Chapter 11

Money and Power: Public Expenditure in Scotland

In this chapter we discuss what may be the most important area of Scottish politics. Public finance is a key aspect of the political process, and the issues raised in this chapter inform most of the themes discussed in this book. Yet, despite the importance of finance to Scottish politics, and long running debates producing calls for reform, the system of raising and distributing money has not changed since devolution. Post-devolution Scotland contin ues to receive almost all of its funding for public expenditure from the UK Treasury in the form of a block grant. The arrangements for the transfer of this money are almost identical to those which existed pre-1999 and reflect the continued use of the **Barnett formula** to alter the block grant at the margins.

Barnett formula: A mechanism used by the Treasury to determine the adjustment in devolved public expenditure (Scotland, Wales, Northern Ireland) following changes to expenditure in England (in certain policy areas).

This formula, and its history, is the main focus of the chap ter since it is central to an understanding of power relations between Scotland and the UK. These relations are often linked to the idea of Scotland's 'financial advantage' compared to the rest of the UK and the ability of the Scottish Government to spend, but not raise, its money (the issue of finance also informs our discussion of power *within* Scotland, but the Scottish Government relationship with the Scottish Parliament and local authorities is discussed in chapters 5 and 10).

There are perhaps two main threats to the current settlement. First, the debate on constitutional change has produced renewed calls for some form of fiscal autonomy even if Scotland does not vote for independence. Chapter 12 examines such future proposals in more depth. All we note just now is that, despite this new agenda, the Barnett formula remains. Second, the global economic crisis has contributed to the UK's new 'age of austerity' and a reduction in UK and Scottish public expenditure. Consequently, devolution has been marked by significant rises in Scottish funding settlements approximately for the first eight years, followed by minimal rises and then reductions in the Scottish Government budget. This chapter:

- discusses the issues of fairness, advantage and power in relation to Scottish public finance;
- outlines in detail what the Barnett formula is and why it was adopted;
- considers why the Barnett formula has endured to this day and what this tells us about power and IGR;
- highlights the role of the Treasury, examining Scotland's unusual inability to determine

its budget but discretion on how it is spent;
- highlights trends in Scottish Government spending.
- examines the consequences of the global economic crisis and the UK's new 'age of austerity'.

Advantage and power in Scottish public finance

The significance of policy inheritance and incrementalism (Box 11.1) and the continued use of Barnett is difficult to overstate because the formula has been 'attacked' from a wide range of commentators for being unfair (McLean and McMillan, 2003). The fact that it has not been reformed, and that it often received minimal attention, is highly significant because it has 'all the characteristics of an issue likely to explode on to the political agenda at some stage' (Mitchell et al, 2001: 66). Yet, academic attention to Barnett often seeks to identify and explain several cases when the UK has deliberately chosen *not* to reform Barnett (Cairney, 2011a: 207).

The SNP Government and Scottish politicians often, and increasingly, denounce the Barnett formula (Settle, 2007), but there is generally far more vociferous criticism from MPs, the media and political commentators in England (regarding Scotland's 'advantage') and, to a lesser extent, Wales (regarding the role of the Barnett formula in perpetuating an unequal financial settlement – see Holtham, 2011). In some cases, the (often rather misleading) way to describe Scotland's alleged advantage is to identify a £1,500 per person advantage over its immediate neighbour in the north-east of England (Sky News, 2007). Scotland is often dubbed the 'land of milk and honey' because commentators argue that the financial advantage allowed Scotland to fund personal care for older people, higher levels of staffing in the NHS, better wages for teachers, better roads and the abolition of student fees (Mooney and Poole, 2004: 458). This argument is still recycled to this day, with more recent complaints suggesting that English taxpayers also fund free prescriptions, free eye tests, heating and transport costs for older people and a freeze on council tax (an excellent example is Chapman, 2007). The continu ation of a finance system which seems so controversial is therefore highly significant; its maintenance highlights both the political costs to reform and the balance of power within territorial politics.

As Keating (2005a: 140) suggests, such discussions can be divided into two main issues. The first is an issue of advantage - whether Scotland gets *more* or *less* than its fair share of resources. The former suggests that Scottish political actors exert power successfully during public expenditure negotiations and/or that they successfully defend previously generous settlements. This may be doubly significant since devolution has operated within the most sustained period of UK public expenditure growth in the postwar period (until 2007). The latter suggests that Scottish oil revenue is subsidizing UK expen diture and that economic policy is geared towards the south-east of England to the exclusion of the north. Further, since it costs more in Scotland to provide the same level of service as England, the Scottish Government is actually constrained by funding levels. This contributes to an inability to introduce innovative (and expensive) public policies in Scotland unless the money can be found from cuts in other budgets. Therefore, any change to the Barnett formula will find criticism from one or both of these quarters.

Box 11.1 Incrementalism and public expenditure

A key theme of this book is that governments inherit a range of commitments and they rarely reject those commitments in a radical way. In other words, policy change is generally incremental, not radical (see Lindblom, 1979; Rose, 1991; compare with Baumgartner and Jones, 1993). In the case of Scottish finance we can apply these discus sions in two main ways. The first relates to the development of Scotland's financial settlement. As we discuss with reference to Goschen and Barnett, the various ways in which Scotland has negotiated its budget with the UK Treasury can be traced back to 'temporary' formulas which have endured to this day. Further, decision-makers have been reluctant to revisit policy because of the likelihood of opposition to a well-established system which reflects previous negotiations (or displeases fewer people than policy change would). The second relates to changes in Scottish spending patterns. Any spending changes are likely to be incremental regardless of the source of funding (in other words, regardless of who – the UK or Scottish Government – raises taxes), since few governments are willing to shift existing funding allocations beyond the margins or raise taxes to fund new initiatives. One qualification to this argument is that the pursuit of different funding priorities may be more straightforward during years of fast-rising public expenditure (since the extra money can be given to new priorities without lowering the budgets for existing commitments). So, for example, if we seek to compare Scottish Government spending in relation to patters of spending in English equivalents (to detect different policy priorities) we will generally find differences only at the margins (with key exceptions, such as UK and Scottish Government funding for Universities – see chapter 8). In such cases, the differences may be significant even if they are not radical.

