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December 2015

Fiscal Federalism in the UK

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ISBN 978-1-903403-98-3

The Federal Trust is a Registered Charity No. 272241
84 Moorgate
London EC2M 6SQ
United Kingdom

Company Limited by Guarantee No. 1269848

Design by Fred Fieber

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Fiscal Federalism in the UK

Introduction

Fiscal federalism is the aspect of federalism which concerns the precise allocation of fiscal powers/responsibilities, i.e. tax-raising and public spending, between the constituent parts of the federal or confederal, national or other political structure.

In the UK, fiscal federalism has hitherto related to the allocation of these powers/responsibilities as between the UK government and the devolved administrations/governments of Wales, Northern Ireland, and, perhaps particularly, Scotland.

However, recently, linked to the appellation "The Northern Powerhouse", it may also be construed as applying to the Combined Authorities devolutionary fiscal approach in England of the previous and, particularly the current, UK government. It is setting this initiative in the context of constitutional fiscal devolution – applied to the UK as a whole, and the substantially increased fiscal devolution being provided to Scotland – which is the subject of this paper.

There is little doubt that the informal constitutional settlement in the UK is under considerable strain. The British philosophical tradition of empiricism often protects against the excesses of rationalism. However, it often, these days, represents a tendency to 'muddle through' and to adopt short-sighted ad hoc solutions to problems as they emerge.

Nowhere is this more evident than in the apparent 'sleep-walking' towards on the one hand a break-up of the UK, with Scotland becoming independent and, on the other hand, a potential BREXIT, with the possibility of the UK (or at least England) deciding to leave the EU, following a referendum.

The response to the former problem has been a combination of a reactive call from the Conservative government for 'English votes for English laws' and a rapid, but ill-thought through, shift of funding and new responsibilities to collections of English local authorities. Insofar as there may be said to be a rationale to the latter proposal it appears to be based on a competitive market approach which seems likely to disadvantage many local and regional areas.

This sudden political passion for decentralisation would be welcome if it showed the slightest sign of being part of a well-argued move towards a higher degree of

federalism, including fiscal federalism. After the 2015 general election, the granting of even more fiscal autonomy to Scotland will further imbalance the differing fiscal federalism structures between Scotland, Wales, and Northern Ireland, and the lack of fiscal federalism in England (aside from the special case of London), which has 84% of the UK population. It is difficult to see how this piecemeal arrangement can be allowed to persist. The time would appear to have come for a detailed discussion of, and then implementation of, a democratically accountable devolution of powers in the context of fiscal federalism, encompassing the English regions, Scotland, Wales, and Northern Ireland. Unfortunately, for England, a 'creeping decentralisation' via Combined Authorities (CAs) is the menu being offered, but one which is flawed in its economic, political, cultural, and democratic dimensions, as will be argued below.

The annihilation of the three main UK-wide parties in Scotland, and the strongly anti-austerity stance of the SNP, means that the SNP demands are likely to go beyond any reasonable fiscal federalism, and move in the direction of demanding a 'quasi-independence' position for Scotland, if not outright secession. Hence fiscal federalism is going to be a key issue for discussion, including how it might be implemented across England as well as across the currently devolved administrations in Scotland, Wales, and Northern Ireland.

We need to establish guidelines to ensure an optimum level of equity and efficiency for all, but clearly also to recognise the learning processes which will be involved. We need a radical overall approach, but also a pragmatic one which is prepared to be willing to adjust if there is evidence of inequities and inefficiencies.

Background to the UK Debate

There is a considerable amount of research surrounding fiscal federalism, both in the UK and more widely. In relation to the experience of other countries a useful, up-to-date survey is provided in the paper by the Scottish Parliament Information Centre (SPICe), December 2014. The survey covers six countries: Belgium, Australia, Germany, Spain, Switzerland, and Canada.

Perhaps the most surprising piece of data in the report is the diagram which indicates Scotland's substantial share of sub-national government expenditure as a percentage of total public expenditure. This share is substantial even in comparison with other federal nations. Under the Smith Commission recommendations Scotland would be in almost the same position as the cantons in the Swiss Federation, with

only the provinces in Canada having a greater fiscal autonomy in terms of shares of fiscal turnover.

What is clear from this information and the above discussion is that in the foreseeable future Scotland will be a federalised part of the United Kingdom, with a very high degree of fiscal autonomy, certainly on spending powers. This information only reinforces the argument for a comprehensive examination of fiscal federalism in the UK as a whole. Some of the tensions and concerns on both sides of the Scottish/English border are due to a move towards substantial fiscal federalism in one part of the UK. It is interesting to speculate whether, if a federal structure for the UK, as a whole, had been established by the Labour government before 2010, there might not have been the same impetus for Scottish independence?

