmosphere of centralised culture and power. In the UK, there are few fields of endeavour where it is possible to scale the commanding heights without being close to the national capital."<sup>41</sup>

It will be interesting to observe how the United Kingdom as a whole adjusts to asymmetrical government.<sup>42</sup> The greatest irony is that this has long existed—but few outside the territories ever noticed. ■

#### Footnotes

<sup>1</sup> This paper draws upon work financed by a sabbatical project on the financing of decentralised government funded by the Nuffield Foundation.

<sup>2</sup> Scottish Constitutional Convention, *Towards Scotland's Parliament and Scotland's Parliament, Scotland's Right*, Edinburgh, 1990 and 1995

<sup>3</sup> See D Richards, 'Oral evidence', in Treasury Committee, *The Barnett Formula*, Second Report of Session 1997-98, HC 341, Stationery Office, London, 1997. Firm conclusions can not be reached without a replication of the Treasury's 1979 expenditure needs assessment, which was embarked upon in the context of the then Labour government's devolution plans for Scotland and Wales (Treasury, *Needs Assessment Study—Report*, London, 1979). The 1997 devolution white papers for Scotland and Wales said there would not be fundamental change to the Barnett formula without a new needs assessment (Scottish Office, *Scotland's Parliament*, Cm 3658, Stationery Office, Edinburgh, 1997; Welsh Office, *A Voice for Wales: The*

*Government's Proposals for a Welsh Assembly*, Cm 3718, Stationery Office, London, 1997). In my view, Lord Barnett overstated the importance of relative GDP when he gave oral evidence to the Treasury Committee on November 13th 1997: given the services financed by the blocks, demographic structure and participation rates in publicly provided health and education will be more important determinants of relative need than relative GDP.

<sup>4</sup> D A Heald and N Geaughan, 'The tartan tax: devolved variation in income tax rates', *British Tax Review*, no 5, 1997, pp 337-48

<sup>5</sup> See D King, *Fiscal Tiers: The Economics of Multi-Level Government*, Allen and Unwin, London, 1984; D Bell, S Dow, King and N Massie, *Financing Devolution*, Hume Papers on Public Policy, vol 4, no 2, Edinburgh University Press, Edinburgh, 1996; L Blow, J Hall and S Smith, *Financing Regional Government in Britain*, Institute for Fiscal Studies, London, 1996; Constitution Unit, *Scotland's Parliament: Fundamentals for a New Scotland Act*, London, 1996; Heald and Geaughan, 'Financing a Scottish Parliament', in S Tindale ed, *The State and the Nations: The Politics of Devolution*, Institute for Public Policy Research, London, 1996; and S Smith, 'Regional government, fiscal and financial management in Northern Ireland', in Northern Ireland Economic Council, *Decentralised Government and Economic Performance in Northern Ireland*, Belfast, 1996.

<sup>6</sup> Heald, Geaughan and C Robb, 'Financial arrangements for UK devolution', *Regional & Federal Studies*, vol 8, no 1, 1998

<sup>7</sup> Many observers believe the imposition of the two-question Scottish referendum (first on devolution, separately on tax-varying powers) was designed to ditch the 'tartan tax'. Ironically, the result was the opposite. Allan Massie wrote in the *Scotsman* ('Common culture, but

divided loyalties', August 24th 1998): "It may seem odd that those of us who argued against devolution should now wish the Scottish parliament to have more powers than it is to be granted. It is odd, but it is not illogical ... we can't believe that creating a parliament with the power to spend but without the responsibility of imposing taxes can either make for good government or prevent recurrent and damaging friction between London and Edinburgh."

<sup>8</sup> See the chapter by R Barnett and G Hutchinson in this volume.

<sup>9</sup> The intuition is quite straightforward. Over time, base expenditure (on which the three territories have *per capita* relatives above UK=100) becomes a smaller proportion of total block expenditure, with incremental expenditure (which has passed through the population-based formula) becoming a larger proportion.

<sup>10</sup> The combined effect is quite complicated. If the expenditure blocks were exactly coterminous and all expenditure went through the formula, the effect of rounding was that Scotland would obtain 9.73 per cent rather than 9.31 per cent of incremental UK expenditure (4.53 per cent higher); Wales would obtain 4.87 per cent rather than 4.98 per cent (2.31 per cent lower); England would obtain 82.73 per cent rather than 82.99 per cent (0.32 per cent lower); and Northern Ireland would obtain 2.68 per cent rather than 2.71 per cent (1.40 per cent lower).

<sup>11</sup> Heald, 'Territorial public expenditure in the United Kingdom', *Public Administration*, vol 72, Summer 1994; 'Memorandum submitted by HM Treasury' and 'Supplementary memorandum submitted by HM Treasury on Tuesday 16 December 1997', in Treasury Committee, op cit

<sup>12</sup> When, as on health, the territorial expenditure relative is substantially above that for the

United Kingdom as a whole, this is likely to reflect in part higher *per capita* employment of nurses. If the Treasury were to underwrite the full cost to each health department of a UK nurses' pay settlement, the territories would receive more than if the total UK cost of the award were to be distributed through the Barnett formula.