The second is an issue of power - the contrast between Scotland's *lack of influence* over the way in which money is raised and its *considerable discre tion* over the way it is distributed. The former refers to the power of the UK Treasury which still controls the means to raise money and then distribute it to Scotland. In this chapter we examine whether it *attempts* to exercise its power in a devolved Scotland. The latter suggests that when Scotland receives its block grant it has considerable power over how to spend it (particularly compared to other territorial governments).

The two issues of advantage and power are closely related. For example, if one concludes that Scotland acts to ensure a systematic financial advantage over the rest of the UK, this informs a consideration of Scotland's power (compared to other UK regions) in relation to the Treasury. As Chapter 9 suggests, although the Scottish Government may be subordinate to, or depen dent on, the UK Government, its influence may still be more significant than an equivalent English region.

The Barnett formula and the Barnett 'squeeze'

The Barnett formula was named after Joel Barnett MP, Chief Secretary to the Treasury from 1974-79. Although this began as an interim measure in the run up to political devolution in 1979, it still operates today. The settlement covers most of the Scottish Parliament budget and accounts for approximately 60% of all public spending in Scotland (the remainder is spent directly by Whitehall departments). It comprises two elements: an initial block settlement based on historic spends and the Barnett formula to adjust spending in Scotland to reflect changing levels of spending in England. In other words, the formula only relates to *changes* in the level of spending.

The formula is based on an estimate of population relativities. Initially this was a 10-5-85 split for Scotland, Wales and England which suggested that Scotland would receive 10/85 of any increase in *comparable* spending for England in Whitehall departments (or lose the same amount if spending fell). This comparability varies according to department. While some are almost fully devolved (e.g. Health, Education), others are partly devolved (e.g. Transport) and only the comparable spending will be applied to Scotland. The size of these 'Barnett consequentials' are based on three *estimates*: Scotland's share of the UK population; the change in levels of spending of UK Government departments; and the level of comparability in specific programmes.

Barnett 'squeeze': Denotes a rise in expenditure (using the Barnett formula) according to Scotland's share of the UK population, rather than its traditionally higher share of UK public expenditure.

Further, if we make certain assumptions - that these estimates are accurate, that public expenditure in England rises and that all other things remain equal - then the formula suggests that Scotland's relatively high share of public expenditure will be eroded over time. This **Barnett 'squeeze'** occurs because the consequence of extra spending in England is extra spending in Scotland according to its share of the population rather than its share of UK public expenditure (the latter is proportionally greater, based on the size of Scotland's initial block settlement). In other words, let us assume that:

- Scotland initially received a block settlement which represented 120% per head of spending in England;
- subsequent 'consequentials' are paid at the rate of 100 percent;
- over time, as the size of the consequentials grows in comparison to the original settlement, the formula will help bring the Scottish share of UK public expenditure down to a level closer to its share of the population.

In other words, the 'Barnett squeeze' denotes a rise in expenditure (using the Barnett formula) according to Scotland's share of the UK population rather than its traditionally higher share of UK public expenditure. Therefore, the term 'squeeze' is misleading because it is only apparent when levels of spend ing are *rising.* A 'squeeze' can never refer to an *actual reduction* in public expenditure in Scotland.

Agenda-setting and the politics of public spending

A discussion of the history of finance shows that the decision to adopt and maintain the Barnett formula represents an effective form of agenda-setting. A key tenet of the 'policy communities' literature is that policy issues are often portrayed as dull affairs to limit public interest and participation. If an issue can be successfully presented as a 'technical' or a 'humdrum' topic for the 'anoraks' (because the problem has been solved and all that remains is the implementation), then power can be exercised behind the scenes by a small number of partici pants (Baumgartner and Jones, 1993; Jordan and Maloney, 1997).

With Scottish public finance we can identify a consistently successful attempt by decision-makers in Scotland and the UK to keep the 'big' (and potentially most contentious) questions of funding off the political agenda. They have tended to avoid reforms because a very clear sense of winning and losing would result from any deviation from the status quo. Indeed, the only time that the big questions have received consistently high levels of attention is when they have been linked to more fundamental issues - such as devolution in 1979 and independence in 2007. Even then, it is telling that during the 2007 Scottish electoral campaign, the issue of fiscal autonomy struggled to compete with the issue of local income tax (which would only account for around 20% of Scottish local authority budgets). Barnett reform was also mentioned rather briefly in the Calman Commission report in 2009 (chapter 12). Perhaps more important is the level of interest in *England,* with the election of the SNP and the reac tion to a Scottish Prime Minister (box 8.2) contributing to higher levels of media inter est in Scotland's 'advantage' in 2007.

Life before Barnett

Machiavellian: A term (deriving from Niccolò Machiavelli, writer of *The Prince*) used to denote a person/institution's tendency to deceive and manipulate others for political gain.

Goschen formula: A formula introduced in 1888 (in anticipation of Irish Home Rule) to distribute public expenditure to territorial administrations.

The modern history of funding settlements demonstrates the incremental and almost accidental side of Scottish politics (although see McLean and McMillan, 2003: 50 for a **Machiavellian** explanation). This began in 1888 with the **Goschen formula**, named after the then Chancellor of the Exchequer. The formula is a byproduct of the attempts by Goschen to link local revenue to local spending and separate it from funding designated for Imperial finance. Although this overall project failed, the formula itself lasted over 70 years as a means of determining Scottish entitlement from the UK exchequer (Mitchell and Bell, 2002). The figure of 11/80 of England and Wales was a rough estimate of Scotland's population share at that time, based loosely on Scotland's contribution to probate duties (taxes levied on the estate of the deceased), but was never recalcu lated to take Scotland's (relative) falling population into account.

