

Alignment of Budgetary Processes of UK and Scottish Parliaments

Professor David Heald

1. Subsequent to my oral evidence session on 14 January 2016, the Convener of the Devolution (Further Powers) Committee requested a supplementary written note on “the steps that could be taken to better align the UK and Scottish Parliaments’ budget decisions”.
2. There are two separate issues to consider. First, the budgetary processes of the UK Parliament are Executive-dominated to an exceptional degree. The key budgetary documents are now the periodic Spending Review in which the House of Commons has no formal role except to receive multi-year plans, elements of which have been trailed in the media in the preceding weeks. The Supply Estimates are entirely formal and generate no Parliamentary interest. In contrast, following the recommendations of the 1998 Financial Issues Advisory Group, the Scottish Parliament is actively involved in budget procedures. Long-term widespread dissatisfaction, outside government, with the UK procedures has had negligible effect: I submitted written evidence on the pathology of the UK Parliamentary budgetary process in February 2014 to the Westminster Committee on Fixed-term Parliaments (Heald, 2014).
3. Second, the difficulties encountered in setting the ‘Fiscal framework’ owe much to the way in which the Smith Commission agreed proposals without the implications having been fully analysed. According to the Secretary of State for Scotland in January 2015, “the Scottish Parliament will become one of the most powerful devolved parliaments in the world”.¹ I disagree and reject the proposition that the proportion of devolved expenditure notionally financed by devolved or assigned taxes is an indicator of devolved power. What critically matters is the usability of powers to set taxes, which depends upon political context and administrative timings as much as on formal powers. In 1997 I was co-author of an academic paper that warned of the danger that the 1998 tartan tax power might atrophy through non-use (Heald and Geaughan, 1997). On that occasion, atrophy resulted from that being a period of unprecedented public expenditure growth and accumulating unspent End-Year Flexibility, and fears that downward use of the tartan tax would lead to non-transparent reductions in the block grant. By contrast, the UK Government’s austerity agenda is now transmitting large expenditure reductions to the Devolved Administrations through the Barnett mechanism. This is separate from the future pressures that might arise from the specific form of block grant adjustment that accompanies partial income tax devolution² and partial VAT assignment.
4. The United Kingdom has a dismal record on managing its taxation system. The credibility of council tax has been eroded by Scotland and England not having had property revaluations since 1991. There has been an 8-year freeze on council tax in Scotland, enforced by a penalty regime, which has further eroded the democratic accountability of local government. This again emphasises that the usability of devolved

¹http://www.heraldscotland.com/news/13198265.Mundell_Scotland_will_have_one_of_the_most_powerful_devolved_parliaments_in_the_world/

² Partial because the UK Government defines the tax base, sets the personal allowance, and continues to tax savings and dividend income.

taxation powers depends upon more than statutory provisions. In a geographically small, historically centralised and economically integrated state such as the United Kingdom, territorial variations in taxation will always be politically difficult and require strong enforcement. Such powers might lead to more reflective debates about policy choices at the margin, but will not offset a state-shrinking agenda imposed by the UK Government. Expectations management about what can be achieved with new tax powers is essential, otherwise unrealistic ambitions (eg extensive offsetting of the UK welfare reform agenda) will be dashed and create further disillusionment in all constituent countries of the United Kingdom.

