Public Expenditure in Scotland & Wales

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This paper looks at three issues relating to public expenditure in Scotland and Wales that may provide useful background to the debate on devolution. It summarises the Treasury's latest analysis of identifiable public expenditure by country, looks at recent estimates by the Scottish Office and Welsh Office of total expenditure, revenues and borrowing in the two countries and describes the so-called Barnett formula. For further information about detailed expenditure plans of the Scottish Office and Welsh Office readers are referred to the relevant departmental reports [Cm 3614 & Cm 3615]

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I Introduction & summary

The level of expenditure on services in Scotland and Wales has featured in the devolution debate, as has the financing of such expenditure. This paper does not look at possible future arrangements, but, as background to the debate, provides information on three issues relating to the present situation.

The Treasury produces annual estimates of 'identifiable' public expenditure in the four home countries. These indicate that the level of per capita spending in Scotland and Wales is significantly above that in England. However, there is evidence to suggest that these differentials are, to some extent, justified by different levels of needs. Section II provides further details.

In the last two years the Scottish and Welsh Offices have published estimates of total expenditure, revenues and borrowing in their areas. These suggest that, relative to GDP, borrowing is higher in Scotland and Wales than in the UK as a whole. Section III provides further details.

One element in determining the annual budgets of the Scottish and Welsh Offices is the so-called Barnett formula. The 1995 Executive Committee's report to the Scottish Constitutional Convention stated that: "...the current formula for the calculation of government expenditure in Scotland - the Barnett formula - will continue to be used as the basis of the allocation of Scotland's fair share of UK resources. We recognise that any formula will need to be jointly reviewed from time to time."[1] Section IV provides further details of the current system.

[1] *Key Proposals for Scotland's Parliament*, p.14

II Identifiable general government expenditure

Although much public spending in Scotland and Wales is conducted within the responsibility of the relevant secretary of state, some major areas of expenditure (in particular social security) are the responsibility of Whitehall departments. Each autumn the Treasury conducts a territorial analysis of public expenditure that, to a large extent, apportions spending to each of the four home countries. The results are currently published in the *Public Expenditure: Statistical Analyses* white paper but, prior to 1991, appeared as answers to written parliamentary questions.

The territorial analysis only covers 'identifiable' general government expenditure on services. Expenditure not on services (e.g. debt interest) is excluded as is spending on services which either cannot be split between the home countries on the basis of the available information or is deemed to be spent on behalf of the UK as a whole (e.g. defence and overseas aid). In the latest analysis, identifiable spending in 1995/96 represented some 75% of general government spending excluding privatisation receipts and some 85% of spending on services.[2]

The table below shows identified spending in Scotland and Wales in 1995/96 analysed by function and department.

Table 1

Identifiable General Government Expenditure
Spending by function and department: 1995/96: £ million

Function	Scotland			Wales		
	Scottish depts	Other depts	Total	Welsh Office	Other depts	Total
Agric., fisheries & food	515	2	517	241	1	242
Trade, ind'y, energy & employ't	527	145	672	239	69	308
Roads & transport	841		841	467		467
Housing	731		731	387		387
Other environmental services	1,354		1,354	762		762
Law, order & protective services	1,325	47	1,372		575	575
Education	4,062		4,062	1,655	167	1,823
National heritage	284		284	90		90
Health & personal social serv's	5,082		5,082	2,674		2,674
Social security		8,608	8,608		5,290	5,290
Miscellaneous expenditure (a)	177		177	75		75
Total	14,899	8,801	23,700	6,591	6,103	12,693

Note: (a) Includes central administration of the Scottish & Welsh Offices.

Source: Cm 3601 table 7.7

2 HM Treasury, *Public Expenditure: Statistical Analyses 1997/98*, Cm 3601

In 1995/96 spending by the Scottish departments represented some 63% of total identifiable expenditure in Scotland and spending by the Welsh Office represented some 52% of total identifiable expenditure in Wales. In both cases DSS spending on benefits was the next most important form of spending. In Wales there was also significant spending by the Home Office on law and order.