As the size of the UK state grew, so did the size of the Scottish Office, with the Goschen formula more or less at the heart of its budget settlement. Indeed, although the formula was not used formally from 1959, the culture of accepting Scotland's existing share as a starting point and adjusting at the margins (in much the same way that other government departments negotiated their budgets) was well-estab lished and not challenged seriously until the 1970s. Therefore, what began as a formula which initially advantaged per capita spending in England and received minimal Scottish support, eventually became a system redistribut ing money to Scotland as its share of the UK population fell (McLean and McMillan, 2003: 50).

Comprehensively rational decision-maker: an ideal-type referring to the ability of a policymaker to consider all the information and options, then make consistent decisions which perhaps suit all parties (Cairney, 2012a: 96)

The long-term use of the Goschen formula reinforces the idea of incrementalism and inertia in politics: the existing or default position is difficult to shift. Fundamental change is expensive and likely to undermine a well-established negotiated settlement between competing interests. While the Goschen formula is not something that would have been chosen by a **comprehensively rational decision-maker** or a more open process of decision-making, as a default position it was diffi cult to challenge. We may then ask why this process was eventually replaced. The answer is that a 'window of opportunity' (see Kingdon, 1984) came in the 1970s with the prospect of political devolution which drew attention to Scotland's share of public expenditure.

Barnett and needs assessment

The level of UK attention to Scotland's financial status (particularly among English MPs representing constituencies with 'comparable needs') was such that it prompted governmental action. The 'window of opportunity' was opened by the prospect of a referendum on devolution. This contributed to the 'reframing' of the policy problem - from a *technical* process to ensure Scotland's share of resources to a *political* process providing advantage to Scotland. The Treasury's response was to commission a Needs Assessment Study to estab lish the share that each UK territory was 'entitled' to (based on indicators of need such as schoolchildren, pensioners and population sparsity). This would be used in negotiations with the newly-formed Scottish Assembly, perhaps allowing the issue to return, eventually, to its low-salience status (although Barnett himself disputes this motivation - see Twigger, 1998: 8).

In retrospect we may say that the needs-assessment exercise was doomed to failure (in that it was not officially adopted) for three reasons. First, there is no common definition or consensus on the concept of need. More money spent on one 'need' means less on another; it is a political issue involving winners and losers, not a technical issue in which everyone's problems can be solved. Second, there were problems with the quality of information and it implications. For example, even when 'objective factors' (e.g. population sparsity or age) were taken into account it was never clear if any extra spending would refer to *inputs* (e.g. number of doctors), *outputs* (number of operations) or *outcomes* (equality in levels of health). Third, the outcomes from a needs assessment will always require a political decision which takes into account not only the 'facts' but also factors such as the public reaction. The report itself represented only one aspect of that process. In particular, while the Treasury report in 1979 suggested that Scotland's greater need was 16% (when at that time the level of extra spending was 22%) there was no rush to close this perceived gap.

Instead, the Barnett formula was introduced on an interim basis. Then, following the negative referendum vote, the needs-assessment agenda was quietly dropped. The Treasury was not inclined to impose a system with little more benefit than the Barnett formula in the immediate aftermath of a refer endum process seen by many in Scotland as an attempt by the UK Government to thwart home rule. Effectively, the end result was the replace ment of the Goschen formula with a very similar Barnett formula and, although the latter began life as an interim measure, it has yet to be challenged to the extent that it will be replaced.

In large part, this is because the existing process has several political advantages. First, it satisfies broad coalitions in Scotland and England. In Scotland, it maintains (at least in the short term) historic levels of spending. In England, the 'Barnett squeeze' gives the impression that over time this advantage will be eroded (and perhaps few people will highlight the opposite effect during periods of reduced public expenditure). Second, it satisfies many governmental interests. For the Scottish Government it traditionally provided a guaranteed baseline and a chance to negotiate extra funding. The overall system also allows Scottish control over domes tic spending, with limited Treasury interference. For the Treasury, it provides an automatic mechanism to calculate territorial shares which represent a small part of its overall budget.

The adoption of the formula therefore represented successful agenda-setting - establishing the principle in fairly secret negotiations and then revealing the details only when the annual process could be presented as a humdrum and automatic process (allocating funding at the margins) which was efficient and had support from all sides within government. Indeed, the level of implicit support for Barnett was so high that there was no serious, sustained chal lenge to this formula either before or after political devolution in 1999 (perhaps aided by the perception that the Barnett 'squeeze' was working – Cairney, 2011a: 208).

Funding from other sources

If anything, the value of Barnett has been reinforced since 1999 because the trend is towards determining a greater proportion of Scottish Government spend from this process. Yet, Barnett accounts for only 60% of 'identifi able' public expenditure in Scotland (Keating, 2005a: 143), with the rest deter mined by the UK government, either in funding which merely passes through the Scottish Government budget (overall, the Scottish Government accounts for approximately 68% of identifiable spending) or is spent directly by Whitehall departments. Whitehall spends approximately 32% of 'identifiable' spending in Scotland directly, with 91% of this devoted to 'social protection', includ ing family benefits, income support and tax credits (HM Treasury, 2012a: 150). The total identifiable expenditure in Scotland (2010-11) was £53 billion (2012: 150).