<sup>13</sup> Money 'saved' by applying a constant percentage cut to the territorial blocks and to comparable expenditure can then be passed through the Barnett formula, generating 'formula consequences' supplementary to those generated by year-on-year increases in comparable expenditure. Naturally, the arithmetical effect is disadvantageous to the territories because the constant percentage cut generates more 'savings' from their blocks than they subsequently receive back in these 'artificial' formula consequences.

<sup>14</sup> J Barnett, *Inside the Treasury*, André Deutsch, London, 1982

<sup>15</sup> G Radice, 'Oral evidence', in Treasury Committee, Q1, *op cit*

<sup>16</sup> R Jenkins, *The Chancellors*, Macmillan, London, 1998; D Dewar, 'Lives at No 11', *Scotland on Sunday*, August 23rd 1998

<sup>17</sup> The Goschen formula is even more badly documented than Barnett. It was enunciated in 1888 as a means of regulating changes in education expenditure, and continued to be used in some form until the late 1950s. The basis of the Goschen proportions was the assignment of probate duties in the rounded percentages of overall contributions to the exchequer. The Barnett formula has been used since 1978. The use for Scotland of one or other of these two formulae for approximately 90 of the last 110 years is indicative of the enduring appeal of such a mechanism. Formula links to public expenditure in Great Britain acquired importance in the financing of the Northern Ireland Parliament once the

financial scheme of the Government of Ireland Act 1920 had effectively collapsed. The Colwyn formula, devised by the Northern Ireland Special Arbitration Committee in 1925, has been described by Norman Gibson ('Northern Ireland and Westminster: fiscal decentralisation—a public economics perspective', in NIEC *op cit*, p33) as "a kind of forerunner of the Barnett formula of some fifty years later". Moreover, it can also be seen as a successor to the Goschen formula, which had continued to operate in Great Britain. Significantly, Gibson observes that "none of this material was available for public scrutiny".

<sup>18</sup> Heald and Geaughan, 'Fiscal implications', in P Norton ed, *The Consequences of Devolution*, Hansard Society, London, 1998

<sup>19</sup> See 'Barnett formula: impact on relative public spending per head in England, Scotland, Wales and Northern Ireland', in Treasury Committee, *The Barnett Formula: The Government's Response to the Committee's Second Report of Session 1997-98*, Fourth Special Report of Session 1997-98, HC 619, appendix 2, Stationery Office, London, 1998. Expressed in terms of England=100 for that expenditure which is comparable with each territorial block—the coverages of which differ significantly—the block relatives for 1995-96 implied by the data are: Scotland 132, Wales 125 and Northern Ireland 132. In particular, the Northern Ireland figure is significantly affected by social-security expenditure being included in the comparison. While the Scotland relative is in line with the data for earlier years (see Heald, 1994, *op cit*), the Wales relative is considerably higher than would have been expected. Greater disaggregation is obviously required.

<sup>20</sup> See Heald, 1994, *op cit*. This can happen even when changes in the public-expenditure planning system have no immediate connection with policy on territorial programmes.

Some changes are not even announced by the Treasury. One of the sources of formula bypass identified in Heald, 1994, was the Treasury's practice of creating a baseline for the third year of each Survey by incorporating an automatic inflation adjustment. Not until December 1997 did it reach the public domain ('Supplementary memorandum ...', in Treasury Committee, 1997, op cit) that this practice had changed: "In Surveys since 1993 it has been the practice to create the year three baseline by rolling forward Year 2 cash plans at the same level in cash terms."

<sup>21</sup> Treasury, 'Resource accounting and budgeting', in Treasury Committee, *The New Fiscal Framework and the Comprehensive Spending Review*, vol II: minutes of evidence and appendices, Eighth Report of Session 1997-98, HC 960-II, Stationery Office, London, 1998. Strictly, for 'cash' should be read 'total financing requirement' (which extends beyond cash to include non-cash items such as local-authority credit approvals and capitalised Private Finance Initiative projects).

<sup>22</sup> The new expenditure planning system does not entail three-year rolling programmes; at present, there is a three-year horizon for departmental expenditure limits (1999-2000, 2000-01 and 2001-02) but the time horizon will successively shorten as these years arrive. Exceptionally, in 2000, a new set of three-year plans will be promulgated for 2001-02 to 2003-04, as a consequence of the introduction of resource budgeting.