The table below summarises compares total identifiable spending in Wales and Scotland in the years 1991/92 to 1995/96 with that in the other constituent parts of the UK..

Table 2

Identifiable General Government Expenditure

Total spending on services: 1991/92 - 1995/96

Financial year	England	Scotland	Wales	Northern Ireland	United Kingdom
{A} £ million (cash)					
1991/92	143,581	17,885	9,367	6,725	177,558
1992/93	156,263	20,110	11,030	7,322	194,725
1993/94	166,527	21,571	11,709	7,813	207,619
1994/95	175,989	22,898	12,294	8,173	219,354
1995/96	183,063	23,700	12,693	8,474	227,929
{B} £ per resident (cash)					
1991/92	2,978	3,502	3,240	4,200	3,072
1992/93	3,230	3,935	3,805	4,524	3,357
1993/94	3,431	4,213	4,029	4,788	3,568
1994/95	3,613	4,461	4,220	4,979	3,756
1995/96	3,743	4,614	4,352	5,139	3,889
{C} Per resident (percent of UK)					
1991/92	97	114	105	137	100
1992/93	96	117	113	135	100
1993/94	96	118	113	134	100
1994/95	96	119	112	133	100
1995/96	96	119	112	132	100

Source: Cm 3601 table 7.1

In 1995/96 identifiable expenditure in Scotland was equivalent to £4,614 per resident, which was 19% above the UK average of £3,889. Expenditure in Wales was equivalent to £4,352 per resident, which was 12% above the UK average. Spending in England was some 4% below the national average and spending in Northern Ireland some 32% above the national average.

A more detailed analysis for 1995/96 is contained in table 3 (overleaf).

Table 3

Identifiable General Government Expenditure
Spending on services by function: 1995/96

Function	England	Scotland	Wales	Northern Ireland	United Kingdom
{A} £ million					
Agric., fisheries & food	2,384	517	242	270	3,412
Trade, ind'y, energy & employ't	3,878	672	308	484	5,341
Roads & transport	8,442	841	467	184	9,934
Housing	3,326	731	387	239	4,683
Other environmental services	7,333	1,354	762	306	9,755
Law, order & protective services	12,044	1,372	575	1,035	15,025
Education	28,773	4,062	1,823	1,430	36,088
National heritage (a)	2,361	284	90		2,735
Health & personal social serv's	39,412	5,082	2,674	1,523	48,691
Social security	75,112	8,608	5,290	2,943	91,954
Miscellaneous expenditure (b)		177	75	59	312
Total	183,063	23,700	12,693	8,474	227,929
{B} £ per resident					
Agric., fisheries & food	49	101	83	163	58
Trade, ind'y, energy & employ't	79	131	106	293	91
Roads & transport	173	164	160	112	170
Housing	68	142	133	145	80
Other environmental services	150	264	261	186	166
Law, order & protective services	246	267	197	627	256
Education	588	791	625	867	616
National heritage (a)	48	55	31		47
Health & personal social serv's	806	989	917	924	831
Social security	1,536	1,676	1,814	1,785	1,569
Miscellaneous expenditure (b)		34	26	36	5
Total	3,743	4,614	4,352	5,139	3,889
{C} Per resident (percent of UK)					
Agric., fisheries & food	84	173	142	281	100
Trade, ind'y, energy & employ't	87	144	116	322	100
Roads & transport	102	97	94	66	100
Housing	85	178	166	182	100
Other environmental services	90	158	157	112	100
Law, order & protective services	96	104	77	245	100
Education	96	128	101	141	100
National heritage (a)	103	119	66		100
Health & personal social serv's	97	119	110	111	100
Social security	98	107	116	114	100
Total	96	119	112	132	100

Notes: (a) Expenditure on national heritage in Northern Ireland is included in education.
(b) Includes central administration of the territorial departments.

Source: Cm 3601 table 7.6

In 1995/96 there was considerable variation between functions in the relative levels of per capita spending. For example, per capita spending on roads & transport in both Scotland and Wales was below the national average whereas spending on housing is almost twice that in England.