The 'assigned budget' from Barnett is a subset of the Departmental Expenditure Limit (DEL) which also includes a small miscellany of funds (non-assigned budget) to cover, for example, UK initiatives such as Welfare to Work which are largely administered by Whitehall departments but have devolved elements. The DEL in the 2011-12 draft budget was £28 billion (Scottish Government, 2011: 236). The DEL is a subset of Total Managed Expenditure which also includes the Annual Managed Expenditure (£5.6 billion). The AME includes non-discretionary money merely 'passing through' the Scottish Government from the UK or EU - for example payments to NHS/teacher pensions.

There is also provision for *ad hoc* funding. This is often referred to as 'formula bypass'. However, this is misleading because decisions out-with the formula are actually commonplace (since the DEL is calculated three years ahead). Post-devolution examples have been the costs of addressing foot-and-mouth disease, funding the Lockerbie trial and the 'write-off' of local authority hous ing debt (reflecting the Treasury's policy of promoting housing stock transfer).

Box 11.2 Fiscal autonomy

Chapter 12 discusses the current debate about 'fiscal autonomy' either under a devolved or independent Scotland. It suggests that the term is rather vague and subject to numerous constraints and qualifications when Scotland remains part of a UK, EU and global economic system. But, if we set aside the Scottish-specific issues and focus on the abstract argument, what are the arguments put forward to support or oppose devolving more fiscal powers?

For

- A clearer link between spending and taxes would enhance accountability and make the Scottish Government more responsive to public responses. It would also encourage Scotland to pursue economic growth since this would raise its income.
- Greater autonomy would allow more discretion in choosing who to tax (e.g. individuals or businesses) and how to tax (e.g. the balance between taxation and charging for services).
- Local taxation allows a greater knowledge about the preferences of the popula tion. Central processes are less flexible to adapt to changing local circumstances.
- It creates the potential to compete with other regions. If English regions respond, taxation is kept low. If competition does not materialize, lower business rates could attract more businesses.
- It would reduce hidden inequalities such as the greater benefit, to residents in England, from UK Government tax expen ditures.

Against

- The centralization of taxation allows economies of scale, a wider tax base to secure more redistribution and greater insurance for regions facing exceptional difficulties (this traditionally underpinned the Labour party's support for devolution, not independence).
- The legacy of higher spending in Scotland suggests higher taxes and the migra tion of people and businesses.
- Higher welfare entitlement in Scotland may foster welfare migration and higher levels of dependency.
- The pursuit of fiscal autonomy would raise questions which could create Scottish-UK tensions. For example, how much would Scotland pay for common UK services? What share of oil revenue would Scotland be entitled to?
- Tax competition within member states is problematic in the European Union

The Scottish Government/Scottish Parliament can also raise money directly. It has the ability to raise (or lower) income tax by three pence in the pound (this will rise to 10 pence following the Scotland Act 2012 – see chapter 12); collects business rates (non-domestic rates) and distributes the money to local authorities (£2.1 billion in 2010-11); and regulates and influences the collection of council tax by local authorities (£1.9 billion - see Scottish Government, 2012a: 11).

In all three cases there is limited room for manoeuvre. For most parties there is no prospect of raising income tax given the likely political costs for a measure which would raise Scotland's total budget by less than 5% in exchange for a rise of 3 pence in the pound (which suggests that the forthcoming ability to raise income tax by 10 pence will make little difference). Similarly, given recent SNP moves (from 2007 onwards) to lower business rates and freeze then abolish council tax, there is little prospect of the Scottish Government seeking to raise significantly higher sums from these sources (in fact, the council tax freeze is funded from the Scottish Government budget – Scottish Government, 2011: 227). Without 'fiscal autonomy' the Scottish Government is in a relationship of finan cial dependency with the UK Treasury (see Boxes 11.2 and 12.1).

Is the Scottish settlement 'fair'?

Per capita spending: Spending 'for each head'; the average (mean) spend per person.

In recent years, and particularly since the new era of SNP Government, the Barnett formula and the issue of higher Scottish **per capita spending** has emerged more prominently on both the Scottish and UK political agendas. In 2007 a report by Professor Gavin McCrone suggested that Scotland, 'would be in deficit without the subsidy from the UK', while then UK Chancellor Gordon Brown argued that the gains from Scottish oil revenue were outweighed by the advantage from Barnett (Gray, 2007; Devlin, 2007). In contrast, the SNP argued that not only was Scotland 'paying its way', but its funding each year was being 'squeezed' by the Barnett formula, while some academics have extrapolated a '5% cut in Scotland's workforce' as a result of the squeeze' (SNP, 2007; McMahon, 2007). More recent media and social media accounts continue this rather confusing and often misleading debate. For example, Holyrood Magazine (2012) argues that the 'Barnett formula squeezes the block grant by one per cent, about £250m each year, which encouraged the 61 per cent hike in council tax up to 2007', while the blog conservativehome (2012), quoting the Daily Telegraph, argues that 'if the Barnett Formula was abolished then English local authorities would be paid an extra £2.6 billion'.

To make sense of these debates, we can identify three distinct issues:

- What was the Barnett formula *designed* to do?
- What does it *actually* do?
- Is this fair?

What was the Barnett formula designed to do?

We have two plausible answers. The first suggests that the aim of the Barnett formula was to reduce per capita spending levels in Scotland to a level similar to England. Assuming that estimates on population size and comparability are correct (and that all other things remain equal) this would seem to be the long-term consequence of rises in English public expenditure (Bell, 2001). However, Midwinter (2004a; 2004b) argues that this was never a stated aim by the UK government. A second, more likely, aim was to prevent any *further* advantage to Scotland and/or bring Scotland's per capita spending closer to the figure identified in the needs assessment. While the formula was intro duced before the needs assessment was completed, Joel Barnett suggests that an estimate of greater Scottish need was identified within the Treasury to account for:

> population sparsity in Scotland, transport needs, needs because of relative ill health, rural needs and education and so on and industrial needs - but above all ... income per head. (Quoted in Twigger, 1998: 8)

What does the Barnett Formula actually do?