Fiscal federalism has been the subject of debate in the US for a number of years, perhaps not surprisingly. The term was originally coined by Ralph Musgrave, a US economist, in 1959, followed by Wallace Oates (1972). Oates (1999) makes the point that fiscal federalism implies “a rather narrow concern with budgetary matters”. He suggests that the term “encompasses much more, namely the whole range of issues relating to the vertical structure of the public sector”. Fiscal federalism, therefore, goes beyond the public sector per se and relates to the influence of both taxation and public expenditure on the behaviour and performance of the private sector on the territories involved. This wider political economic use of the term is employed in this paper.

Finally, in this context, and justifying the political economic approach it is worth quoting the last paragraph of the Conclusions of the Smith Commission Independent Expert Group:

“Overall, we believe that the selection of an alternative means of financing the Scottish Parliament that will deliver increased financial accountability has to be a judgement based on the trade-offs we have sought to identify. This judgement is dependent on the choices made by the Commission regarding the appropriate constitutional structure. In other words, it is necessary to first have a clear view on the very nature of the union with the rest of the United Kingdom prior to working through the trade-offs of different approaches to territorial finance”.

An Overall Approach to Fiscal Federalism

The key issues which have to be addressed and, if possible, resolved in any coherent system of fiscal federalism are the following:

- 1) Equity and Accountability
- 2) Complexity versus Transparency
- 3) Taxes: Central or Devolved?
- 4) Tax Competition

One might add to these four, the issue of:

- 5) Impact on Economic Growth

The last argument, i.e. faster economic growth, is used by the SNP to justify further devolution. It is also an argument supported by the combined local authorities who have recently been given more powers within some regions. We will later examine this argument in the context of challenging the city-region economic growth model.

However, it will also be important to consider the evolutionary pathway towards fiscal federalism in the UK. In other countries it has been a mixture of both the historical/cultural and the functional, but these proportions have varied considerably.

Hence, it is necessary to examine these issues from an analytical and an empirical perspective in considering the case for a substantial fiscal federalism agenda for the UK, including England.

Fiscal Federalism in the UK – An Evolutionary Pathway

The analysis will take account of the Smith Report and of the current paths which are being explored and delivered in England, via powers given to CAs under the 'localism' agenda of the government.

Equity and Accountability

This issue is actively being considered in the context of the political debate following the decisions taken after the result of the Scottish Independence referendum, 2014.

It has been suggested, though it was rejected by the Smith Commission, that the

Barnett Formula, governing public expenditure allocation across Scotland, Wales, and Northern Ireland, should be scrapped or at least significantly reformed. The Smith Commission gave considerable weight, perhaps undue weight, to the administrative convenience which the Barnett formula provides. Though this element should not be ignored it is surely incorrect to let it over-rule the more important logical and economic considerations, relating to improving equity between England and between the existing three devolved administrative areas, which a needs-based formula would provide.

There have been a number of studies related to the inequities involved in using the Barnett formula, which, as its author Lord Barnett, admitted, was meant only as a temporary formula to cut through the political arguments at the time, and is now well past its sell-by date. In terms of a replacement needs-based formula, the one put forward in the Welsh government (Welsh government working paper, December, 2009) has the merit of a thorough analysis of the problem and a solution based on simplicity.

In essence the requirement is for the insertion into the Barnett formula of a needs-based element. The needs included are those related to: the number of children under 16; the number of retired persons; ethnicity breakdown; percentage claiming income support, and percentage of population having long-term illness needs. In addition a cost-based delivery comparability factor is included by comparing the cost of delivery linked to the proportion of people living outside settlements of 10,000 people with the cost of delivery in inner London.

This would remove the current bias in the Barnett formula which results in a significant over-compensation to Scotland in terms of the block grant formula for budgetary allocation, between Scotland, Wales, Northern Ireland, and England.

Obviously given the commitment to the Barnett formula in the new settlement for Scotland, agreed by the three main Westminster parties, it may be difficult in the short-term to abandon the formula in favour of a needs-based formula. However, this issue should be in the remit of any UK Constitutional Commission which may be established.

Clearly, as the experience of other federal countries illustrates, some form of grant and tax sharing formula is required to achieve, and to maintain, equity between the decentralised units within a country.

In the UK currently, accountability is within the devolved authorities, e.g. the Scottish government. Here it may be argued that the Scottish Parliament is the place where

accountability should reside. But there are two other aspects of accountability. There is that between the UK government and the Scottish government, and within the UK Parliament between the Scottish Westminster representatives and other Westminster MPs.

