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Financial Arrangements for UK Devolution

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Referendums in Scotland and Wales, conducted on the basis of sharply differentiated proposals for devolution (Scottish Office, 1997c; Welsh Office, 1997), have provided the necessary indications of public support sought by the Labour government before embarking upon constitutional legislation. Devolution in Northern Ireland – and there alone – was the policy of the Conservative government defeated in May 1997. The 1982 scheme (Northern Ireland Office, 1982) remains on the table, though the obvious caveat relates to the security situation. Much further down the track, if at all, would be some form of devolution to England or to regions within England.

Although this article concentrates upon financial arrangements, this introductory section will briefly address broader constitutional and political issues so that the reader will be able to locate the technical issues within their proper context. Accordingly, the following issues are discussed: the question of asymmetry; the need to address matters of institutional design and political culture; and the need to establish financial arrangements for Scottish devolution generalizable to other parts of the United Kingdom and consistent with European Union (EU) obligations. Inevitably, the case of Scotland receives the most attention, because debates there will be crucial to outcomes across the United Kingdom.

First, a degree of asymmetry in constitutional arrangements is inevitable whenever there are differentiated circumstances (Keating, 1997). If fully symmetrical 'solutions' to the governance problems of the United Kingdom were regarded as essential, only three options would be available:

- *Full integration* would involve abolishing the three territorial departments (Scottish Office, Welsh Office and Northern Ireland Office/Departments);
- *Federalism* would involve having four separate parliaments for England, Scotland, Wales and Northern Ireland, and also a Federal Parliament; and
- *Independence* for one or all of Scotland, Wales and Northern Ireland would either abolish the United Kingdom or narrow its geographical coverage, in which latter case either full integration or federalism could be implemented in the remaining United Kingdom.

Wales, which was annexed to England by the unilateral *Act of Union 1535*, was in most respects fully integrated.[1] This was not the case for Scotland (whose parliament voted by the *Act of Union 1707* for its own abolition) nor for Ireland (which, following the abolition of its parliament by the *Act of Union 1800* passed by the Westminster Parliament, was annexed to Great Britain). The resulting political entity was the United Kingdom of Great Britain and Ireland. There are many ways in which Scotland has been differentially governed since 1707 (Kellas, 1989),[2] a pattern reinforced by the creation in 1885 of the Scottish Office and the post of Secretary for Scotland (Gibson, 1985). In our view, majority opinion in Scotland and Wales would strongly oppose full integration, and no UK government would be likely to adopt the policy of the UK Unionist Party for full integration of Northern Ireland, not least because of how that would be interpreted by world opinion.

The key obstacle to federalism is the lack of interest in England. Our own position is that, *if* the circumstances were conducive to federalism, that would produce the best possible resolution of the United Kingdom's governance problems. As these circumstances seem unlikely to arise, asymmetrical devolution is both desirable and workable. The independence option is outside the scope of this article.

All schemes of asymmetrical devolution raise issues about parliamentary representation. The 'West Lothian Question' (so named in the 1970s after the then constituency of the Labour MP Tam Dalyell) draws attention to Scottish MPs at Westminster voting on the English counterparts of devolved services whereas they cannot vote on such matters affecting Scotland. However, this same question existed as the West Belfast Question from the date of the establishment in 1921, under the *Government of Ireland Act 1920,* of the Northern Ireland Parliament, until its prorogation in 1972. The abolition of the Northern Ireland Parliament eventually led to the convening of a Speaker's Conference on Northern Ireland parliamentary representation. After this had reported in 1978, processes were set in motion which led to an increase in the number of Northern Ireland MPs from 12 to 17 in the 1983 election. This increase was interpreted as the removal of the 1920 Act's 'devolution discount' (that is, one-third less Westminster representation than population would then have indicated) (McLean, 1995). Nevertheless, the Conservative government's Northern Ireland devolution plans (Northern Ireland Office, 1982, 1995) did not propose the reintroduction of any such discount.

Although there is a good case for avoiding unnecessary asymmetry, certain asymmetries are inevitable in the United Kingdom. What ultimately matters is whether particular asymmetries (of governmental structure or of parliamentary representation) are regarded as acceptable or unacceptable.[3]

Intriguingly, it has recently been those who claim to be defenders of the Union who have been attempting to convince public opinion in England that *proposed* asymmetries would be unacceptable, without regard to the *existing* asymmetries which have been endemic and often unremarked (Crick, 1995).

The second general point is that devolution, as now proposed, will be a considerable shock to the highly centralized political and governmental institutions of the United Kingdom, even though – when viewed in international terms – these same proposals look rather cautious. For example, both Australia and Canada adopted federal rather than unitary forms of government, and the United Kingdom played a significant role in the post-1945 establishment of a federal basis for Germany. There is one practical consequence of this history of centralism. Elsewhere in the world there is a vast amount of experience of the technical aspects of handling the vertical relationships between tiers of government and of ensuring that such systems work, albeit with (varying) degrees of fractiousness. Professor Russell Mathews, a distinguished Australian academic who served on the Commonwealth Grants Commission, expressed amazement in the 1970s at the apparent determination in the United Kingdom to re-invent the wheel.[4] The difficulties confronting successful devolution will not be technical, rather they will be political. Potential for centralism existed in the United Kingdom long before the 1979–97 Conservative government, but during this period it was unleashed, seriously undermining the role of local government (Select Committee on Relations between Central and Local Government, 1996). Increased centralization affects devolution as well as the future role of local authorities. With great prescience, Farquharson (1995) warned of the tension between the centralist party management characteristic of New Labour and devolution proposals which claimed to return certain areas of Scottish life back to Scotland for decision.

It is therefore necessary to ensure that this legacy of centralism does not generate a situation in which relationships and systems which work in countries with different political cultures fail to work in the United Kingdom. For that reason, institutional design requires a great deal of thought and care. During the 1990s, the period during which the activities of the Scottish Constitutional Convention (SCC) raised the UK political profile of Scottish devolution, there were a number of statements from those hostile to constitutional reform which might brutally, but accurately, be summarized as warnings that 'London will take revenge'. This theme had two variants: unilateral abolition by Westminster of a Scottish Parliament; and the threat of financial penalties. Stephen Dorrell, then Secretary of State for Health, said in February 1997 that a future Conservative government would abolish a Scottish Parliament if such had been established by Labour

(Parker, 1997). The flavour of the threats about money will later be illustrated by quotations from Cabinet ministers in the Major government, including those made by Jonathan Aitken (Chief Secretary to the Treasury, 1994–95) and Lord Mackay of Clashfern (Lord Chancellor, 1987–97). Limiting needs-based equalization to a situation in which decentralization remains administrative (Aitken) or linking block grant reductions to the exercise of tax-varying powers in either direction (Mackay) are simply wrecking propositions. Such threats corrode the threads which bind the United Kingdom together; their implementation would be a conclusive demonstration that the Union – ostensibly being supported by such actions – had ceased to be worth defending.

The third general point relates to the need to keep in mind when designing institutions and technical systems that there may in future arise the possibility of generalizing the model of Scottish devolution to other parts of the United Kingdom. The only valid reason for treating Wales differently from Scotland would be that the constitutional debate was held to be at a different stage of development and that proposals for a non-legislative, non tax-raising Assembly better conformed to majority opinion. Developments in Northern Ireland are contingent upon a lasting peace settlement. Devolution to Scotland cannot wait until changes in Wales, Northern Ireland and perhaps England make a parallel form of governance preferred in these countries and acceptable to the UK Parliament. Nevertheless, wherever possible, the arrangements made for Scotland should be sufficiently robust to accommodate later extensions. As will be shown below, these debates have to be conducted within the framework of the obligations which flow from membership of the European Union.