While a strict application of the Barnett formula suggests long-term convergence, this relies on assumptions which may not be met in practice. The first relates to the accuracy of the estimate of Scotland's population relative to England. At the inception of Barnett this was set too high - at a level of 11.8% (10/85) - and the estimate was not revisited until 1992. While the Treasury now uses more accurate annual estimates, there is still a degree of uncertainty and a time-lag between spending reviews and the new figures. Although the 2011 census addresses the problem of esti mates, uncertainty remains about the continuous effect of immigration, particularly from the new EU accession countries, in the south-east of England (Heald, in correspondence). Therefore, since the relative popula tion in Scotland has fallen constantly since 1978 (in 2011 it was 5.1 million or 8.1%), this overestimation of the Scottish population has for the most part 'cushioned the blow' of reduced per capita spending advantages. The second assumption is that comparable public expenditure always rises significantly (which is not always the case, particularly if we examine 'real' rises, discussed below). The third is that the relative size of the original block settlement falls. Yet, this has been increased regularly to account for inflation. A final assumption is that all other things remain equal. However, they do not. It is normal practice for there to be examples of 'formula bypass', such as Treasury-funded pay increases for public sector staff and various other arrangements to ensure additional funding (Keating, 2005a: 145). These were negotiated and used to great effect by pre-devolution Secretaries of State for Scotland who were sensitive to levels of nationalism and keen to highlight the financial benefits of remaining within the Union. As a result, the overall Barnett 'squeeze' did not appear to materialize (Midwinter, 2004b: 505-6).

Union dividend: A phrase used by Labour politicians in electioneering to bring attention to the financial benefit Scotland receives as part of the union of Great Britain and Northern Ireland.

A feature of post-devolution predictions is that the 'Barnett squeeze' would be more apparent *after* 1999 since the UK Government would not feel the same need to react to high levels of nationalism. This is reinforced by Bell and Christie (2001: 145) who estimated a £1 billion or 5% 'squeeze' by 2003-04. Keating (2005a: 145; but compare with 2010: 175) also suggests that the formula had 'begun to bite' in some policy areas following a combination of accurate population estimates, minimal side deals, the extension of Barnett's coverage and high levels of public expenditure in England. What this argument means in practice is that, when we compare per capita spending in some areas, such as health, we see some evidence of convergence (but we recognise that this did not result directly from the Barnett squeeze because the Scottish Government manages an overall budget, not specific budgets determined by the Treasury).

An alter native hypothesis is Scotland's advantage continued because it was still in the interests of the Labour-led govern ments to stress the benefits of the **Union dividend**. This is supported by figures presented by Midwinter (2004a; 2004b) and Schmueker and Adams (2005) which highlight stable levels of *overall* per capita spending and no evidence for the squeeze. We can explain the latter by looking beyond the funding related to Barnett, finding that Scotland's share was maintained by increased payments in areas such as social security and agriculture. If we combine the arguments, we can identify what we might call 'a quasi-squeeze within an overall pattern of funding continuity', with the 'squeeze' felt particularly in health where spending per capita in Scotland 'is roughly the same as in the North East of England' (Cairney, 2011a: 209). Yet, this more balanced argument is generally not made in academic accounts and the issue is rife with confusion, argument and counterargument – an outcome that does not bode well when we consider how the debate might spill out into the media and social media.

Is the Scottish settlement fair?

The discussion of Barnett provides only a partial answer to this question, since fair distribution can also relate to the levels of funding *raised* in Scotland and the effects of wider economic policies and other UK spending. This leads to a consideration of other factors (see

Keating, 2005a: 148-50; 2010: 175-9):

- Barnett only refers to comparable regional spending. If we look at UK spending as a whole, there are areas of 'non-identifiable' spending (in areas such as Defence, the Channel Tunnel and the Olympics 2012), where Scotland does not enjoy the same 'multi plier effect' of this spending (e.g. army personnel spend their money locally and this benefits local businesses; Olympic regeneration was generally concentrated in London).
- The level of tax expenditure may be greater in England. For example, payments for private education (a much larger sector in England) are Value Added Tax (VAT) free, since most independent schools have charitable status.
- The Treasury raises significant revenue from taxing North Sea Oil. In 1984/5 UK government revenue from oil and gas peaked at £12.3 billion, or 15% of the proportion of overall revenue (BBC News, 2006; Scottish Government, 2012b: 30). In 2010-11 it was £8.8bn. However, we should be careful about how to describe that revenue. For example, it may represent more than one-quarter of the Scottish Government budget or one-sixth of all Scottish related expenditure. In either case, such statements imply that Scotland is entitled to all tax revenues from the North Sea (Scottish Government, 2012 considers population shares and 'geographical' shares).
- Economic policies favouring the south-east of England may hinder economic development in Scotland. For example, the maintenance of high interest rates to reduce inflation or stop the south-east economy 'overheat ing' may disproportionately affect a Scottish economy more reliant on manufacturing (an argument made particularly strongly during the Thatcher era).

Lies, damned lies and Scottish public expenditure statistics?