Also, outside the Whitehall administrative and Westminster parliamentary nexus, there is the accountability, or perceived lack of it, in the context of the views, particularly of the English regional populations.

Scotland, for instance, is sometimes seen as benefitting from the largesse of the 'Rest of the UK', in terms of welfare and pensions. Part of this feeling can be assuaged, if the rest of the UK is similarly treated and has a degree of fiscal autonomy.

Complexity and Transparency

It is often argued that fiscal federalism involves considerable complexity, particularly if it involves taxation powers exerted at decentralised level, and if the needs of public service equity between the decentralised units require considerable compensation payments.

The complexity of the system increases, and, generally, transparency diminishes, the greater the range of taxes which are devolved to non-national authorities, even on the basis of tax sharing.

It will, therefore, be simpler and more efficient to devolve only a limited number of taxes, but these may be substantially transferred. There could, for instance, be almost complete fiscal autonomy of income tax. VAT would be more difficult to devolve because of its regulation, via European Union rules.

It should be noted that, unlike the German Länder and the Spanish Autonomous Authorities, local authority taxes, i.e. council taxes (now including the totality of business rates), are devolved in the UK. The intention in both Germany, a federal system, and Spain, a quasi-fiscal federal system, is to avoid strong conflicts between national tax-raising powers and regional tax-raising powers. In the UK the control is exerted via central control over levels of taxation, e.g. local authority rates.

It is not clear that this issue of the tension between complexity and transparency can ever be fully resolved. Indeed, it is sensible to aim simply to attempt to resolve major problems as they arise, rather than to seek to achieve a 'perfect' system design.

Taxes: Central or Devolved

In general, and certainly at the outset of any devolution of powers, it is spending powers only which are transferred. Devolution of taxation, except a degree of tax sharing, is generally considered to be relatively undesirable or impractical. However, as indicated above, Scotland already has control of the product of council taxes levied on domestic property and, on businesses, taxes are pooled, between the devolved administrations and the UK central administration (the same is true of Northern Ireland; from 2015 Wales, and now also, in 2016, for English local authorities on businesses). As far as the English local authorities are concerned currently they are restricted to the raising of council tax rates on domestic property by no more than 2%. However, revaluation of domestic properties has not occurred since 1991 and with low rates of house-building this source of income has not kept pace with spending requirements. The new CAs will be able to retain a proportion of the growth in business rates, if they elect a Mayor.

Property taxes (including, potentially, land value taxation) are an almost ideal tax to be devolved to non-national authorities as they are immobile and have no externalities, though there still may be an attraction for central government to impose central taxes on property, or on land, in addition to local property taxes, which may affect vertical equity between the central government and non-national authorities.

Taxes on natural resources are generally regarded as a far less attractive proposition as they are likely to distort scarce natural resource allocation.

Decentralised taxes on goods and services are used extensively in the USA and Canada, but VAT, in terms of rate setting, is not allowed to be devolved within the European Union. A sales tax, in addition to VAT would probably be regarded as unlawful by the EU.

Income taxes are a favourite source of decentralised taxation, though establishing the tax base and collection usually remain at central level.

In the case of Scotland the proposals currently being discussed are to devolve both revenue and powers to alter rates in relation to income tax; the final devolution of powers is not yet agreed and may go further than the Smith Commission recommendations.

Tax Competition

Tax competition between different decentralised regional tax jurisdictions is potentially a serious problem. So much so that tax devolution has, inevitably, lagged well behind public expenditure devolution. The problem is raising its head in relation to Scotland in relation both to corporate taxation, and to the relatively minor issue of passenger duties, particularly between the northern counties and regions of England.

For this reason tax devolutionary systems outside the UK have tended to devolve property and income taxes, which do not create externalities, providing the tax bases are controlled. As indicated above, taxes on goods and services or on company income have on the other hand tended to remain centralised. However, corporation tax on trading profits is to be devolved to Northern Ireland. Demands for a similar devolution to Scotland (and perhaps also Wales) have so far being rejected. It is argued that NI is a special case because of the border proximity of Ireland which has a 12.5 % rate of corporation tax.

Difference in income tax rates between Scotland and England could create a problem of competitiveness, which is presumably why the Scottish government has not exercised the limited powers that it currently has. As with any devolution of corporation tax the devolved administrations have to balance the suggested positive business incentivisation against the guaranteed loss of tax revenue.