FISCAL RESPONSIBILIZATION AS THE CENTRAL ISSUE

Making devolved government fiscally responsible is the central issue which has to be addressed. It will be argued in this article that there was substantive logic for voting in the pre-legislative referendum[5] for:

- *Yes, Yes* (those who supported legislative devolution and tax-varying powers) or
- *No, Yes* (those who opposed legislative devolution but, in the event of a Scottish Parliament being established, wanted it to be fiscally responsible).

However, there was no substantive logic, though there was undoubted tactical appeal,[6] in voting:

- *Yes, No*
- *No, No*

The basis for these categorizations is developed below.

As a preliminary, a clear distinction should be drawn between post-legislative referendums on completed schemes (such as the 1979 referendums in both Scotland and Wales) and pre-legislative referendums on draft schemes (such as the September 1997 referendums). If there had been a post-legislative referendum on a completed scheme adapted from the SCC proposals, the question would have simply asked for approval or rejection of a Scottish Parliament with legislative and tax-varying powers. In practice, while the SCC scheme was largely reproduced in the Scotland White Paper the Scottish referendum unbundled one particular issue (tax-varying powers), though not others (such as the Additional Member form of proportional representation). Asking stupid questions for reasons primarily of electoral tactics runs the risk of receiving a stupid answer.[7] Alexander (1996) warned against the trap:

> When the [Scottish] Parliament is created Britain will have established a quasi-federal system. In any federal system there are three principal levels of government – national, state and local. If Scotland chose a Parliament with no taxation powers it would create the unstable nonsense in which the 'top' and 'bottom' levels of government had fiscal powers and the middle one ... had not. That is the real danger of a two-question referendum and I hope that the Scottish people will not fall into the trap (p.7).

Indeed, scaremongering on the second question[8] did reveal vulnerability on the Yes side, which appeared to grow as both sides to the debate came to expect a convincing Yes majority on the first question.[9] Alexander (1997) considered that a Yes:No outcome would resolve nothing, leaving a scheme which satisfied few:

> ... a Parliament without a power of taxation will produce a feeling of still unfinished business and the question of Scotland's constitutional arrangements will remain open for the foreseeable future (p.2).

A Yes:No vote would have involved legislating for a Scottish Parliament which commanded support in Scotland only on the basis that it was the only Parliament on offer. The arguments used by the Yes side for tax-varying powers would then have been recycled by those opposed to devolution as a means of keeping the issue alive. Simultaneously, there would have been bitter recriminations on the Yes side, concerning, *inter alia*, the behaviour of Labour's UK leadership in imposing the double-question referendum and the damaging sleaze allegations affecting Labour MPs and councillors in the West of Scotland.

Returning to the substantive issue of tax-varying powers, it is useful to separate this into two parts:

- whether a Parliament with legislative powers should have tax-varying powers; and
- whether fiscal responsibilization requires that such a Parliament raise *all the money it spends* or that its electors face the *full cost of marginal expenditure.*

The Imperative of Tax-Varying Powers

The kernel of the argument for tax-varying powers is that – *when differentials in needs and resources have been addressed* – the marginal expenditure decided upon by sub-national governments should be *self-financed* from an *economically appropriate* and *politically acceptable* tax base. This argument is carefully worded, and the wording receives detailed attention below.

The link between elected office and responsibility for revenue-raising is deliberate. All those who spend public money by virtue of elected office should have responsibility for raising some of that money through taxation and/or user charges. Just as 'no taxation without representation' was the battle cry of those who fought for American independence, so 'no representation without taxation' is a maxim which deserves equal priority. Tony Blair, then Leader of the Opposition, was heavily criticized in Scotland during the 1997 general election campaign for seeming to compare a Scottish Parliament with an English parish council.[10] The fact that his eloquence seems to have failed him on that occasion should not obscure the serious point he was attempting to make, namely that the link between election and tax-raising is an accepted feature of democratic societies. Indeed, election to office confers a legitimacy and (time-limited) permanence which does not attach to those who are appointed – and can summarily be dismissed – by ministers. Taxation powers are not conferred upon those public bodies loosely described as 'quangos', the appointees to which must either manage within the budgets allocated by ministers or resign their posts if budgets are thought so inadequate that satisfactory performance is impossible.

Moreover, these arguments about the link between election and tax-raising apply even more forcefully to an elected body which possesses extensive legislative powers, ranging over a substantial part of public expenditure:

> No meaningful Parliament anywhere in the world is without revenue-raising powers (Canavan, 1997).
>
> ... Labour is proposing both an Edinburgh Parliament and an option for the Scots to deny it any tax powers. A Parliament with no powers over taxation is not worth the name (Adonis, 1997).

A study undertaken by the Institute for Fiscal Studies (IFS) strongly emphasized the importance of tax-varying powers, before extending the argument to note that, without them, the decisions of sub-national governments would be dominated by the centre:

> If regional governments are to function as genuine democratic units, with the power to make decisions concerning the level and pattern of public services, they will need to have access to some form of tax revenues under their own control. Reliance on fiscal transfers from central government will undermine the ability of regional government to make their decisions free from central influence (Blow, Hall and Smith, 1996: 62).

Full Self-financing versus Self-financing at the Margin

A number of commentators have begun to argue that fiscal accountability can only be achieved if a devolved Scottish Parliament were to be responsible for raising all the money it spends. Even though this argument is often used as a spoiler – knowing that this condition is incapable of being fulfilled – the argument requires a proper answer.

The most eloquent advocates of 'full self-financing' are those opposed in principle to devolution but willing to engage in serious debate, notably the journalists Andrew Neil and Michael Fry:

> Any Scottish parliament which is not responsible itself for raising from the Scottish people *all the money* it intends to spend on our behalf will only perpetuate the unhealthy myth which has dominated Scottish political culture for too long, that big government is a free ride. Worse, when the overwhelming source of that parliament's funds (even if the tartan tax were to levied at full whack) is a grant from Westminster, then you have a system tailor-made for exploitation to Nationalist advantage. An Edinburgh parliament will be run by the outdated collectivist consensus that still dominates Scottish politics. It will want to spend, spend, spend. But instead of having to go to the Scottish people to raise the money, it will rattle the begging bowl in London; and when Westminster refuses to stump up more cash, the Nationalists will have a field day ... The only way to avoid a bust-up would be to make the Edinburgh parliament responsible for raising

> *every penny* it plans to spend (Neil, 1997a, italics added).

> Instead of [a Scottish Parliament] being funded by a block grant from London (which the Nationalists will always insist is never enough) there ought to be a far closer correlation between what a Scottish Parliament spends and the taxes it levies on the Scottish people. That is the only way to undermine the collectivist consensus which dominates Scottish politics; it is also a pre-condition for any Scottish Tory revival (Neil, 1997b).

> Others [Scottish Tories] might split their votes, Yes-No or No-Yes, the latter being my own preference ... The [outcome] which appears most promising to me is *full fiscal responsibility* for a Scottish Parliament (Fry, 1997, italics added).