The upshot is that there is a lack of consensus on what Barnett was designed to do, what it actually does and how fair the Scottish settlement is. Further, since there is no consistent data to rely on, the different use of financial measures to make different points has become a key tool for agenda-setting. We can see this most clearly in partisan debates about Scotland's contribution to the UK Exchequer. In 2007, while Labour talked of the 'Union dividend' and argued that the Treasury, 'is prepared to fund an £11 billion fiscal deficit' the SNP (in opposition) referred to the non-inclusion of oil-based revenue and the biased nature of government figures (see Scottish Parliament Official Report 10.1.07 cols 30847-99; since 2007 the Scottish Government has included a discussion of North Sea revenue in its finance reports – see Scottish Government, 2012b). Some broader points are also worth noting:

- Spending can be expressed in 'real' (i.e. adjusted for inflation) or 'volume' terms (adjusted, if possible, for public-sector inflation). Midwinter and Burnside (2004) suggest that although spending rose from 1999-2003, 'outputs' in areas such as education fell (due in part to above inflation pay awards for doctors and teachers - see

Cairney, 2007c: 27). This is key to our discussion of 'advantage' since Scotland could receive more money to fund *inputs* (e.g. doctors), but still achieve fewer *outputs* (number of oper ations) and less favourable *outcomes* (levels of health).

- Scotland's expenditure per capita is the figure that tends to attract most political attention. In 2005/6 it was approximately 22% more than England (as a whole) (Schmueker and Adams, 2005: 37) but in 2010-11 it was 17.5% (see HM Treasury, 2012a: 119 and note the variations across English regions – for example, more money is spent per head in London than Scotland).
- While there are distinct Scottish Government figures, these are either derived from the same Treasury figures (HM Treasury, 2012a) or are presented in a non-comparable form, referring to funding for departments (with shifting boundaries) rather than policy areas.
- It is difficult to estimate Scotland's share of 'non-identifiable' spend ing (e.g. defence, international) incurred on behalf of the UK (£9.1 billion in 2010-11 - Scottish Government, 2012b: 43).

The result is that it is difficult to come to hard-and-fast conclusions about public expenditure statistics, since levels of comparability are often limited and the presentation of figures is determined by the source of information and the way that this information is presented. This ties in with a widespread public view that most politicians in Scotland (like everywhere else) utilise public expenditure statistics for support rather than enlightenment. A less cynical view can point to two elements. First, there are valid and reliable statistics that are collected and published without political interference, such as Government Expenditure and Revenue in Scotland (GERS) (although this was often criticized by the SNP when in opposition). Second, most politicians simply *do not know* how the public sector accounts for its own budget. An understanding of the complexities of these procedures is often restricted to expert professionals, 'and there is a danger of democratic processes becoming increasingly mystified rather than more transparent' (Ezzamel *et al.,* 2005).

Box 11.3 How much did the SNP government's budget rise in 2007?

Heated debates between the SNP Government in Scotland and the Labour Government in the UK in October 2007 show how difficult it is to calculate changes in public expenditure. In part this is because the figures presented by both sides were both correct! In other words, this is really an issue of agenda-setting and the ability to draw attention to one set of figures to paint a picture of growth or stagna tion. Following its Comprehensive Spending Review (to set three-year budgets for government departments), the Treasury announced that Scotland's budget (or DEL) would rise from £26.059 billion in 2007-08 to £27.244 billion in 2008-09, £29.584 billion in 2009-10 and £33.309 billion in 2009-10. This represents an average real annual rise of 1.8%. On this basis, the UK Government argued that a prudent Scottish Government should be able to fulfil all of its commitments since this repre sents a significant rise from a budget which has doubled in cash terms since devo lution. The SNP countered this claim by pointing to a shift in the 'baseline' to calculate the figures. The 2007-08 baseline figure for Scotland's budget was reduced by £340 million to take into account lower levels of actual spending in England by the Department of Health in previous years. Therefore, the *actual* annual real rise is 1.4%. Further, the SNP Government pointed out that since the baseline was reduced, the increase in 2008-09 is actually £845 million (1,185 minus 340), In cash terms this represents a rise in 3.2%, but in real terms this comes to 0.5%. The SNP argued that this was the lowest real annual rise since devolution (when Scottish oil revenues were rising) and that it undermined its ability to deliver pre-election pledges.

Where does Scotland spend its money?

Table 11.1 gives a general overview of Scottish public expenditure that highlights the big-spending policy areas such as health, education and training (i.e. includ ing further and higher education), transport and public order. This impression of the *size* of each spending area is crucial when we then examine real rises (or falls) in expenditure. For example, real spending on Science and Technology rose by 291% from 2000 to 2006, while in social protection it rose 23%. Yet, social protection is still the biggest spending area and the *cash* rise in Science is relatively small. Therefore, a focus on change alone may exaggerate the significance of small but expanding portfolios (particularly if this involves change from a low base or a long period of underinvestment).

£million	1999/2000	2000/1	2001/2	2002/3	2003/4	2004/5	2005/6	**2006/7**	2007/8	20
General Public Services	573	596	697	756	837	841	833	**973**	956	
Public Order and Safety	1399	1436	1628	1655	1820	1911	2021	**2,203**	2,287	2
Civil Defence	.	.	.	.	.	.	.	**7**	7	
Miscellaneous Economic	442	583	548	463	549	625	640	**461**	524	
Science and Technology	68	70	87	110	161	238	309	**273**	417	
Employment	748	712	740	736	913	802	813	**697**	730	
Agriculture, Fisheries. Forestry	564	579	655	661	733	631	679	**686**	771	
Transport	850	908	980	1150	1725	1672	2093	**2,706**	2,835	2
Environment Protection	877	967	1141	1028	1111	782	1135	**1,073**	1,105	
Housing and Community Amenities	459	624	943	834	906	1279	1462	**1,679**	1,746	
Health	5057	5435	5744	6710	7363	7683	8497	**9,035**	9,727	10
Recreation, Culture, Religion	722	718	757	821	920	931	1050	**990**	1,029	
Education and Training	4322	4599	5090	5246	5574	5892	6378	**7,147**	7,368	7
Social Protection	11187	11587	12934	13527	14537	15271	15967	**16,014**	17,027	18
Total	27274	28820	31944	33701	37151	38582	41902	**43,945**	46,529	48
Real rise (total) per year	.	5.1%	8.8%	2.9%	7.9%	0.9%	3.4%	4.9%	3.3%	