Impact on Economic Growth

The impact on economic growth of fiscal federalism, which is an aspect of efficiency, has not generally been paid a great deal of attention. However, the SNP has raised the issue in relation to Scotland, indeed partly arguing that increased economic growth is a major argument for separation.

It is not possible, in this paper, to deal with the wider economic analysis required to make any realistic judgement in relation to Scotland.

However, it may be useful to indicate what should be the parameters of any analysis: these will relate to the overseas markets which are targeted by Scottish exporters; the movements in oil prices; the impact of UK fiscal and monetary policy; events in the Eurozone, particularly relating to Grexit, and, clearly, the impact of a possible BREXIT from the EU.

Ironically, Scotland has long had control over what many regard as the key human investment motor of decentralised growth, namely education. The OECD study (2013) concluded that:

“Investment in soft infrastructure appears to be more productive than investment in hard infrastructure. Summarising these findings, the main results from this paper suggests that the channel from decentralisation to growth runs through education policy and how it is organised across governments. Appropriate assignment of education responsibilities and functions across government levels and between administrations and schools appears to be key to foster prosperity.”

The City-Region Economic Growth Model

The principal economic argument in favour of the CAs approach to the devolution of powers (albeit limited to transport and economic development), is the one favoured by economic geographers, i.e. the preferred spatial economic concept of ‘city-regions’ and the associated growth model. This approach has a distinguished history, put forward by Peter Hall in 1966, and it was also advanced in the Minority Report of the 1969 Redcliffe-Maud Committee by Derek Senior. Latterly it has been linked with globalisation in terms of linking cities across national boundaries, and there is a specific EU Cities programme. Greater Manchester is perhaps the strongest model for city-regional growth (Chancellor George Osborne has recently popularised it as the Northern Powerhouse). However, though a case may be made out in relation to Greater Manchester as the regional growth hub, the case is not as overwhelming as it first appears, as indicated below.

The city-region growth model, now linked to the Combined Authorities mechanism, has wide cross-party and regional/local political support, e.g. IPPR North: Decentralisation Decade: A plan for economic prosperity, public service transformation and democratic renewal in England, 2014, and Core Cities: Declaration for Devolution, May 14th, 2015.

Notwithstanding this political support, it is important to recognise that the almost sole motivation behind the city-region growth concept is the generation of competitive economic growth. It is not aimed at equity between regions or redistribution or social justice.

But even in economic regeneration terms the city-region growth concept is inadequate. It rests, essentially, on the singular notion of agglomeration economies,

within and around the major city involved and linked to access to transport. In fact, this view of regional development is too narrow, both in economic conceptual terms and, ironically, in geographical terms.

The empirical basis for an alternative view from the city-region growth model was provided by the ESRC study (2014). The study, by researchers at the University of Cambridge, looked at the performance of the business-led Local Enterprise Partnerships (LEPs) across England, which essentially utilise the same underlying 'agglomeration economies' model and the same commitment to 'localism' as the CAs. Indeed, under the government's plans the LEPs will effectively be merged with the CAs.

Having examined the various factors which affect local growth rates the researchers concluded that:

"The relatively poor performance of the large urban areas in their local growth component tends to suggest that whatever the positive contribution to their growth made by agglomeration economies there are other factors that are still constraining their growth compared to more accessible rural areas across England".

They further concluded that:

"The priority for policy development is to move away from the temptation to rely on simple recipes such as industrial mix or agglomeration and city size, and to better understand the causes of local competitiveness effects with the goal of introducing measures that stimulate and raise these effects, particularly in large urban areas outside of London."

The factors affecting growth are complex, but have to do more with competitiveness and innovation, plus the institutional and socio-economic system aspects of the regions concerned, rather than spatial agglomeration economies. Hence, what is required is an analysis which rejects the narrow and misleading city-region approach in favour of a modern outward-looking approach to the emerging regeneration of the administrative regions, based on their specific and wider strengths, and on continuity.

It should be said that this counter-argument is not to dispute totally the economic development opportunities afforded by large city-regions. It is simply to assert that an over-concentration on these economic geographic structures will lead to an ignoring of other relevant economic development factors, e.g. company access to finance, research and development skills and capacity, wider supportive institutional factors, particularly educational structures and attainment (see OECD above), which

can lead to successful economic futures for more widely defined regions.

Moreover, emphasis on the city-region growth model – as in the new UK government’s policy towards city-regions and Combined Authorities more widely – is likely to lead to unbalanced economic growth; greater socio-economic inequity between regions and sub-regions; inequality between cities of differing size; a less democratic local and regional situation, and no substantial lessening of central fiscal control.