Our view is that fiscal accountability at the margin of decision is what can practically be achieved in contemporary economic and political circumstances. The same conclusion was drawn by the IFS study team which investigated the financing of regional government:

> ... explicit equalising grants from central to regional government could be used – regional accountability is satisfied even where, on average, most spending is grant financed, as long as *extra* spending is financed by extra taxes. However, grant finance also makes regional government less autonomous (Institute for Fiscal Studies, 1996).

The sting in the tail of the IFS quotation – too much grant dependence curtails freedom of action – indicates that it would be preferable to secure independent sources of revenue to the maximum extent possible under the specific circumstances of the case.[11]

However, an insistence upon a strict interpretation of full self-financing (one which saw control over tax rates as an integral part of the concept) would:

- breach EU law;
- involve serious economic inefficiencies and weaken safeguards against tax avoidance and evasion; and
- preclude needs and resources equalization.

Indeed, in the context of EU developments, even national governments will find it more difficult to vary tax rates.

There are four factors shaping these conclusions. First, on a general level, economic globalization and deregulation, and, on a specific level, European economic integration and possible monetary union, have all combined to limit fiscal discretion. Capital and labour have become much more mobile. With regard to corporate taxes, the fact that jurisdictions find it more difficult to protect their own tax bases strengthens long-standing arguments against the use of such taxes by sub-national governments (King, 1984). Moreover, certain categories of labour are now internationally mobile to an unprecedented extent: good examples are managerial labour (such as those who work in financial sectors) and professional sportspersons (for example, footballers such as Paul Gascoigne and Paolo di Canio). In such circumstances, mobile labour may be able to shift personal taxation back to the employer, through the ability to bargain about net wages. More generally, this is a signal that progressive taxation, which is coming under strain even at a national level, cannot be sustained at a sub-national level. This reinforces a standard conclusion of the public finance literature, emphasizing that, in the context of greater income inequality, even a proportional sub-national income tax may have to have a cap on total individual liability.

Second, membership of the European Union involves acceptance of extremely strict limits on the extent of variation in consumption taxes, which the European Commission has been attempting to standardize across member states. When the November 1975 White Paper on devolution (Lord President of the Council *et al.*, 1975) was being prepared, European constraints on territorial variations in VAT and on the introduction of a retail sales tax were not recognized for some time. The use of such taxes as one of the revenue sources of the German Länder is covered by derogations in regard of pre-existing taxes which, even before the big push for tax harmonization, would not have been extended to the United Kingdom (Heald, 1980).

Third, there have been remarkable changes over the last 20 years in the technology of consumption and in the organization of retailing. Even without the presence of EU constraints, there would be powerful revenue protection arguments for keeping VAT as simple as possible and for not complicating matters by introducing regionally variable rates and/or supplementary retail taxes. It should also be noted that reductions in real transport costs have lowered the costs of shopping in other jurisdictions, as indicated by the controversies about the extent of cross-Channel shopping. In any case, effective distances in the United Kingdom are small in international terms, thereby ruling out many of the revenue sources from consumption taxes which are used by states in Australia[12] and provinces in Canada.

Fourth, proper attention has to be paid to the macroeconomic context. Just because the power of central government over local authorities was seriously abused during the 1980s and 1990s does not imply that there is no legitimate central government interest in the expenditure and financing of sub-national governments. Central governments have the responsibility for securing macroeconomic balance, an undertaking which must affect sub-national governments when they account for a significant proportion of General Government Expenditure (GGE) and of GDP. This issue most obviously arises when sub-national governments overwhelmingly depend upon central grants. More subtly, the issue reappears when local authorities have access to buoyant tax bases, as in Sweden, which would elsewhere be the preserve of central government. Nevertheless, the most pressing concern for the finance ministries of EU member countries relates to the obligations under the Maastricht Treaty's Excessive Deficits Protocol: member states have pledged themselves to 'avoid excessive government deficits', interpreted as ceilings of 3 per cent for the ratio of the government deficit to GDP at market prices and of 60 per cent for the ratio of government debt to GDP at market prices. In consequence, the main concerns will relate not to expenditure financed by sub-national taxes[13] but rather to central grants and sub-national borrowing.[14]

The culmination of these developments has clearly been to favour tax-raising being effected at higher levels of government. Moreover, strong arguments can be mobilized that the best taxes for variation at sub-national levels are highly visible ones such as personal income taxes (though the variation band has to be kept modest) and property taxes, supplemented by user charges. There is no reason to be too depressed by these conclusions about limitations on which taxes can be devolved: these are fiscal dilemmas that confront other states. Musgrave (1997), who firmly rejects the Leviathan view of the state advanced by public choice theorists, cautioned that arguments for pushing tax-raising down to lower tiers of government are, in part, designed to reduce tax progressivity and to increase the economic costs[15] and political obstacles associated with generating the revenues required for (what he would regard as) an efficient and equitable level of public expenditure.

THE SCOTTISH CONSTITUTIONAL CONVENTION'S FINANCING FRAMEWORK

The purpose of this section is to consider the overall design of the SCC's financing framework, set out in proposals published in 1990 and revised in 1995 (Scottish Constitutional Convention, 1990, 1995). Accordingly, the following structure is adopted: the main features of the SCC proposals are summarized; recent threats that devolution means the end of needs-based equalization are exposed as spoiling tactics; the suggestion that the exercise of tax-varying powers in either direction would lead to block-grant reductions is shown to be either misinformed or malicious; and, finally, there is further discussion of the proposition that the financial framework will generate unmanageable conflict.

Financing Proposals of the Scottish Constitutional Convention

The final scheme published by the Scottish Constitutional Convention (1995) based the financing package upon a block grant (described as an 'assigned budget' for presentational reasons), supported by the 3p each-way income tax-varying power. Mitchell (1995, p.20) made the reasonable complaint that there was considerable vagueness, noting that 'The Convention scheme has less detail than the 1978 [Scotland] Act.' In defence of the SCC, the increasingly difficult political environment needs to be recognized. Between 1990 and 1995, Labour had lost the 1992 general election for reasons widely believed to be connected with tax, and there was obvious nervousness in its UK leadership about the repercussions in 'middle England' of a Scottish debate increasingly dominated by Michael Forsyth (Secretary of State for Scotland from July 1995) who had dubbed the SCC's tax-varying powers the 'tartan tax'. In the event, the UK leadership bounced its SCC partners into abandoning assigned revenues, which had formed part of the 1990 financing scheme (Scottish Constitutional Convention, 1990):

> The shift from assigned revenues to assigned budget was foreshadowed in *A Parliament for Scotland: Labour's Plan* which proposed the system subsequently adopted by the Convention. There was some concern within the Convention that the change was adopted to suit the electoral fortunes of the Labour Party. Labour has noted that the assignment of taxes to Scotland would have left a shortfall on current Scottish Office expenditure requiring a top-up grant from the Treasury, and considers that a well-established formula-driven public grant would be more stable. However, the change raised fears that the tax-raising powers of the Parliament might be under attack (Gay *et al.*, 1995: 13).

Heald (1990) advocated some tax assignment, though differently structured from the SCC's 1990 scheme, for exactly the same reasons of fiscal pyschology as motivated the SCC: namely, to emphasize that such revenues were not subsidy from central government.[16] If Gay *et al.* were correct in their attribution of Labour's motives, this hope of diverting attention was misplaced: an inevitable consequence of devolution, especially asymmetrical devolution, will be to bring far greater transparency to territorial public finances (Heald, 1992, 1994).