There are some limitations to this type of analysis. There is not necessarily a simple relationship between the geographic area in which money is spent and the resident who benefit. For example, roads (and other transport infrastructure) benefit people other than local residents. It is also important to remember that this analysis is not exhaustive and only covers around three-quarters of total spending. Other forms of assistance, including tax expenditures such as MIRAS, are also excluded. The analyses described in Section III attempt to provide, albeit on an approximate basis, a more comprehensive analysis.

There are reasons why it may be appropriate for per capita spending in Scotland and Wales to be higher than in England. For example, the more sparsely distributed population makes the provision of equivalent services more expensive and a larger agricultural sector would imply higher spending on agricultural support. Also, for much of the post-war period, much of Scotland and Wales have experienced declining traditional industries and relatively high unemployment.

An inter-departmental study (co-ordinated by the Treasury) in the late 1970s attempted to assess the extent to which per capita expenditure in Scotland and Wales would need to be higher than in England in order to provide a comparable level of services.[3] This exercise - which was based on data for 1976/77 - looked at the six main services which were to have been devolved under the Scotland and Wales Acts (1978).[4] Using a large range of 'objective factors' such as the age distribution of the population, road lengths, recorded crimes and numbers of sub-standard dwellings, the authors estimated the cost of providing an equivalent level services in Scotland, Wales and Northern Ireland to that in England. The overall results (albeit heavily qualified by considerations about the methodology) were that per capita spending in Scotland would need to be some 16% higher than in England, spending in Wales 9% higher and spending in Northern Ireland 31% higher. The precise results are not directly compatible with the data in tables 1 to 3, but they do suggest that any system that equalised expenditure on the basis of needs would result in per capita spending in Wales and Scotland being above that in England.[5]

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3 HM Treasury, *Needs Assessment Study – Report*, 1979

4 Health & personal social services, education (excluding universities), housing, other environmental services, roads & transport (excluding railways) and law, order & protective services (excluding the police)

5 For example, the coverage of devolved services is more restricted than identifiable spending and the relative levels of the underlying objective factors will have changed.

III Total expenditure, revenue and borrowing

A. General

As stated in Section II, the annual geographical analysis of public expenditure is limited to *identifiable* general government *expenditure* on *services.* The emphasis shown in italics is important as it clearly restricts the remit of the analysis:

- non-identifiable expenditure is excluded;
- expenditure not on services (e.g. debt interest) is excluded;
- most importantly of all, the analysis is restricted to expenditure and makes no attempt to assess revenue flows.

The expenditure and revenue flows will undoubtedly form a vital part of the debate surrounding the constitutional future of Scotland and Wales. Politicians, academic researchers and others have already given attention to the size of any budget deficit or surplus for Scotland.[6]

There is no single official publication that draws together information from the three territorial Departments and the Treasury to produce an integrated set of accounts for the four home countries, covering both expenditure and revenue.[7]

Separate exercises have however been conducted by the Scottish[8] and Welsh[9] Offices which seek to estimate an overall budget position for these two countries. It should be pointed out that these do not speculate on possible future constitutional arrangements or on how these might affect expenditure and revenue flows. The objective is solely to examine the existing position with the available data. Even at this level it is necessary for various assumptions to be made - about spending on non-identifiable services, and especially in connection with attributing tax revenues to each country.

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6 see for example the Scottish National Party's paper published in September 1995 *For the Good of Scotland: Paying our Fair Share - and More!* and the study published in the Fraser of Allander Institute Quarterly Economic Commentary Vol. 20 No.3 entitled *The Scottish Public Finances in 1992/93* by Jim Stephens (March 1995).

7 Figures for total expenditure, revenue and borrowing in England (calculated as a residual) appeared in a written answer on 5 June: HC Deb c.211W.