Table 11.1 ***Identifiable expenditure (£ million) on services (current and capital), 2000-2011***

Notes: 1. Some Treasury categories changed from 2006-7 which makes comparisons problematic. In fact, HM Treasury (2012: 6) **warns against comparisons of periods greater than 5 years apart** (and notes that its figures on Scotland do not correspond to its overall UK figures). Some are marked with N/A (e.g. civil defence was not a separate category in PESA entries before 2007). Others should be treated with caution – e.g. observe the rise in Transport funding 2006/7. 2. The real rise calculation is based on the GDP deflator (HM Treasury, 2012b). The first edition figures (McGarvey and Cairney, 2008: 190) were incorrect, so we include a correct column on the real rise 2000-06 and an overall rise 2000-11. The real rise is determined by calculating the cash rise adjusted for the GDP deflator (2000-06 is 76.562/ 86.542; 2000-11 is 76.562/97.672). For example, the 2011 total of 53085 is the equivalent of 41612 in 2000 prices (or 27274 in 2000 is the equivalent of 34794 in 2011). 3. Data collated from PESA reports: HM Treasury (2005: 92-3; 2006: 100-11; 2012: 154-5).

A focus on the big-spending areas from 2000-11 suggests an above-average rise in health (68%), while housing (203%) and transport (158%) were clear priorities. Perhaps surprisingly, given the wage rises for Scottish teachers and the commitment to reduce student fees, the rise in educa tion (46%) spending is lower than the overall average and often lower than equivalent spending increases in England (Schmueker and Adams, 2005: 39). Overall, the real rise in spending in Scotland from 2000-11 has been 53% – a figure that gives some important context to current discussions of economic austerity below (but note that the cash rise, close to 100%, is a very (and increasingly) misleading figure often used by elected politicians to reinforce the importance of the Union dividend). The first drop in real spending (2010-11) follows a series of very large real rises in annual budgets since devolution.

UK Treasury power and the Scottish political system

Chapter 2 suggests that before devolution there may never have been a 'Scottish Political System' because the ultimate authority or final decision rested elsewhere. The significance for present purposes is that this authority *still* resides elsewhere - in the hands of the UK Treasury which determines the size of Scotland's budget and its method of collection (even when taking into account the Scotland Act 2012 reforms discussed in chapter 12). Yet, our discussion of Barnett confuses this picture by suggesting that Scotland may have been the most likely to *benefit* from this relationship. Indeed, the history of spending settlements seems to suggest that the UK Treasury has done all it can to avoid conflict rather than impose its will publicly. In other words, we should not assume that the capacity to exert power is synonymous with the exercise of that power. The idea of Treasury power is also complicated by the fact that while it can control the *size* of Scotland's budget, it does not determine how it is *spent.*

Comprehensive Spending Review: A review by the Treasury to set three-year budgets for government departments. From 2010 it was merely called the 'Spending Review'.

The Scottish Government is reliant on its block grant from the Treasury. This was highlighted during the **Comprehensive Spending Review** (CSR) dispute in 2007 (Box 11.3) when Alex Salmond argued that the low rise in UK spending in 2008-09 reflected Labour's general election strategy (its plan to accentuate spending increases in the run up to a General Election in 2009 or 2010). Many Scottish newspapers also suggested that Prime Minister Gordon Brown and Chancellor Alistair Darling were trying to constrain the SNP's spending decisions in its first year of government. These asser tions are difficult to demonstrate. What we can say with more certainty is that Scotland remains heavily depen dent on the UK Government's attitude to taxing and spending. Treasury rules also influence heavily how Scottish local and health authori ties fund major capital projects (such as new schools, hospitals and housing programmes).

This particular power of the Treasury was highlighted in housing policy where it allowed borrowing to improve the local-authority housing stock only through approved corporate bodies such as Housing Associations (in other words, local authorities borrowing was very limited). In return, the Treasury rewarded a successful transfer of housing stock from local authorities to housing associations (following a ballot of council tenants) by writing-off the debt linked to the housing stock (in Glasgow alone this accounted for £1 billion in 'formula bypass'). As a general rule with borrowing and Treasury power, the Labour-led Scottish Executive (1999-2007) decided to make a 'virtue out of necessity'. During this period it supported housing-stock transfer wholeheartedly (although not always successfully, following rejections by ballot in areas such as Edinburgh, Stirling and Renfrewshire). It also encouraged the use of public private partnerships to build new schools and hospitals (since they are able to raise the capital without raising public borrowing - see Box 10.3).

As chapter 10 discusses, the SNP Government sought to challenge this constraint by setting up the 'Scottish Futures Trust', a public body tasked with reducing the 'excessive costs of PPP projects associated with the profit-seeking motives of private companies' (Cairney, 2011a: 217). The Scottish Government, with very limited borrowing powers of its own (before the Scotland Act 2012 – chapter 12), sought to use the borrowing power of local and health authorities to fund capital projects. The effect is difficult to measure (partly since private firms are still employed and still make some profits), provoking considerable academic, media and party political debate on the SNP's claim for a distinctive policy (2011a: 218).

Treasury power and the strange case of EU structural funds

EU structural funds: funds allocated by the EU to support the poorer regions of Europe and integrate the European infrastructure through transport projects.

The issue of **EU structural funds** demonstrates the reach of Treasury power in Scotland. As Keating (2005a: 151-3; 2010: 184) discusses, there are now four types of funds - on regional development, employment train ing, agriculture and fisheries. They are allocated on three bases - to regions lagging behind the UK average (objective 1), areas affected by industrial decline or rurality (objective 2), or people who are socially excluded (objective 3). While such funds were in the past given without condition, since 1988 the Commission has sought to use them as a policy instrument to further EU policy objectives. As a result, the money must be *seen* to be spent in the relevant region and it must be *added* to the original budget. The regions are also obliged to match the additional money spent.