Although not specified in the SCC's 1995 scheme, the block grant system should operate in the following way. The first step is to make arrangements for a systematic needs assessment, covering each of the four constituent parts of the United Kingdom; how this should be done is discussed below. The second step is to determine a formula which automatically controls changes in each territorial block relative to changes in comparable English expenditure. This would be the third such formula, following in the tradition of the Goschen formula (established in 1888) and the Barnett formula (established in 1978) (Heald, 1994). In the unlikely event that each constituent part's expenditure relative exactly matched its assessed needs relative, the new formula would allocate expenditure changes on the basis of weighted population. The formula, once determined, would be set to run for a period of, say, ten years, thereby establishing a degree of certainty about future shares. If, as is more likely, there were divergences between the expenditure and assessed needs relatives, the new formula would be set to lead to convergence over a manageable period, say, ten or 20 years.[17] There is substantial experience in the National Health Service of convergence mechanisms, though these have operated for the health authorities of each territory, rather than across the United Kingdom as a whole.

A key task of the devolution legislation will be to establish the framework both for the needs assessment exercise and for the determination of the formula: the first task should be exclusively allocated to a Territorial Exchequer Board (Heald and Geaughan, 1996), to which any governmental or private body would be able to make representations; proposals for the content of the formula would also be made by this Board, though the final decision would be the subject of negotiation between the UK government and devolved governments. It would be helpful to establish arbitration procedures for use in cases of failure to agree on formula revisions consistent with the terms of the devolution legislation.

Threatened Withdrawal of Equalization

Lurking behind threats about the financial consequences of devolution for Scotland can be found certain issues of principle; these have to be recognized now and acted upon. The following quotations are some of the best examples, both in content and tone:

> As the Cabinet minister concerned with the level of overall public expenditure I am very conscious of the benefits Scotland enjoys under the UK's system of public expenditure. Identifiable government expenditure per head in Scotland in 1992–93 is estimated to have been 16 per cent higher than the equivalent UK figure. The conclusion must be that under the present constitutional arrangements Scotland derives substantial financial benefit from the Union. There is nothing wrong in that, but it should not be lost sight of either in the current debate ...

> A devolved or independent Scotland no longer underpinned by the present UK public expenditure formula would have to raise extra taxation on a scale which could seriously damage Scotland's competitive position (Aitken, 1995).

> ...higher income tax would inevitably follow if devolution became a reality. That is because higher spending in the end has to be paid for by higher taxation. Already, identifiable government expenditure in Scotland in 1993–94 was 21 per cent higher than in England. That is over £600 more per person a year and over 16 per cent more than the United Kingdom average. If a devolved Assembly were set up in Edinburgh many English taxpayers would undoubtedly expect more of this higher public spending in Scotland to be raised in Scotland (Clarke, 1995).

> 'So just to maintain spending ... a Scottish Parliament would have to levy additional taxes.' Labour has said that the maximum figure by which a Scottish Parliament could vary income tax would be 3p in the pound, but Mr Lang said this would raise only £450 million. 'If a British Chancellor decided to reduce the funding transferred to a Scottish Parliament to the same level as the rest of the UK, funding would be cut by almost £2,845 million. To replace that would need additional taxation in Scotland, on top of UK taxation, of 19p on Scottish income tax.' (Ian Lang's Dimbleby interview on London Weekend Television, as reported by MacAskill in the *Scotsman*, 13 February 1995).

The common thread in these quotations is that needs equalization, in recognition of Scotland's higher per capita expenditure needs, is explicitly linked to the status quo of administrative decentralization; this would be withdrawn if there were to be devolution within the United Kingdom. The Aitken (1995) quotation failed to distinguish between a devolved Scotland (which would contribute to, and draw from, the common pool of UK resources) and an independent Scotland (which would depend upon its own resources). In 1995, the year of all these quotations, the irony was not lost in Scotland that the Major government had been promoting schemes of devolution for Northern Ireland which did not involve the termination of needs equalization.

Two principles need to be clearly enunciated. The first is that the entitlement to needs equalization of any component part of the United Kingdom is not affected by the form of devolved government chosen by its citizens. The second is that successful devolution requires much greater transparency about territorial public finances than has been the case when territorial allocation was a process internal to a single government (Treasury, 1997). This transparency will be required to sustain public confidence throughout the United Kingdom that expenditure relatives properly reflect need relatives, and that corrective action is being taken when divergences emerge. This point remains valid despite the IFS caution that:

> In the longer run, if the current interregional transfers become more explicit, this may reduce public willingness to maintain these transfers at current levels (Institute for Fiscal Studies, 1996: 1).

Without proper transparency, a commitment to matching expenditure with needs will undoubtedly be transformed into a reluctance to sustain needs equalization.

Financial Penalties for Using Tax-varying Powers

The Revenue Support Grant system for local authorities is structured in such a way that, if all local authorities were to spend at their centrally assessed expenditure need, they would all declare the same Band D council tax. The corollary is that divergences of actual expenditure above assessed expenditure lead to a higher-than-norm council tax, just as cases of actual expenditure below assessed expenditure lead to a lower-than-norm council tax. Grant penalties have never been exacted for 'underspending' whereas 'overspenders' have faced grant penalties and tax capping.

With regard to the exercise of tax-varying powers conferred upon devolved government by the UK Parliament, Lord Mackay of Clashfern, then Lord Chancellor and a member of the Major Cabinet, speculated that there might be penalties:

> And on the vexed tax question, Lord Mackay believes that it would be 'meaningless' to ask the Scottish people to approve of a tax-raising parliament, without knowing the consequences of their actions. 'What will be the consequences of the financial arrangements between Scotland and the rest of the United Kingdom if Scots decide to raise income tax by 3p in the pound? Will the government of the United Kingdom be expected to put the same amount into Scotland than if the income tax was the same in England and Wales?' Similarly, he said that if the Scots decided to cut their tax rates, would the English taxpayer be expected to make up the difference? (Cochrane, 1997).

The answers to Lord Mackay's questions are straightforward. Upwards use of the tax-varying power would allow the Scottish Executive to incur higher expenditure on, for example, education, the block grant being increased by an amount equivalent to the positive yield net of administrative costs.

Similarly, downwards use would require the Scottish Executive to reduce its expenditure on, say, education, the block grant being reduced by the negative yield plus administrative costs. It would be remarkably futile to confer delimited tax-varying powers upon a devolved parliament, and then penalize their use. The Scottish Council Foundation (1997) urged that the size of the block grant should be formally insulated from the exercise of the tax-varying power. This might most effectively be done by making such insulation explicit in the devolution legislation and by requiring the separate identification of both the (positive, zero or negative) proceeds of the tax-varying power, and the administrative costs reimbursed to the Inland Revenue.

The Prospect of Perpetual Crisis and Instability

There have been several variants of this line of criticism of the SCC scheme; the one considered here is associated with Midwinter and McVicar (1996a, b). Their argument might be summarized as involving three linked propositions:

- the SCC's financing package would provide inadequate fiscal autonomy, leading to a 'fiscal relationship ... with Westminster of dependency' (1996a: 51), resulting in both
- political conflict, and
- challenges to 'Scotland's preferential funding' (1996a: 50).