8 *Government Expenditure and Revenue in Scotland 1994/95*, Scottish Office, October 1996

9 *Government Expenditure and Revenue in Wales 1994/95*, Welsh Office, January 1997

B. Expenditure

The exercises take as their starting point the figures for identifiable public expenditure. Estimates are then built in for non-identifiable expenditure and other expenditure. The sum of these three components is referred to as "General Government Expenditure" (GGE). The paragraphs below consider each of these areas in turn.

Non-identifiable expenditure on services

Expenditure is described as "non-identifiable" for one of two reasons: either it cannot be identified from official records as having been incurred in a particular part of the UK (e.g. some expenditure on law and order and protective services), or else it is deemed to be incurred on behalf of the UK as a whole (e.g. defence). There are a number of ways in which expenditure in the latter category can be allocated, but the two most obvious methods are on the basis of each country's share of UK population or its share of UK GDP. In both the Scottish Office and Welsh Office studies, non-identifiable expenditure is apportioned on the basis of GDP share.

Defence expenditure constitutes by far the greatest component of non-identifiable expenditure on services, and for this reason has attracted a certain amount of attention in the way in which it is treated for this analysis. In the official studies the view taken is that defence spending benefits everyone in the UK and should therefore be apportioned on a pro-rata basis (GDP share). It is implicitly difficult to allocate expenditure on the basis of where the armed forces are stationed, since many are based abroad.

Both official studies have however made an assessment of *where* defence expenditure is spent, as opposed to *who benefits*. Figures supplied by the Ministry of Defence estimate that in 1994/95 around 8½% of UK defence equipment expenditure was incurred in Scotland and around 1% in Wales. Whilst the Scottish figure is very close to its GDP share, the Welsh figure is significantly lower. Alternatively, Scotland's share of the deployment of UK-based armed forces is around 9% and its share of UK-based MoD civilians is about 10%. For Wales the corresponding figures were 2.8% for military personnel and 4.3% for civilians. Taken together, these estimates would suggest that if defence expenditure were to be apportioned on the basis of where the expenditure was actually incurred, the figure for Scotland would be slightly higher and that for Wales some what lower.

Other expenditure

"Other" expenditure includes a number of items which do not fall easily into either identifiable or non-identifiable categories of expenditure, such as central government and local authority debt interest, VAT refunds within central and local government, privatisation proceeds and various national accounts adjustments. These items are allocated in various different ways. Most are allocated on the basis of GDP share (with privatisation proceeds treated as negative expenditure). Two items however are treated differently: local authority debt interest and the imputed capital consumption charge (see below).

Local authority debt interest (other than to central government) is allocated on the basis of known figures for interest payments made by Scottish and Welsh local authorities respectively to bodies other than the Public Works Loan Board.[10]

The final item of other expenditure is the adjustment to bring the estimates in line with the National Accounts. The major component of this is the imputed capital consumption charge (ICCC). In simple terms, this is the depreciation charged for the consumption of capital assets owned outright by central and local government. In the case of Scotland, the ICCC is more than three times what its GDP share would suggest. This is for two main reasons: firstly, Scotland has a relatively large stock of local authority housing compared with the rest of the UK, and secondly, the water supply industry in Scotland is still within the public sector. An offsetting figure is included in the "other revenues" category since the expenditure is counted on a "double-entry" basis.

C. Revenue

It should be emphasised that the estimation of revenue due to Scotland and Wales is rather more difficult than the estimation of GGE. There are a number of factors that make the overall estimation complicated, for instance:

- there is a variety of administrative arrangements in collecting different taxes (e.g. income tax is collected by the Inland Revenue and VAT is collected by Customs & Excise);
- the differences between the concepts of tax receipts and liabilities;
- for company taxation, whether taxes are allocated on the basis of operations in a particular part of the country or location of the company HQ.

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10 These are excluded since they represent transfers within the government sector.

The notes below outline how the main items of tax revenue are allocated to Scotland and Wales. Where there is no obvious means of allocating receipts between countries the GDP share is applied. Full lists can be found in the respective publications from the Scottish and Welsh Offices. The sum of all the revenues is referred to as "General Government Receipts". In the following analysis all North Sea oil receipts are excluded.