<sup>23</sup> Treasury, *Stability and Investment for the Long Term: Economic and Fiscal Strategy Report 1998*, Cm 3978, Stationery Office, London, 1998

<sup>24</sup> Heald, *Financing Devolution within the United Kingdom: A Study of the Lessons from Failure*, Centre for Research on Federal Financial Relations, Australian National University Press, Canberra, 1980

<sup>25</sup> Heald, *Financing a Scottish Parliament: Options for Debate*, Scottish Foundation for Economic Research, Glasgow, 1990

<sup>26</sup> See Barnett and Hutchinson in this volume and Treasury, *Public Expenditure: Statistical Analyses 1998-99*, Cm 3901, Stationery Office, London, 1998.

<sup>27</sup> It is now widely argued that the market-extending reforms of the Thatcher and Major Conservative governments centralised power in the public sector, drastically limiting the effective discretion of local authorities in Great Britain. See A Gamble, *The Free Economy and the Strong State: The Politics of Thatcherism*, Macmillan, Basingstoke, 1994, and S Jenkins, *Accountable to None: The Tory Nationalization of Britain*, Hamish Hamilton, London, 1995.

<sup>28</sup> Scottish Office, *Scotland's Parliament*, op cit, 1997, §7.24

<sup>29</sup> There are complex interactions between local-government revenue raising and central-government expenditure; for example, part of incremental council-tax revenue will be met from the social-security budget. Moreover, local authorities have recognised that increasing council rents provides them with access to the social-security budget.

<sup>30</sup> J Muellbauer, 'X-rating the housing boom: reforming the council tax could do great things for the economy as a whole', *Observer*, May 4th 1997

<sup>31</sup> Department of Finance & Personnel and Treasury, *Northern Ireland Expenditure Plans and Priorities: The Government's Expenditure Plans 1997-98 to 1999-2000*, Cm 3616, Stationery Office, London, 1997; *Northern Ireland Expenditure Plans and Priorities: The Government's Expenditure Plans 1998-99*, Cm 3916, Stationery Office, London, 1998

<sup>32</sup> Treasury, *Modern Public Services for Britain: Investing in Reform—Comprehensive Spending Review: New Public Spending Plans*



1999-2002, Cm 4011, Stationery Office, London, 1998

<sup>33</sup> Anyone doubting this point is encouraged to watch the video of the Treasury Committee's November 13th 1997 evidence session on the Barnett formula.

<sup>34</sup> Gibson, op cit

<sup>35</sup> Heald and Geaughan, 1996, op cit

<sup>36</sup> Assessments of relative need are partly technical exercises and partly matters of political judgment—notably about what constitutes a policy, what is a consequence of policy discretion and what is a binding constraint. A Scottish example with obvious Northern Ireland resonance illustrates this point. Since 1918, there have been separate non-denominational and Catholic school systems, both managed by local authorities. This duplication undoubtedly imposes extra costs, particularly in the Scottish context of falling rolls. Treasury officials whose ministers were hostile to devolution might argue that these extra costs should be met entirely from Scottish resources. Needless to say, this would raise hugely sensitive issues because of the history of this separate provision. The purpose of a needs assessment would be to validate the continuing use of a Barnett-type formula; it would be contrary to the spirit of devolution to establish an annual mechanism like the revenue support grant for local authorities.

<sup>37</sup> Northern Ireland Affairs Committee, *Northern Ireland Public Expenditure: Current Plans and Priorities*, First Report of Session 1997-98, HC 295, and *Response by the Government to the First Report from the Northern Ireland Affairs Committee, Session 1997-98: Northern Ireland Public Expenditure: Current Plans and Priorities*, First Special Report of Session 1997-98, HC 700—both Stationery Office, London, 1998; Committee on Scottish Affairs, *Scottish Aspects of the 1980-84 Public Expenditure White Paper: Minutes of Evidence*,

*Monday 7 July 1980, together with Appendices*, HC 689 of Session 1979-80, HMSO, London, 1980

<sup>38</sup> Gibson, op cit

<sup>39</sup> Two further points should be noted. First, the Northern Ireland programme is narrower than identifiable expenditure in Northern Ireland, as annually published by the Treasury, but much less so than for Scotland and Wales (largely because it includes social-security benefit expenditure). Secondly, there is public expenditure which takes place in Northern Ireland but which falls within the category the Treasury treats as non-identified (most obviously, the costs of the army presence).

<sup>40</sup> Scottish Office, *Government Expenditure and Revenue in Scotland, 1995-96*, Glasgow, 1997; Welsh Office, *Government Expenditure and Revenue—Wales, 1994-95*, Cardiff, 1997

<sup>41</sup> R R MacKay and R P Audas, 'The economic impact of a Welsh Assembly', in MacKay, Audas, G Holtham and B Morgan, *The Economic Impact of a Welsh Assembly*, Institute of Welsh Affairs, Cardiff, 1997, p23

<sup>42</sup> M Keating, 'What's wrong with asymmetrical government?', in H Elcock and Keating eds, *Remaking the Union: Devolution and British Politics in the 1990s* (special issue of *Regional & Federal Studies*, vol 8, no 1), Frank Cass, London, 1998