Together these lead to the implied conclusion that such a devolved parliament is not worth having.[18]

There is not the space here to work through all the stages of this argument. Comment will therefore be restricted to three points. First, Midwinter and McVicar developed their case in such a forceful way that they unwittingly invite the conclusion that no form of political decentralization is viable. Given Midwinter's long-standing commitment to local authority autonomy, this is highly paradoxical as this argument can be readily extended to local authorities. The reasons why full self-financing is infeasible for either devolved governments or local authorities have been explored earlier in this article. Midwinter and McVicar attach too much importance to the proportion of expenditure which is self-financed and too little importance to self-financing at the margin. Whatever the position on the proportion of self-financing, central government has possessed administrative instruments, such as capping and targets, which have allowed ministers to override local decisions. What has to be sought for both devolved governments and local authorities are financing frameworks in which the scope for choice at the margin is transparent, and which regulate intergovernmental relationships.

Second, considerably more fiscal discretion can be exercised within Scotland than is usually portrayed. The estimated yield of the maximum upwards use of the tartan tax is about three per cent of the Scottish Parliament's likely total budget. Some commentators argued that, even if the tax-varying power was fully used upwards, the additional £450 million would be a trivial amount, leading to a grant dependency of 97 per cent. Given that the Labour Party had pledged itself not to use this power during the period 1997–2002, the grant dependency was likely to be 100 per cent. These figures of 97 per cent and 100 per cent are seriously misleading, because they fail to probe beneath the financing of the Scotland Programme, which is effectively what a devolved Scottish Executive would take over from the Scottish Office.[19] Although satisfactory data are not in the public domain, certain observations can be made. In terms of 1996–97 estimated outturn, central government support to local authorities represented 41 per cent of the Scotland Programme outturn (excluding the Forestry Commission) (Scottish Office, 1997b). For technical reasons, it is not possible to match up this data source with figures published in the local government financial statistics. However, in respect of local authority general fund services,[20] council tax accounted in 1994–95 for 14.4 per cent[21] of total revenue income, while income from sales, fees and charges accounted for 5.5 per cent (Scottish Office, 1997a, Table 1). These figures, excluding non-domestic rates which accounted for 15.6 per cent of total revenue income for general fund services, indicate that there is a considerable amount of revenue generation, and hence discretion, within this part of the Scotland Programme. There is an urgent need for better data in the public domain about the extent of such revenue generation (both the difference between gross and net expenditure, and the yield of other taxes controllable within Scotland).[22]

Third, as stressed by Mair and McAteer (1997), devolved parliaments will be able to draw on considerable political resources, including those that can be derived from the devolution legislation and those from the recognition that Scotland is a nation within the United Kingdom. With reference to the 1970s' devolution debates, MacKay concluded that:

> ... the efficient operation of the devolution settlement requires the development of a workable and reasonably harmonious relationship between the Assembly and Westminster (MacKay: 16).

The decisive 1997 election result will be important in this regard, as the prospect of a five-year parliament provides an opportunity to establish sound working relationships in an environment where there are no incentives for deliberate destabilization. Moreover, the fact that the Scottish

Parliament is to be elected by proportional representation will not only add to its legitimacy, but will also provide strong incentives for devolutionists to support proportional representation for elections to the UK Parliament, as the best guarantee of the long-term survival of devolved parliaments in the absence of any mechanism for entrenchment.

DEFENDING THE TARTAN TAX

Two mutually exclusive criticisms have often been made of the tartan tax: that it would cripple the Scottish economy, and that it would raise so little money that it is an irrelevance.[23] Amusingly, these criticisms are made by the same people, with it being a matter of judgement whether they are dissembling or unaware of the contradiction. Simultaneous use is open to ridicule, as when Michael Forsyth, then Secretary of State for Scotland, contended that '... devolution would bring a parish council which would impoverish the country' (Stewart, 1997). In the case of the first criticism, a constrained power to vary personal income taxes is implausibly forecast to cause momentous damage to the Scottish economy:

> Any form of additional regional tax can only handicap Scottish business and commerce and discourage vital investment by UK and overseas companies – and thus the all important creation of wealth and jobs (Sir Bruce Pattullo, Governor of the Bank of Scotland, quoted in Ballantyne and MacMahon, 1997).

In contrast, economists at the Fraser of Allander Institute at Strathclyde University concluded that the macroeconomic effects would be modest, either way:

> If the Scottish people genuinely wish increased government expenditure in Scotland and, importantly, if they are prepared to pay for this in the form of higher income taxes without seeking compensating changes in their gross wage, then the fiscal innovation of the 'tartan tax' may have significant beneficial effects on employment, output and migration. However, even in the worst likely scenario [full compensating changes in gross wages] the adverse macroeconomic impact is relatively small and spread over a considerable time period (McGregor *et al.,* 1997: 82).

A key factor in determining the impact would be the extent of tax shifting by employees back to their employers. The available evidence suggests that there would be some shifting and that the valuation placed by employers and employees upon the outputs produced with that incremental expenditure would be important (Helms, 1985; Day, 1992; Wallace, 1993).[24]

The SCC's scheme specifically avoided taxes directly levied on business, with corporation tax ruled out and the business property tax (known as 'non-domestic rates' or 'business rates') judged unsuitable (McCormick, 1996). Earlier controversies about Scotland–England differences in non-domestic rates led to the policy of having a Unified Business Rate (a common poundage in Scotland and England), with the staged implementation being completed as from 1995–96. There are few advocates in Scotland of a return of the power to set business rate poundages to local authority control.[25]

On the issue of 'irrelevance', the following views have been attributed to Jim Stevens, an economist with the Fraser of Allander Institute and a member of the Labour Party's Scottish Executive:

> Economically, the tax-levying powers contained in the proposals are insignificant. A 3p increase in basic income tax would raise £400 million or so and once that money is spread across the entire Scottish Office budget its macro-economic impact will be very slight. It is enough money to build a few miles of motorway or keep the Forth Bridge in paint for a few years (Donegan, 1997).

Leaving aside the point that the Scottish Executive will not be responsible for painting the Forth Rail Bridge (which is the metallic structure), such a view misses the point that the fiscal discretion of sub-national governments – increasingly of all governments – is exercisable at the margin.

It is necessary to make three further points about the tax-varying power. First, it was always a matter of political judgement on how to define its extent, and in that sense the band of variation was arbitrary:

> ... there is no particular reason why the 3p maximum should have been chosen. However, politically it would probably be difficult now to propose a higher ceiling. It would have been possible to plan for a much higher proportion of funding to be tax-based, in order to increase accountability (Bell *et al.,* 1996: 67–8).

On the contrary, both the imposition of the referendum and the eventual 10.8 percentage points (14.5 per cent) differential Yes vote in Scotland between the two questions provides support for the soundness of the SCC's political judgement. Second, there is a fundamental distinction between the definition of the powers to be conferred upon a Scottish Parliament by the devolution legislation and the intended use of those powers by the Labour Party in the event that it controlled the Scottish Parliament.[26] At the due date, it will be for the Scottish electorate to decide whether to vote for this policy or to support other parties which might propose to use these powers upwards or downwards. Third, one factor which should be borne in mind during the early years of the Scottish Parliament is that the political obstacles to the use of tax-varying powers, in either direction, would be likely to grow during an extended period of non-use, and the administrative and compliance arrangements originally put in place would atrophy.