The Combined Authority Approach

To an extent the combined local authority area approach of the present government re-establishes the old Metropolitan Counties which were abolished by the Conservative government in 1985. There is, of course, no constitutional guarantee that this new approach will be preserved in future. The devolution of powers is principally of spending powers, plus some minor tax sharing, e.g. on business rates. No new borrowing powers are granted to the combined authorities (CAs) beyond those currently possessed by individual local authorities. On transport a transport levy may be introduced in the Greater Manchester CA. The Greater Manchester CA will also be allocated a £6 billion NHS budget to fund social care, integrated with the NHS services, and similar allocations are planned for the other CA areas. Increased funds for infrastructure are being proposed, but as yet, there is no clear indication of the current baseline funding to enable a valid estimate to be made over the next 5-year period, taking into account the projected 40% cuts in local authority budgets.

It is important to note also that the combined authorities are explicitly expected not to create a new tier of bureaucracy at the level of the new authority. However, it will be necessary for the City-led CAs to establish mayors at the level of the new authorities; starting with Greater Manchester, or the proposed fiscal devolution will not be proceeded with. This obligatory creation of new mayoral posts, without the previous requirement for a local referendum, cannot be described as democratic. In the case of Birmingham and Manchester, plus a number of other smaller cities, mayors have previously been decisively rejected in referendums.

Mayors for such unwieldy geographical areas as those envisaged are not the democratic answer. Important strategic spending decisions will be made at the level of the Combined Authorities and should be subject to full direct democratic influence in the local authority areas concerned, via the ballot-box, particularly given the power of veto which the mayors will have over devolved decisions of spending.

Existing Local Authority Borrowing Powers to be Conferred on CAs

Borrowing powers already exist for local authorities and these will be available to the combined authorities, but no new powers will be created. However, local authorities require satisfactory credit ratings from the Credit Rating Agencies (CRAs) in order to exercise the function. Few authorities have achieved this position. Obviously, the ability to combine spending powers, and potentially borrowing powers, is potentially attractive.

Local authorities have powers to borrow against the rental income generated by their housing stock, but this borrowing is subject to a national cap based on calculations made under the Housing Revenue Account ('HRA') subsidy system, which imposes tight restrictions on local authorities.

Tax Increment Finance ('TIF') schemes also already allows local authorities to borrow money for specific infrastructure projects and use the business rates generated by the project to repay the loans. Again borrowing under a TIF scheme is subject to a cap and local authorities must apply to central government before entering into such a scheme.

Finally, under 'earn back' schemes, central government may allocate funds to local authorities for specific policies that run for a fixed-term; the local authorities are allowed to retain any unspent sums at the end of the term. Such schemes are already in place in a number of local authorities, including Greater Manchester.

What is currently unclear is whether these powers will be retained for the local authorities under the CA 'umbrella', or whether the proposed increased funding for investment, which the CAs will be allocated, will mean that these powers will be suspended as far as the CAs are concerned. As indicated above, without some idea of baseline funding it is difficult to calculate whether, as CAs, the individual authorities will be better off in financial terms as far as spending is concerned. There may be some benefit arising simply from combination itself, but it is impossible, ex ante, to identify it.

Any devolution of expanded fiscal powers in terms of raising money is likely to be politically unpopular at local level, but with public services from local authorities now set to come under further financial pressure, there may be pressure to provide room for borrowing (or raising income by charges or taxes) to support essential services. However, against any substantial devolution of revenue-raising powers, including borrowing, it may, not unreasonably, be argued that any extended use of borrowing powers across the country might prejudice control over national budgets.

Hence, fiscal austerity is providing a reason for increased fiscal autonomy, but at the same time a reason for constraining it. A pragmatic resolution of this conflict of interests is going to be necessary at some point in the future.

Functional Concerns

Another issue relating to concerns about the CAs is whether or not the geographical boundaries of the CAs are efficient in functional terms. Limited city-regions may be regarded as functional, but the addition of county rural areas may create problems for achieving economies of scale via the sharing of services. The issue of such service provision also raises issues of democratic accountability and the engagement of local populations. It is difficult to see that these problems of efficiency and of accountability and engagement can be other than exacerbated by the advent of CAs having wide geographical areas and scattered and disparate electoral constituencies. The original Metropolitan Counties had contiguous functional areas and were directly accountable to the electorate within the MCs.

Finally, there is the problem that there is an invidious selection of city-regions proposed by the present government. Most UK cities are medium-sized and even the proponents of the city-regional growth model will find it difficult to argue for the more general case in relation to these 'secondary' level cities. Hence, the grounds for inequity and resentment are built-in to the current government devolution plans, aside from the more general political and economic objections.