Income tax

Income tax is allocated to each country on the basis of data from the Survey of Personal Incomes (which is conducted by the Inland Revenue each year) which relate to the distribution of income tax liabilities. Employees are allocated according to their place of residence and the self-employed according to their business address.

Corporation tax

Corporation tax is levied on company profits, after the deduction of capital allowances and other reliefs. A large proportion of revenue is collected from companies which have operations located in different parts of the country, so it is not meaningful to allocate corporation tax on the basis of where it is collected. Instead, the method used for both Scotland and Wales is to apportion overall UK revenues on the basis of each country's share in gross trading profits and surpluses less stock appreciation as estimated in the Regional Accounts by the Office for National Statistics.

Inheritance tax

For Scotland, the figure for inheritance tax is based on inheritance tax collected in Scotland from Scottish residents by the Scottish Capital Taxes Office. For Wales, the figure is based on the Welsh share of income tax liabilities applied to total UK inheritance tax receipts.

Social security contributions

The estimate for each country was made from the Regional Accounts. These figures are based on the Department of Social Security's one per cent sample of National Insurance records.

VAT

Most of the expenditure to which VAT is attributed relates to spending by consumers. The Scottish and Welsh share of VAT revenue is therefore estimated on the basis of each country's share of consumer expenditure on those goods and services on which VAT is paid. The source of the data for consumer expenditure is the Regional Accounts and the Family Expenditure Survey.

Duties

For duty on tobacco and alcohol, revenues are again allocated according to each country's share of consumer expenditure on these items. These are calculated separately, to reflect differences in the level of consumption (e.g. the consumption of spirits in Scotland is relatively higher than that of wine). Duties on petrol and diesel are derived by apportioning the UK figure to each country on the basis of their recorded deliveries of each fuel.

Council tax

Separate data for council tax receipts are available.

D. General Government Borrowing Requirement

The measure of fiscal deficit used here is the General Government Borrowing Requirement (GGBR) excluding privatisation receipts and North Sea oil revenues, i.e.:

General Government Expenditure (GGE)
excluding privatisation proceeds

less: General Government receipts (GGR)
excluding North Sea oil

It should be noted that the fiscal deficit is the difference between two large numbers, both of which are estimates, and as such are subject to potentially very large margins of error. Each individual estimate will be sensitive to the assumptions that underpin them. The figures should therefore be viewed as indicative rather than precise.

Table 4 [opposite] summarises the budget position of the two countries in comparison to the UK as a whole.

The figures in this table are taken from the two departmental studies and are based on the 1994/95 financial year. At the time these studies were undertaken the most recent edition of the *Statistical*

Analyses available was the one published in March 1996. Table 4 is therefore consistent with that particular publication and not necessarily with the more up-to-date March 1997 edition.

In 1994/95 it is estimated that Scotland had a fiscal deficit of £8.2 billion (equivalent to 14% of Scottish GDP) and that Wales had a fiscal deficit of £5.7 billion (20% of Welsh GDP). On a comparable basis the UK as a whole had a deficit of £47.9 billion, equivalent to 7.3% of UK GDP. This analysis, of course, relates only to one particular year: 1994/95. It should be recalled that the UK's fiscal deficit reached a peak in 1993/94 and has been on a downward trend since then. The most important determinant of the fiscal position of both Wales and Scotland is that of the UK as a whole, so the downward trend in the UK is likely to be mirrored in the constituent countries. It does however remain the case that both Scotland and Wales had significant fiscal deficits in 1994/95. Furthermore in per capita terms and as shares of GDP these deficits were above that for the UK as a whole.

E. North Sea oil revenues

In 1994/95 UK oil receipts were estimated by the Inland Revenue to be £1.64 billion. In terms of the Regional Accounts, the UK Continental Shelf is treated as a separate region. For the purposes of the Scottish Office study therefore, all North Sea oil revenues are treated as accruing to the Continental Shelf and not to Scotland.

Within the context of the debate about constitutional change, attention has been drawn to the allocation of North Sea oil revenues. For this reason the Scottish Office study has produced a number of different estimates of how the fiscal balance might look if various different allocations of North Sea oil revenues were to be applied. The results of these are shown in table 5 (page 17).