Needs Assessment and Equalization

From the earlier discussion, the pivotal role of needs equalization within the devolved financing system is self-evident. Throughout the period of Conservative government, there was no repetition of the Treasury's (1979) needs assessment study. Instead, the only significant change to the mechanism for determining changes in the Scottish Block was the recalibration of the Barnett formula in 1992.[27] The Scottish Office did not consider that it was in Scotland's interests to propose such a review. During the 1980s, the Scottish Office and its ministers favoured 'talking down' issues of territorial allocation, so as not to provoke developments which might imperil the Scottish expenditure relative. During the 1990s, the position has been remarkably different, with ministers queuing up to proclaim the fact of higher Scottish expenditure and publicize 'threats' to the formula – a tactic which Mitchell (1992) uncharitably suggested was intended to portray the then Secretary of State, Ian Lang, as the defender of Scottish interests. During the Secretaryship of Michael Forsyth, all caution was abandoned; the recklessness of some later statements, which suggested that higher levels of expenditure were unjustifiable, became a scorched-earth policy (Dinwoodie, 1997; Scott and MacMahon, 1997). Regrettably, one consequence was to prejudice the reception given to important new work on government revenues and expenditure in Scotland (Scottish Office, 1992, 1995, 1996); data which ought to have provoked a serious debate were glibly dismissed as politically motivated.

There are two urgent tasks. The first is to incorporate the principle of needs equalization in the forthcoming legislation, together with adjustment mechanisms of the kinds discussed above. The second is to set in motion the steps for conducting a UK-wide needs assessment. Conduct of the needs assessment will have to await the establishment of the Territorial Exchequer Board after the passage of the legislation (Constitution Unit, 1996). However, much can now be done in preparation, particularly with regard to the design of data collection systems. There are several areas in which action is urgently required: two ready examples relate to the territorial analysis of public expenditure and to the sample size of the Survey of Personal Incomes. Those who have complained in recent years about insufficient resources devoted to these tasks have been firmly told that the allocation of resources to statistical activities had to meet the policy and operational needs of current ministers, not the hypothetical ones of hypothetical ministers. These issues now have high policy and operational salience.

Our best guess is that, on devolved services, such a needs assessment exercise might show that Scotland's expenditure relative is higher than its needs relative, necessitating a downwards adjustment through time. There is a powerful case for accepting that such an exercise should be undertaken as soon as the institutional framework is in place, rather than postponing it to a later date, when tension or hostility between the UK and devolved governments may have arisen. There can be no doubt that differences in per capita expenditure need new legitimization, which can only be provided through the processes discussed above. Moreover, the purpose of a territorial formula, namely that these issues are not re-opened every year, needs to be re-asserted after a period in which the mechanics but not the spirit of the formula have been observed.

OTHER ASPECTS OF THE FINANCING SCHEME

There are several important issues which have not been addressed in this article, but which are worth listing as topics for debate:

- the treatment of EU funds, about which there would be concern to ensure that the Scottish and Welsh Executives are properly incentivized to secure such funds without there being unintentional 'double compensation' for additional needs (for example, through both the block grant and EU funds); this is yet another manifestation of the issue of additionality.
- the implications of the introduction of Resource Accounting and Budgeting (accruals accounting, in which capital assets are valued and depreciated) for the measured size of the block grant and the operation of the formula which controls changes in its size.
- the treatment of National Lottery funds.
- the treatment of assets financed through the Private Finance Initiative.
- the monitoring of tax expenditures granted by the UK government which touch upon devolved programme areas.
- the structuring of relationships between the devolved parliament and local authorities.

CONCLUSION

As a prelude to drawing the argument together, it is instructive to juxtapose the observations of two professors of political science, both of whom have explicitly identified themselves as Scots resident in other parts of the United Kingdom:

> I am an expatriate Scot who has until now always been an ardent unionist ... The current plan for Scottish devolution is so unworkable that, if implemented, it must either lead back to unionism, or on to federalism or independence. The state of Scottish opinion makes a return to unionism impossible. Federalism would mean designing institutions for England that nobody wants. So I have taken a deep breath and decided to support independence ... England should offer a fair devolution scheme which would end Scotland's favourable treatment. The Scots could take it or leave it ... [The offer would be] on terms that are fair to all parts of the country – say, a Scottish parliament with no secretary of state, with 45 Scottish MPs at Westminster (currently 72), and with a block grant to the Scottish parliament comprising the UK mean expenditure per head on the services that the Scottish parliament will run ... (McLean, 1997a: 80; the last two parts of the quotation above have been resequenced).

> There were two main reasons for the failure of the last referendum. One, for non-Labour voters, was that the assembly would be dominated by the Strathclyde majority. The second was not only that a parliament without economic powers would be a 'talking shop', but also that their absence would reduce political debate to an unseemly competition over who could 'screw the most money out of Westminster' ... If people in Scotland fail now to endorse proposals which go to the heart of what they regarded as wrong last time, they will not deserve to be heard again and the world at large will be entitled to think of them as whingers (Meehan, 1997).

Undoubtedly, the greatest threat to the future of the Union lies in the deliberate closing of constitutional options, in the attempt to polarize opinion between the status quo and independence. Recourse to this device was widely believed to have contributed to the Conservative Party's better-than-expected 1992 general election result in Scotland, though its use in 1997 did not prevent the loss of all its Scottish seats. The devolution scheme offered by McLean (1997a) would involve: a devolution discount on Westminster representation;[28] a block grant set at UK mean expenditure per head on devolved services, thus ending UK-wide needs equalization; and (presumably) no tax-varying powers. His wording would suggest that his stated conversion to independence is mocking, and that his objective is to devise a scheme which Scotland would reject. Article titles such as 'Yes, yes! Begone with Scotland!' (McLean, 1997b) and use of the 'velvet divorce' analogy[29] (McLean, 1997c) do not resonate with constructive motivation, but rather with a threat to throw Scotland out of the Union.

The context of UK devolution is that the government of a hitherto highly centralized unitary state is being fragmented. It is often the context that federations are created by hitherto independent states unifying their governmental structures. Decisions with long-term consequences are then made about the extent to which needs and resources will be equalized across the federation; marked differences in outcome can be detected among Australia (where the tradition of needs and resources equalization is strong), Canada (where the emphasis is on partial resources equalization), and the United States (which has little systematic equalization). Devolution within the United Kingdom will not work unless there is an explicit recognition that the forms of government chosen by a country or region do not affect its claims upon the pool of UK resources on the basis of differential need.

McLean drew comfort from the deliberate impression created in the 1990s by Ian Lang and Michael Forsyth that Scotland's present expenditure relative is unfair to England, in that the present level of spending is far too high in relation to needs (expenditure relative greatly exceeds the needs relative). Forsyth's scorched-earth tactics to resist devolution are bizarrely portrayed as evidence of the 'success' of his incumbency. McLean's conviction that Scotland's expenditure is too high relative to needs leads on to his proposal to abolish Scotland's access to UK-wide needs equalization as the 'price' of legislative devolution. Logically, however, it should lead to a proposal for a new needs assessment.