The Special Case of London

London, of course, is a special case, as indeed it has always been because of its size and nature. There has been already a considerable degree of devolution to the Greater London Authority, partly related to the historical development of London, and its considerable growth over the past two decades.

London has powers over all aspects of transport and the police, as well as economic development, shared with the individual boroughs. It also, of course, has a Mayor and a Greater London Assembly. In terms of fiscal federalism, it has considerably enhanced spending powers. Moreover, it is able to raise revenue from the congestion charge, which is a local tax, and it has raised a bond issue to fund part of the cost of the Crossrail project.

Regions or Combined Authorities; Real Fiscal Federalism?

As we have suggested above, the CA approach is an inadequate long-term approach to fiscal federalism. It fails on a number of counts:

1. It is not a genuine federal approach. There is no constitutional guarantee of even the limited spending powers granted being retained. Moreover, the powers are circumscribed as transport and economic development (with the exception of the proposed granting of an allocation of part of an NHS budget for the CA area to cover social care provision).
2. Devolution of limited spending powers is not genuine devolution of the significant fiscal autonomy required for fiscal federalism to be a reality. This latter type of fiscal devolution will not be granted to CAs. Indeed unless the mayoralty for the whole CA area is accepted, against a short deadline, then the CA proposed arrangement will simply not go ahead.
3. The CAs have no institutional apparatus (e.g. like the RDAs) or democratic capacity or accountability (like the metropolitan boroughs) to go beyond their allocated combined powers, and, indeed, are actively dissuaded from acting in such a manner.
4. Their geographical coverage is broadly the same as the earlier metropolitan boroughs (excepting the two county extensions on the Tyne and Wear CA).
5. To an extent the CAs will be in competition with the private/public, business-driven LEPs, even though local authorities are represented on the boards of LEPs. In some cases good relations may overcome this problem (e.g. in Tyne and Wear)
6. The CAs will interact directly with the European regional development and training funding programmes. However, increasingly many of the EU funding programmes are now managed nationally rather than regionally.
7. Only in the case of Greater Manchester are extra powers for NHS spending currently being devolved, though similar proposals for the other CAs are in train. This £8 billion spending devolution from the English NHS budget is an experiment, the implications of which have not been adequately considered. The current uncertainties and difficulties experienced in Scotland and Wales in relation to health and social care budgets over the past years do not suggest that the experiment will be without problems.

8. The CAs seem unlikely to be given any significant fiscal autonomy outside the specific areas granted, despite substantial pressures on the provision of services at decentralised level, including those required to be delivered by statute.
9. As we have argued earlier in the paper, the city-region economic growth model underlying the CA approach is flawed and is unlikely to achieve the expected growth benefits, unless combined with a more sophisticated understanding of the key factors required to achieve regional economic growth.
10. Potential resentment will be caused in 'secondary' level cities and urban areas at being excluded from the devolution of spending powers and possibly increased revenues.

These failures, in respect of devolution of powers (of principally spending powers only) to a few CAs as decentralised units, cannot be said to represent a well-founded design of fiscal federalism. It is simply further evidence of the tendency of the UK central administrations to pursue ad hoc solutions, without any full consideration of the medium- or long-term political or economic implications.

What is required is a constitutional regional approach to fiscal federalism. Only in this way will a stable and democratic balance of powers between the UK's nations and regions be achieved.

An Administrative Regions Approach

The immediate first question to be asked is which regions? It is often argued that many of the 9 English administrative regions are simply artificial constructs, which have no functional economic basis and, in some cases, no cultural basis. These objections are challenging, but are not fatal to the concept of administrative regional devolution in the context of fiscal federalism.

Administrative economic regions. We will not repeat the arguments and empirical evidence challenging the agglomeration economies sustaining the city-region growth model. It is sufficient to indicate that growth will be enhanced via the wider coverage of the administrative regions, and hence the ability to incorporate the relevant wider geographical dimensions covering rural development, and contributions to economic growth from key institutional and system aspects of the region.

The cultural dimension. It is argued that Scotland, Wales, and Northern Ireland are culturally distinct from England, and that England, as a whole, has a broadly coherent culture. But this is an overly simplistic view. Some English regions do have a clear and expressed cultural identity. The North-East, Yorkshire and Humberside, the North-West, Cornwall, which admittedly is currently part of the South-West administrative region, all demonstrate distinct regional cultural identities.