Table 4

Estimated Budget Position: Scotland and Wales
1994/95

		Scotland		Wales		UK	
		£ billion	£ per head	£ billion	£ per head	£ billion	£ per head
Expenditure							
Identifiable		23.1	4,505	12.3	4,208	219.6	3,760
Non-identifiable	E	3.3	643	1.7	584	40.2	688
Other	E	3.9	760	1.6	549	35.7	612
Total General Govt. Expenditure (excl. privatisation proceeds)	**E**	**30.3**	**5,908**	**15.6**	**5,341**	**295.5**	**5,060**
Privatisation Proceeds	E	(0.6)	(117)	(0.3)	(89)	(6.3)	(108)
Total General Govt. Expenditure (incl. privatisation proceeds)	**E**	**29.7**	**5,791**	**15.3**	**5,252**	**289.2**	**4,952**
Revenue							
Income Tax	E	5.0	974	2.2	755	63.1	1,081
Social Security Contributions	E	3.7	721	1.8	618	42.1	721
Value Added Tax	E	3.6	701	1.7	584	41.8	716
Local Authority Revenues	E	2.1	409	0.6	206	22.4	384
All Other revenues	E	7.7	1,500	3.5	1,202	78.2	1,339
General Government Revenue (a)		**22.1**	**4,306**	**9.9**	**3,399**	**247.6**	**4,240**
Fiscal Deficit (b)	**E**	**(8.2)**	**(1,602)**	**(5.7)**	**(1,942)**	**(47.9)**	**(820)**
as % of GDP		*14.0%*		*20.0%*		*7.3%*	

Notes: (a) Excluding North Sea oil receipts completely.
(b) General Government Borrowing Requirement excluding privatisation proceeds. GGBR differs from the PSBR in that it relates only to central and local government borrowing and does not include the market and overseas borrowing of the nationalised industries & other public corporations.
(c) "E" indicates that the figures for Scotland and Wales are estimated
(d) Figures are consistent with the two departmental studies and with the 1996 edition of the Public Expediture Statistical Analyses white paper.

Source: Government Expenditure and Revenue in Scotland 1994/95; Scottish Office, October 1996
Government Expenditure and Revenue in Wales 1994/95; Welsh Office, January 1997

Table 5

1994/95 Fiscal Balance for Scotland (£ billion)
Effect of Different Allocations of North Sea Oil Revenues (a)

	GGR	GGE (b)	GGBR (b)	GGBR (c)
North Sea revenues completely excluded (e)	22.1	30.3	-8.2	-7.6
North Sea revenues allocated by GDP share	22.3	30.3	-8.0	-7.5
North Sea revenues allocated by population share	22.3	30.3	-8.0	-7.5
66% of North Sea revenues included	23.2	30.3	-7.1	-6.5
80% of North Sea revenues included	23.4	30.3	-6.9	-6.3
90% of North Sea revenues included	23.6	30.3	-6.7	-6.2
All North Sea revenues included	23.8	30.3	-6.5	-6.0

Notes: (a) North Sea Oil revenues were £1.64 billion in 1994/95
(b) Excluding privatisation proceeds
(c) Including privatisation proceeds
(d) As per table 4

Even when all North Sea oil revenues are allocated to Scotland, it is estimated that the fiscal deficit would still be £6.5 billion in 1994/95 (£6.0 billion when privatisation proceeds are included). To facilitate a meaningful comparison when expressing the size of the fiscal deficit including various proportions of oil revenues as a percentage of Scottish GDP, the latter should also incorporate the relevant proportion of output from the Continental Shelf. For example, if all oil revenues *and output* are allocated to Scotland, the fiscal deficit is estimated to be 8¾% of (the now much higher) Scottish GDP, compared to 6% for the UK as a whole. Therefore, whilst the addition of North Sea oil revenues to Scottish GGR (and also to Scottish GDP) clearly reduces the size of the fiscal deficit, a deficit nevertheless clearly remains.