Moreover, the UK pool of resources embraces oil revenues from the UK Continental Shelf, defined for UK statistical purposes as a separate region. These revenues would come back into the political reckoning were Scotland either to be independent or, post-devolution, implausibly denied access to UK-wide needs equalization. In the run-up to the 1997 general election there was extensive controversy about the Scottish National Party's (SNP) proposed budget, the news appeal of which was greatly enhanced by the Treasury unexpectedly providing a written parliamentary answer, on the basis of the SNP's hypotheticals (Waldegrave, 1997a, b). The resulting calculation represented Scotland's General Government Borrowing Requirement (GGBR), expressed at 1996–97 prices, as a surplus of £26.7 billion over the years 1978–79 to 1994–95.[30] Though a good propaganda number, these figures – even if accepted – refer to byegones and not to Scotland's present budgetary position, stated by the same written answer as a GGBR in 1994–95 of £6.5 billion (at 1996–97 prices) on the same assumptions (Waldegrave, 1997a). The benefits to England projected by McLean (1997b: 21) from Scottish independence ('the English will gain from the ending of its £6 billion transfer payment') constitute a misinterpretation of Scotland's share of the UK GGBR as 'a structural deficit between Scotland and the rest of the UK of £6 billion a year' (p.19).[31]

Four concluding points are appropriate. First, the SCC fulfilled an invaluable function by keeping devolution on the political agenda during a period in which the UK government was hostile to the idea, except for Northern Ireland. Following the 1997 election, the Scotland White Paper published by the incoming Labour government was well received by its SCC partners; they largely held their silence on the issues of a pre-legislative referendum and the separating out of the taxation issue. In the longer-term, however, the work of the SCC may have created the basis for new alliances in Scotland, which will be resistant to unilateral impositions of policy by the UK Labour leadership. There was a questionable assumption during the referendum campaign that Labour would overcome the hurdles of the Additional Member system and be able to impose its will, notably on the exercise of tax-varying powers.

Second, the United Kingdom, which has exported its system of government across the world, must now be willing to learn from elsewhere. Obvious examples relate to how the Commonwealth Grants Commission in Australia organizes the data collection systems which underpin its judgements on relative needs,[32] and how the Loans Council co-ordinates borrowing activities. Closer to home, there is a much to be learned from the experiences of the devolved Northern Ireland Parliament, about which there are several authoritative accounts (for example, Lawrence, 1965; Birrell and Murie, 1980; Bloomfield, 1996). The reaction in Great Britain to most things to do with Northern Ireland – communitarian strife discouraging interest and understanding – should no longer inhibit learning from the United Kingdom's only experience of legislative devolution, notably about how *not* to undermine financial autonomy.

Third, to repeat what has already been stressed, devolution makes elected bodies responsible for territorial management, rather than this being internal to one government. Many relationships, especially financial ones, must become more explicit and hence more transparent. Where this is not arranged through formal machinery, the information will be leaked out or forced out later, with damaging repercussions.

Fourth, there should be no illusions about how tough the public expenditure climate will be, both because of UK-level pressures (Heald, 1997) and because the Scotland (and Northern Ireland) expenditure relatives have received a dramatically higher public profile as result of their flaunting by those opposed to Scottish devolution:[33]

> Everyone knows that sooner or later Westminster will refuse to continue funding the much higher health, education and housing expenditure in Scotland than is spent in England and Wales. Devolution will bring that moment of truth far closer and will result in either heavier taxation in Scotland or massive cuts to deal with the deficit (Rifkind, 1997).

The moment of truth, in the different sense that expenditure relatives will now have to be publicly justified, was dawning well before the referendum verdict. The crucial task of relegitimating the territorial allocation system can now be joined by a Scotland with renewed self-confidence, having stepped over Alexander's (1996) trap and brushed aside Meehan's (1997) charge of irredeemable whingeing.

NOTES

1. One of the most most telling illustrations of this is that Chancellor of the Exchequer Sir George Goschen (1888), when announcing the territorial allocation formula now bearing his name, referred only to the three countries of Scotland, Ireland and England (Heald, 1992).
2. Nairn (1981: 129) described the results of the Act of Union as '... a nationality which resigned statehood but preserved an extraordinary amount of the institutional and psychological baggage normally associated with independence – a decapitated nation state, as it were, rather than an ordinary 'assimilated' nationality'. Leruez (1983) elegantly captured the idea with his book title: *L'Ecosse: Une Nation Sans Etat.*
3. No firm criteria as to what is or is not 'acceptable' can be enunciated. A parallel is that ministers have to resign when they have lost the confidence of their colleagues, not when they have crossed some invisible line (Woodhouse, 1994).
4. This observation was made in his editorial comments on a draft version of Heald (1980).
5. The *Referendums (Scotland and Wales) Act 1997* provided for electors entitled to vote in local government elections in Scotland to be asked to indicate their assent to one of two opposing statements offered on two questions. On a 60.4% poll, voting on the first question (whether there should be a Scottish Parliament) was 74.3% (Yes) to 25.7% (No). Voting on the second question (whether that Parliament should have tax-varying powers) was 63.5% (Yes) to 36.5% (No). Because there were two separate ballot papers, the combinations chosen by voters are not known. However, results on each question were declared separately for the 32 local authority areas; there were Yes majorities in all 32 on the first question and in 30 (Dumfries and Galloway, and Orkney being the exceptions) on the second question. The referendum in Wales was held one week later on 18 September. On a 50.1% turnout, the voting was 50.3% (Yes) and 49.7% (No). The 22 local authority areas split 11:11, with Pembrokeshire (No) in the far south west being the sole exception to the geographical pattern of results (the east voting No and the west voting Yes).
6. There were tactical motives for voting for the third combination (e.g. someone favouring independence who wanted to see constitutional movement from the status quo and the creation of a Scottish Parliament without long-term credibility) or for the fourth combination (e.g. someone favouring the status quo or full integration who believed that the defeat of tax-varying powers in the referendum would improve the chances of defeating devolution in Parliament). Urging the fourth combination, Mowbray (1997) stated that '... we should have little difficulty defeating tax-raising powers. And without them, what is the point of having a parliament at all?'
7. Paradoxically, the trap which Alexander (1996) identified as confronting Scotland ensnared the devolution proposals for Wales, which had been caught up in Labour's pre-legislative referendum tactic to diffuse the tartan tax controversy.
8. This extended beyond the use of the tax-varying powers in the devolution scheme to innumerable imagined extensions to those powers, including those which had been explicitly ruled out.
9. The System 3 poll regularly published in the *Herald* showed the following percentage division into Yes: No: Don't Know on the second question: 53:28:19 (May); 56:26:18 (June); 54:27:19 (July); and 47:32:21 (August).
10. In response to the question 'Would he ever try to stop a Scottish Parliament from using its

tax powers?', he is reported as having said: 'The powers are like those of any local authority. Powers that are constitutionally there can be used, but the Scottish Labour Party has no plans to raise income tax and once the power is given, it's like any parish council, it's got the right to exercise it' (Penman, 1997). This controversy has attracted attention to the role of the 8,100–8,200 parish councils in England. These councils have responsibility for services such as cemeteries, crime prevention, swimming pools, entertainments and local halls, tourism and for the provision and maintenance of open spaces, bus shelters, parking places and public lavatories. In some areas, county councils have devolved budgets for certain of their functions to parish councils, thereby turning them into local purchasers of county council services. Parish councils are financed for their own functions by means of a precept on the district council. In 1997–98, the average Band D equivalent parish council precept stands at £8.82, compared with £688.98 for the total Band D equivalent council tax bill. Some of the larger parish councils also have significant income from fees and charges. An interesting sidelight is that capping powers do not extend to parish councils, which, in principle, levy whatever precept they wish. However, since their expenditure falls outside the Revenue Support Grant system, the whole precept falls directly upon the council taxpayers within the parish, who are themselves electors in parish council elections.