Given the above points (aside from the obvious fact that 84% of the UK population reside in England), the argument that England as a whole should be the basis of the devolved administration, because of a single coherent English culture, is further weakened. There are many divergent regional cultures, within England. Insofar as the arguments for devolution to Scotland are based on its cultural distinctiveness it can be argued that so should any economic case for fiscal federalism be bolstered by similar English regional considerations, Cornwall being the most striking example. However, there is a further, more general, argument against the coherence of English nationalism, which militates in favour of regional identities.

English nationalism is a more slippery concept than might be imagined. As Kumar (2003) persuasively argues, for the English, presiding over an empire, there was no distinction made between being English and being British. In the global world of the British Empire to be British was sufficient. It also enabled the Scots and Welsh to be co-opted into the British identity and to play key roles in imperial Britain.

But it is clear that until relatively recently (the last 20 years), with the increasing devolution to the Celtic nations, and the rise of a more aggressive Scottish ethno-nationalism, English nationalism has been a subdued affair. The even more recent rise in popularity of UKIP – an essentially right-wing English nationalist party – has drawn attention to demands for an English parliament. As Kumar suggests – despite UKIP's appeal in both some suburban and rural middle-class areas and some socially and economically deprived working class enclaves – the vision of Englishness presented is taken from the 1920s: "It is an England that is rural or small-town, white, male, middle or upper-middle class, and fearful of change and the challenges of a global, multi-cultural world" (Kumar, 2003).

This latter-day, English nationalism appears to be being forged by a challenge from the nationalism in Scotland (and, to a lesser extent, Welsh nationalism) and a fear of globalisation. This pressure and tension is exacerbated, for some English nationalists, by the fact of the UK's membership of the European Union.

Despite the relatively recent emergence of this nostalgic, anachronistic form of English nationalism, it has led some, and not only on the right, to argue that UK

federalism should mean a federal structure involving Scotland, Wales, Northern Ireland, and England, as a single entity, with an English parliament. Leaving aside the obvious problems of Northern Ireland, this exclusion of devolution for English regions is both neglectful of the need for constitutional regional devolution and would represent a completely unbalanced federal structure, dominated by England.

The case for constitutional regional devolution in England, therefore, appears strong, on cultural grounds. This provides additional arguments (admittedly stronger in some regional areas than in others) to the arguments on democratic and on economic grounds. Such a constitutional federal settlement would, ideally, embed a workable, evolving fiscal federalism across the UK. The settlement will meet a number of conditions, clearly not met by the CAs approach.

Comparing the Alternatives

If we compare the alternatives (CAs and English administrative regions) then the arguments against the devolution approach as expressed in the CA concept, essentially based on the city-region economic growth model, may be summarised as:

It in no way addresses the issues of economic and social equity and redistribution.

1. The patchwork design and implementation of CAs will provoke resentment from the smaller city and urban areas and institutions adjacent to the main city growth pole.
2. Even in terms of economic growth it is a uni-valued, spatial growth strategy which ignores the complex of factors which determine economic and social prosperity.

On the other hand, the arguments in favour of the wider administrative regional devolution approach are:

1. It will be a genuine constitutional regional settlement and will address the current set of discontents among the English.
2. It will provide an approach to the devolution of fiscal powers which will enable a region-wide, broad-based approach to economic growth, taking into account both key geographic and institutional/system contributions to economic development.
3. It will enable fiscal autonomy to be devolved over time and in the context of a UK-wide fiscal federalism.

The Pathway to English Regional Devolution and a Comprehensive UK Fiscal Federalism

In order to begin the process of achieving UK fiscal federalism, via devolution of fiscal and other powers to the whole of the component parts of the UK, the establishment of a Constitutional Convention is required, with an appropriately wide remit.

One of the key issues will be the size, nature, and number of administrative regions in England. A comparison with Germany may be instructive. In Germany there are 16 Länder, varying in size from the 3 city states of Bremen (including Bremerhaven), Hamburg, and Berlin to the 13 wider regional Länder, the largest of which is North Rhine-Westphalia at 17.5 million and the smallest is the Free Hanseatic City of Bremen at 661,000. There may be a need to adjust the current boundaries of the 9 UK administrative regions (NUTS1 regions in EU parlance), including Greater London. Possible changes might include establishing Cornwall as a separate region and marginally adjusting the boundaries of the South-East, South-West, and possibly the North-West.

There should be a commitment on the part of all political parties to abide by the recommendations of the Convention's Final Report. This could be assisted by the publication of an Interim Report, to be widely consulted on and debated in both houses of the UK parliament.

The final report should set out a comprehensive blueprint for the final outcome of the process of devolution and fiscal federalism. However, part of the remit of the Convention should be to suggest a staged approach to devolution in England, following the same evolutionary pattern as that in Scotland and in Wales.