5. In a better world, the UK Parliament would amend its budgetary procedures, perhaps along the lines suggested by Heald (2014), who proposed bringing the UK Budget forward to November³ and completing the formal process before the beginning of the financial year on 1 April. In practice, the powerlessness of the House of Commons on fiscal matters is too convenient for UK Governments for that to change. Moreover, accommodating the needs of the Devolved Parliaments/Assemblies is unlikely to be persuasive in the Commons.
6. The Scottish Government will be required to inform HMRC of the Scottish income tax bands and rates not later than 30 November, for implementation on the following 6 April. Later notification would lead to an automatic demand for reimbursement of additional HMRC costs and hostile publicity arising from HMRC sending out replacement coding notices to Scottish taxpayers. The number of (what are effectively) UK Budgets each year is a political matter for the Chancellor of the Exchequer. For example, changes in Scottish banding or rates could be undermined in a late March UK Budget, thereby pressurising the Scottish Government to change its decision and amend its own budget arithmetic. By such action, the UK Government could impose its will on the Scottish Parliament, analogous to the Scottish Government's control of local authorities. There are competing fiscal mandates and the UK Government will seek to impose its views about the size of the state on the Devolved Administrations.
7. I have stressed in my evidence to this and other Committees⁴ that no devolved fiscal system in the United Kingdom will work without a measure of goodwill that, even in the middle of intense political conflict between governments, enables the system to survive. This is something which characterises successful federations such as Canada. The United Kingdom is unlikely to become a federation because of its asymmetry but it is acquiring some federal-like characteristics. Whether the post-Smith Commission fiscal system 'works' will depend in large part on whether key actors wish it to do so, or wish to destroy it.
8. Given the above context, what can be done to improve the chances that the fiscal framework will work? The assumption should be that Westminster is unreformable, despite the fact that it would be the largest beneficiary of reform.

³ Because of the dangers of forestalling and the spread of avoidance devices, there would have to be provision for either immediate implementation of certain draft budget proposals or delegation of power to the Executive to make certain changes at short notice outside the formal budget process.

⁴ This Committee on 11 December 2014, 3 December 2015 and 14 January 2016; the Scottish Parliament Finance Committee on 25 June and 5 November 2014; the Scottish Affairs Committee of the House of Commons on 13 January 2016; and the House of Lords Economic Affairs Committee on 21 July 2015.

9. The first requirement relates to transparency about processes and numbers, on a timely and comprehensive basis. The Barnett system has never been fully transparent with key information denied by the Treasury to the Devolved Administrations, Parliaments/Assemblies and the public. The lack of transparency over the 35 years of the Barnett formula's life is one of the reasons why it has been misunderstood, misrepresented and has been de-legitimised outside Scotland and Northern Ireland (Heald and McLeod, 2002). Specific commitments by the Treasury on timely information release should be built into the fiscal framework.
10. The second requirement is to recognise the importance of the first 'No Detriment' principle. The 'act' of devolving income tax and partial VAT assignment should not disadvantage the Scottish Parliament. For the reasons discussed on 14 January 2016 in public session and covered by the Eiser (2015) and Muscatelli (2015) presentations on the Committee website, the 'per capita indexation' method of block grant adjustment should be adopted. Otherwise relative population change between Scotland and England, well documented in history and predictable on future trends, will intensify budget pressure on the Scottish Parliament. If this occurs through a little-understood process, it would become a grievance that would undermine the new fiscal settlement. Outside Scotland, there is a view that Scotland is presently over-funded, as illustrated by the reports of House of Lords Committees. If that were agreed to be the case, a block grant deduction should be explicit, after a systematic assessment of relative needs.⁵ Attempting to reduce Scotland's relative level of public expenditure through the indexed block grant adjustment is likely to discredit the notion of devolved tax powers.
11. The third requirement is to consider the possible future requirements of Wales and Northern Ireland. Both jurisdictions often seek to emulate arrangements made for Scotland and there are benefits for Scotland in there being common interests across the 16% of the UK population which does not live in England.
12. The fourth requirement is to recognise that the second 'No Detriment' principle is incoherent and unworkable. If taxation and expenditure decisions are devolved there are bound to be spillovers to other jurisdictions if such powers are ever used. Moreover, there is unlikely to be the data on which reliable calculations of first-round effects can be made, let alone of the subsequent behavioural effects. The once-simple Barnett formula has become increasingly complex and would be obscured further by claims for reimbursement of conferred benefits or imposed costs. If the fiscal settlement is going to work, there will have to be a high level of co-ordination between the UK and Scottish Governments, which allows attention to be paid to each other's interests during policy-making. This includes not sabotaging policy initiatives by the other government. Confidentiality will have to be respected, on the understanding that, once agreement has been made, both Governments will put relevant data into the public domain. The prospects for success are not high if there is constant proxy warfare via the media.

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⁵ I have always expected that, in due course, there would be a needs assessment to re-calibrate the Barnett formula. However, I stressed that such an exercise would be technically demanding and politically fraught. Given more divergent views on what the state should do, these difficulties have become more pronounced.

References

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