F. The SNP Study

The Scottish National Party (SNP) has published its own estimates of Scotland's fiscal balance. Whilst some aspects of methodology are similar to that used by the Scottish Office, others represent a clear departure from the official analysis. Their figures are presented in its policy paper entitled *For the Good of Scotland: Paying Our Fair Share - and More!* The SNP calculations use the Public Sector Borrowing Requirement (PSBR) as the main measure of fiscal deficit. Using their methodology, Scotland would have a fiscal deficit of £1.7 billion in 1995/96, compared to a figure of £1.9 billion if the UK's PSBR were apportioned on a per capita basis: Scotland therefore had a fiscal deficit **per capita** below that for the UK.

The SNP start their calculations by using the 1993/94 edition of the Scottish Office study, which was the latest one available at the time of publication. Figures were then up-rated to 1995/96 by applying the proportions for Scotland from the study to later UK-wide data.

Looking first at the expenditure side, identifiable expenditure is taken directly from the Scottish Office study. The treatment of non-identifiable expenditure differs from that used in the official studies in that most is allocated - as far as is possible - on the basis of where it is spent, rather than who necessarily benefits. Expenditure which can be reasonably thought not to have been spent in Scotland is therefore excluded from any pro-rata apportionment. Thus defence expenditure is allocated in this way, as is much of the spending on central administrative functions, such as the collection of taxes, collection and processing of official statistics and the running costs of Whitehall departments.

The main difference between the treatment of revenue between the SNP study and the Scottish Office figures is on income tax. The Inland Revenue data used by the Scottish Office are further adjusted to take account of lower average earnings in Scotland compared to the UK as a whole. The SNP argues that Scotland subsidises the UK on mortgage interest relief at source (MIRAS). They allocate a figure of 8.8% of income tax receipts to Scotland, but since only 6.5% of the total cost of MIRAS (using SNP figures) benefits Scotland[11], this again amounts to a subsidy *by* Scotland.

Using these calculations, the SNP estimates that GGE in Scotland in 1995/96 was £29.0 billion and GGR was £27.2 billion, leaving a GGBR of £1.8 billion. This is then adjusted for borrowing by public corporations to give a PSBR figure of £1.7 billion - £200 million *less* than a pro-rata share.

G. The Labour Party View

Since being elected to office the Labour Party has not published detailed plans about how public expenditure and revenue may change as a result of its intended policies of introducing a Scottish Parliament and a Welsh Assembly. It is, however, widely known that one of the options for a Scottish Parliament would be to allow it to vary the basic rate of income tax by up to three pence in the pound.

11 The share of MIRAS actually benefiting Scotland is less than a per capita share because of lower property prices (and therefore average mortgages) and a lower level of home ownership generally.

In response to allegations by the Conservatives in spring 1995 that a tax-raising Scottish Parliament could cost the average Scottish family an extra £6 per week, Tony Blair stated that: "…in the UK resources are pooled at the centre and then distributed according to need. That is what dictates Scotland's level of public expenditure now and the same will apply when devolution is in place."[12]

[12] *The Scotsman* "Blair rounds on 'Tory lie machine' tax warning", 28th March 1995

IV The 'Barnett formula'

The so-called Barnett formula - after former Chief Secretary Joel (now Lord) Barnett - is used within the course of a public expenditure survey to adjust the spending plans for the three territorial departments to reflect changes in comparable programmes in England (or, in the case of Northern Ireland, Great Britain). The formula in its current form was first used in 1978 in the context of preparations for devolution in Scotland that subsequently did not occur. However, some form of population-based formula for Scotland can be traced back to arrangements introduced in 1891 by the then Chancellor, George Goschen. The following comments describe the position in Scotland and Wales: the arrangements for the Northern Ireland Office are slightly different.

The Barnett formula is an example of a "...non-statutory policy rule based on a mutual understanding between parties within the policy network, the implementation of which is subject to both sides observing the behavioural 'rules of the game'."[13] As such there has never been an authoritative document describing in detail the operation of the formula in either Wales or Scotland. This description draws on a number of sources that are listed in the bibliography.