Hence, though there would be a clear, rational approach to fiscal federalism, the path to the final destination would be gradual. This path may lead to a multi-speed approach, in the UK as a whole, to fiscal federalism and to constitutional political devolution. This situation would be perfectly manageable and would proceed on the basis of democratic decision-making in the regions. Indeed, it will be advantageous for regions to be able to learn of any problems in implementation from other regions or from Scotland, Wales, or Northern Ireland. In any case, this disparate situation is the one which currently applies across the UK, between England and the rest of the UK devolved administrations.

Conclusion

Currently, the UK is stumbling forward, almost blindly, to an inexorable movement towards an incoherent degree of fiscal federalism. Devolution to Scotland, Wales, and Northern Ireland over the last number of decades has been prompted by a need to resolve certain political problems as they have arisen and are still arising. The strongly centralised nature of the British state and the traditional British empirical method of dealing with problems, including fiscal federalism, are no longer sufficient to deal with the pressures for change. In relation to Scotland the fissiparous tendency is evident. But there are other tensions arising from the growth of English nationalism, relatively dormant until the last decade or so, and now asserting its right to be heard, both in the UK and within the EU, given a strident and discordant voice by UKIP to match the extremes of the SNP.

The Smith Commission's retention of the Barnett formula is mistaken. Its attraction is essentially its convenience, but as its international uniqueness indicates it is difficult to provide a rationale for this approach to block grant settlement. The arguments in favour of substituting a needs-based formula are strong, as indicated earlier in this paper. Such a needs-based approach can be devised (see above) which need not be unnecessarily complex, but would better meet equity requirements.

These political tectonic shifts, challenging also the central political and administrative elites, are reinforced by the financial and economic dimensions of the pressure for decentralisation, devolution, and localism. The response of Whitehall and Westminster has been to provide 'devolution on demand'. Hence, we are now moving to a situation in Scotland which is approaching the fiscal federalism of Switzerland and in the direction of Canada. But this is not being accompanied by a parallel devolution to Wales or to the English regions. Instead the ad hoc groupings of English local authorities, Combined Authorities, are being 'awarded' new powers and funding in relation to transport, skills, and economic development, initially under the aegis of the Localism Act 2011. Localism is a form of decentralisation of spending and of limited tax-sharing, but it falls far short of the regional settlements which would usher in a constitutional fiscal federalism, akin to that allocated to the nations in the UK.

This is not to argue for an immediate parallel re-allocation of fiscal powers to the English regions which is now being settled on Scotland, and to a lesser extent

Wales, or Northern Ireland, but a start should be being made in that direction and within the same constitutional legal framework. A 'variable geometry' approach will be an appropriate way forward, linked to demand for powers on the ground in each of the regions.

That some decentralisation of governance in the UK is required, and more particularly in England, is now common political ground for all political parties. Such changes necessarily involve degrees of fiscal federalism and hence considerations of equity, efficiency, and accountability. The existing institutions, including those of local government, will inevitably argue for reforms which will enhance their role. The issue is whether such an approach, currently being pursued in England, will meet the long-term internal constitutional and economic needs of the UK, set in a changing and challenging European Union context. It is imperative that we establish a Constitutional Convention to establish the guidelines for a rational and pragmatic approach to the achievement of a balanced fiscal federalism, particularly for the English regions, which meets both political and economic objectives for the whole of the UK.

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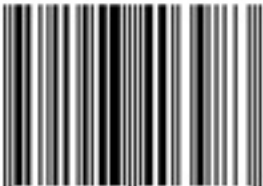
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This paper reviews the current degree of fiscal federalism across the UK, i.e. effectively between the UK central government and the devolved administrations of Scotland, Wales, Northern Ireland, together with the developing scenarios of the spending powers being allocated to the Combined Authorities: the recent groupings of English local authorities. The paper argues against this last-mentioned, diluted form of fiscal devolution being activated in England, arguing that it is economically dysfunctional, unequal in its application to cities, reduces democratic control at local level, and offers no more than a marginal increase in fiscal autonomy.

The paper recommends a full constitutional fiscal federalism for the English administrative regions as well as the already devolved UK national and provincial administrations, and the special case of London. The economic, political, and cultural dimensions are discussed, including a rejection of the city-region economic growth approach. The paper concludes by arguing that unless there is a genuine federal constitutional settlement, for the UK as a whole, involving a step-by-step move to full economic and political devolution, then a comprehensive and sustainable UK fiscal federalism will not be achieved.

ISBN 978-1-903403-98-1



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