11. Public finance economists have drawn attention to the 'flypaper effect', namely that money tends to stick where it lands. This draws attention to the greater enthusiasm of sub-national governments for spending money they receive as grants rather than money they have to raise themselves (King, 1993).
12. There are ongoing legal arguments in Australia about the constitutionality of so-called quasi-excises: e.g. high volume-related licences issued by the state governments for the right to sell alcohol, the taxation of which is constitutionally the exclusive preserve of the Commonwealth.
13. An important qualification relates to cases where increases in a sub-national tax (e.g. council tax) or charge (e.g. public sector housing rent) would partly be met through higher benefit expenditure. The Scotland White Paper (Scottish Office, 1997c, para 7.24) explicitly warned that 'excessive' growth in local authority expenditure relative to England might be charged to the block grant. The Treasury's (1996a,b) estimate at the UK level is that about 20% of property tax increases would be benefit-financed. The second-round effects are more difficult to track; for example, the effects of higher council tax on the RPI would feed through to indexed benefits, and more expenditure on teachers' salaries would increase UK income tax receipts.
14. Borrowing by provincial governments, both for capital expenditure and to finance deficits, has been a significant factor in the growth of Canada's debt/GDP ratio.
15. More technically, the Marginal Cost of Public Funds (MCPF) will be lower when corporate and consumption taxes are levied by central governments than when levied by local governments. It should be noted that the MCPF of raising £1 will be higher than £1 because of two separate elements: the administrative and compliance costs; and the 'excess burden' arising from the distortion of firm and household market choices due to the tax wedge between the amount which one economic transactor pays and the other receives. The argument is that there will be economies of scale in central tax administration, and that harmonized tax rates will generate lower excess burden.
16. It is worth recalling the extent to which central government in the 1980s treated Revenue Support Grant to local authorities as a subsidy, rather than as a reflection of the differential assignment of expenditure functions and revenue sources.
17. The motivation for adopting the Barnett formula was to secure a better alignment between each country's expenditure and need relatives, not to bring convergence of per capita expenditure.Two of the probable reasons why this has not happened are that there have been significant changes in relative population, and there has been formula by-pass, the quantitative significance of which cannot be assessed from material in the public domain (Heald, 1992, 1994).
18. The nearest this became to being explicit was: 'It is not clear to us that the problems of fiscal dependency can be overcome' (Midwinter and McVicar, 1996a: 51); 'We do not see this as promoting more accountable government' (1996a: 51); and 'This is not a mix for enhancing

political accountability, but for a pattern of friction-based relationships over spending, which will further confuse responsibility in government' (1996: 51).

19. Midwinter and McVicar (1996a: 50) adversely compared 3% for the devolved Scottish Executive with 15% raised for local authorities by the council tax, without regard to the fact that a significant proportion of the denominator for the first calculation relates to the way the Public Expenditure Survey scores local government.
20. Housing, trading services and special funds are excluded.
21. It should be noted that council tax rebate grants represent 18.9% of council tax income, thereby reducing the proportion actually met by council taxpayers to 11.6%.
22. The exclusion of local government finance from the remit of the proposed Independent Commission on Local Government and the Scottish Parliament (Scottish Office, 1997d) has deservedly attracted severe criticism.
23. Issues of principle concerning the tax-varying power are covered in Heald and Geaughan (1996) and matters of detailed design and implementation are analysed in Heald and Geaughan (1997).
24. Because the tartan tax is restricted to the basic rate band, the maximum liability of an individual taxpayer would on 1997–98 tax schedules be capped at £660 (Heald and Geaughan, 1997).
25. Nevertheless, the Labour Party 1997 manifesto said that 'there are sound democratic reasons why, in principle, the business rate should be set locally, not nationally' (Labour Party, 1997: 34). There was, however, a commitment to 'make no change to the present system for determining the business rate without full consultation with business' (p.34). If policy for England were to move in this direction, a Scottish Parliament might index a Scottish unified rate to a weighted average of English rates. Even this approach might create some controversy if business rates in the English counties adjacent to the Scottish border were set below that weighted average. For a discussion of policy options, see Denny *et al.* (1995). A curious aspect of these debates is the emphasis which public statements place on tax rates, with much less attention paid to tax bills (which depend also on valuations which differ markedly between local authority areas).
26. The wording on personal tax rates used by Labour in the 1997 election survived the referendum campaign: namely, that the Prime Minister's promise covered the five years of the present Westminster Parliament and would therefore bind Labour members of a Scottish Parliament not to use the tax-varying power for the first two years (which would overlap).
27. The Barnett formula (10:5:85) of 1978 provided that increases in public expenditure in Scotland and in Wales for specific purposes within the territorial blocks would be determined according to the formula consequences of changes in equivalent English expenditure. A parallel formula allocated 2.75% of the change in equivalent GB expenditure to Northern Ireland. The formula was recalibrated in 1992 following the 1991 census: the new factors were set at 10.66:6.02:100.00, with Northern Ireland revised to 2.87% (Heald, 1994).
28. There are some variations in his proposals for Scottish representation at Westminster: 40 (McLean, 1995), 45 (McLean, 1997a), and 40 or 45 (McLean, 1997b). The Scotland White Paper (Scottish Office, 1997c, para 4.5) announced that a common population quota would in future boundary reviews be applied to Scotland and England, though the existing statutory requirements to give due weight to geographical considerations (which are more likely to be thought applicable in the Scottish highlands and islands) and local ties would still apply. (In the Scottish Constitutional Convention, the Labour Party had resisted a Liberal Democrat proposal to this effect.) There is no similar reduction envisaged for Wales (Welsh Office, 1997). Taken together, the White Papers indicated that executive devolution would hold no implications for Westminster representation, and that legislative devolution would bring proportionality. McLean (1995) advocated a devolution discount for both Scotland and Wales, which would reduce their representation below proportionality, citing a one-third discount applied to Northern Ireland under the *Government of Ireland Act 1920*.
29. The break-up of Czechoslavakia has been attributed to the desire of Czech politicians to evict Slovakia from the federation.
30. These numbers are crucially affected by the revaluation of an assumed 90% Scottish share of oil revenues over that period to 1996–97 prices. The contribution of 1983–84, 1984–85

and 1985–86 to the total surplus was £30.1 billion (Hall, 1997; Wilson, 1997; Wood, 1997).

31. On the basis of Scottish Office figures (1996, p.32), Scotland's GGBR was £8.2 billion in 1994–95 out of a UK GGBR of £47.9 billion (excluding privatization proceeds and North Sea oil revenues). On the basis of Waldegrave (1997a,b), Scotland's GGBR (assuming a GDP share of privatization proceeds and a 90% share of North Sea oil revenues) was £6.2 billion.
32. There will be an opportunity for the United Kingdom to import expertise from countries whose governmental systems it strongly influenced in the past. For example, the Commonwealth Grants Commission in Australia has been advising the Government of China on the structure of financial relationships between tiers of government.
33. There are technical factors reinforcing these political points. First, on the basis of a strict application of the Barnett formula, Scotland will always get a lower percentage increase due to the relationship between the base and the increment. Second, because the formula is driven by what happens in England, developments in England feed through to Scotland, Wales and Northern Ireland. For example, middle-class exit from inner London schools will in time mean less money through 'formula consequences'. Third, because of higher participation rates, whatever is decided in England about higher education funding and fees is likely to be more expensive in Scotland.

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