The formula applies to the Scottish and Welsh 'blocks' which now cover all expenditure within the responsibilities of the Secretaries of State for Wales and Scotland except 'agriculture, fisheries and food' and finance for nationalised industries. In both countries the block currently accounts for some 96% of all spending by the territorial department. The formula is used in determining the aggregate size of the block which the relevant secretaries of state are then free to allocate between services as they see fit. However, as much public spending is on-going or demand-led, the scope for the exercise of this discretion is limited in practice.

At the start of a new public expenditure round a new year is added to the survey: in the case of the 1997 round, the year will be 2000/01. The initial level of the blocks in this year is determined by the Treasury using rules applied to all departments. In broad terms this normally involves a percentage up-lift on expenditure in the year before. Thereafter, if there are changes in the plans for the three years under consideration (in the case of the 1997 round; 1998/99, 1999/00 and 2000/01) involving English[14] programmes that are 'comparable' to the Scottish and Welsh blocks, then a fixed proportion is added to - or in the case of cuts subtracted from - the block. These proportions are population based and, until 1992, reflected (in rounded form) mid-1976 population estimates. However, in 1992, they were revised, for the first time, to reflect data from the 1991 Census of Population. The ratios are set out in the following table:

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13 C Thain & M Wright, *The Treasury and Whitehall: The Planning and Control of Public Expenditure, 1976-1993*, p.307

14 Spending on law & order is planned on an England and Wales basis. Thus, spending on law and order is outside the Welsh block and changes in the Scottish block use a slightly different formula.

Programme	Pre-1992	Post-1992
Scotland: Law & order	10/90ths(11.11%)	10.06%
Scotland: Other programmes	10/85ths(11.76%)	10.66%
Wales	5/85ths(5.88%)	6.02%

Thus, for example, if £1 billion is added to planned health service expenditure in England, then £106.6 million is added to the Scottish block and £60.2 million to the Welsh block. Conversely, if there were public expenditure reductions in England, there would be reductions in the territorial blocks. The formula only applies to the PES process; normal Treasury rules apply in the case of in-year changes.

Although the formula represents the normal procedure, it can be by-passed as a result of changes negotiated on the basis of specific factors affecting Scotland or Wales and/or by changes imposed by the Treasury across all departments. There may also be other factors, such as transfers of responsibility, which will affect the final settlement. There is insufficient information in either the *Financial Statement and Budget Report* or the departmental expenditure reports to show how the formula has actually operated. According to Thain & Wright,[15] there is considerable discussion between the territorial departments and the Treasury about what constitute comparable programmes as it is impossible to ensure a precise fit. Generally there is a "...willingness on both sides to 'take the rough with the smooth'..." but there are occasionally circumstances in which a department will 'bid outside the block' or seek an 'add-on'.

This system offers three advantages to the territorial departments:

- the operation of the formula protects (to a large extent) the existing situation where spending per head is above the national average. See below.
- there is no need for the department to argue the case for equal treatment on each occasion that a relevant programme in England receives increased funding.
- the Secretary of State retains the freedom to allocate the block between programmes.

15 Op cit, p.316ff

The level of public spending in Wales and Scotland is currently higher on a per capita basis than in England (see section II). In principle, in a situation where public expenditure continues to grow, the operation of the Barnett formula would, in the long-term, tend to reduce these differentials. This is because the territorial departments only gain their per capita share of new resources. (Reductions in spending would conversely tend to increase differentials.) However, work by David Heald of Aberdeen University suggested that, in practice, convergence during the 1980s was less than might be expected.[16] This may have reflected the impact of special factors by-passing the formula. Also, in the case of Scotland, the population was falling for most of the 1980s and the unchanged the pre-1992 formula gave Scotland an increasingly generous share of additional spending compared to the actual population.

16 David Heald, *Formula-based Territorial Public Expenditure in the United Kingdom*, Aberdeen Papers in Accountancy Finance and Management, 1992

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