On paper, this looks like a good deal for the regions since it appears that they can bypass the UK government and receive extra money directly from the EU (approximately £1.1

billion from 2000-06 - Scottish Executive, 2007c). However, a more accurate picture is that the UK as the member state negoti ates the funding, with sub-national authorities often peripheral to the process (Bell and Christie, 2001: 147; Sutcliffe, 2002). Further, the Treasury treats EU structural funds as UK money since it is still a net contributor to the EU (and any direct funding would circumvent its public spending plans). Therefore, while in theory the funding is routed through the Barnett system, Scotland receives no extra money (it also has to find matching funding from within its existing budget!). The unintended consequence is that it is in Scotland's inter ests for *England* to receive structural funds since it will enjoy the consequen tials without having to be seen to spend the money in a certain area. Indeed, this has often been the case, prompting successive Scottish Governments to be relaxed about their often limited allocations from the EU (Keating, 2010: 185-6).

Treasury power and Scottish spending

Treasury influence over the way Scotland *spends* its budget is more difficult to demonstrate. We have three main aspects to explore. The first is that Treasury control over Scotland's total budget undermines its ability to fund any new policies with a significant cost. Therefore, any changes in Scottish spending must be incremental. As one member of the Scottish Government Finance Department (interview, 2005) puts it:

> Two-thirds goes to the NHS and local authorities and then there is justice and other sectors. So there is maybe only £1 billion left over to use our discretion with.

Given such constraints, Bell and Christie (2001: 143) suggest that any solution is likely to be limited: any redistribution would be constrained by national public wage structures and legislative commitments, cut-backs in other services would have high political costs, and new revenue is unlikely.

Box 11.4 Scottish finance in comparative perspective

Scotland's ability to determine its own spending priorities is unusual in a compara tive context. In countries such as Spain, Canada and Germany the system of finance and regulation is more restrictive, with more conditions on how to spend (Greer, 2003). This perhaps reflects a greater preoccupation with strong 'fiscal account ability' in other countries. However, the ability of the UK Treasury to determine how taxes are raised and to influence how money is spent in Scotland suggests that these differ ences are often exaggerated (Heald, 2001). This influence may still continue if fiscal powers are devolved further (chapter 12).

Second, the Scottish Government (particularly if controlled by the same party in control at the UK level) comes under pressure to make spending deci sions similar to those announced in the UK Chancellor's budget (as with education) or to play catch-up and follow UK agendas (as with the example of NHS waiting-list comparisons).

Third, in some cases Treasury rules influence Scottish policy indirectly. The most high-profile example followed its decision not to refund Attendance Allowance benefits foregone by older people receiving 'free personal care' funding (see Chapter 9).

However, in each case there are convincing qualifications to Treasury power. First, funding changes would always be incremental as there will always be constraints on the ability of the Scottish Government to raise taxes (Midwinter, 2004a). Of more importance is the *real rise* in public expenditure and, until very recently, this has been considerable. Second, the post-devolution trend is towards greater Scottish Government discretion in allocating resources. Even when Scotland *appears* to follow England's health spending, this may be redi rected to (for example) public health rather than healthcare funding, according to different priorities within Scotland. Further, since 2007, there has been no shared party of government in the UK and Scotland to coordinate spending (although some pressures, such as on NHS performance, still exist). Third, these Treasury rules sometimes have a net benefit for Scotland. For example, the loss of Attendance Allowance bene fits was more than offset by the gain in council house debt removal.

The Age of Austerity?

As chapter 2 discusses, most Scottish politics must now be viewed through the lens of the economic crisis, which has produced the likelihood of significant real reductions in Scottish spending for the foreseeable future. For example, group-government relations (chapter 7) and IGR (chapter 9) may become tenser as tougher policy choices are made, producing more losers and fewer winners. Of course, as the discussion of statistics (above) suggests, there is much competition and debate on how best to express this projected fall in funding. What we know currently, from HM Treasury (2012: 27), is that the Scottish Government DEL fell from £28.512 to £27.567 billion from 2010-11 to 2011-12. This is a cash reduction of £0.945 billion (3.3%) but a real reduction of £1.587 billion (5.6%). This drop is part of a pattern of reduced spending from 2010-11 until at least 2014-15 (the end point of current Treasury predictions). A new SNP era began with fluctuating budgets from 2007-11, to be replaced by consistently falling budgets during the current parliamentary session.

Table 11.2 Current and Estimated Scottish Government DEL, 2007-08 to 2014-15

	2006-7	2007-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Cash budget	24951	26475	26893	28431	28512	27567	27757	27725	27937
Adjusted to 2010-11	27423	28391	28073	29238	28512	26925	26398	25725	25289

prices									
Change	.	967	-318	1166	-726	-1587	-527	-674	-436
Change %	.	3.5%	-1.1%	4.2%	-2.5%	-5.6%	-2.0%	-2.6%	-1.7%

Source: HM Treasury (2008: 23; 2012a: 27), adjusted using the GDP deflator (HM Treasury (2012b).

There are some other factors to consider for future budget decisions. First, the UK Government is currently reforming the 'social protection' element of identifiable spending in Scotland – a process that produced a very unusual Scottish Parliament response. The Welfare Reform Bill 2012 is the first to be subject to a rejected 'Sewel motion' (chapter 9). However, the rejection is likely to have a minimal impact because the Scottish Parliament can only legislate on devolved aspects. The UK Government will still control the welfare reform process (including controversial new rules on disability benefits), which is likely to produce knock-on effects for Scottish Government services (BBC News, 2011; 2012). Second, the cuts in spending may come at a time when the demand for some services is rising. For example, policies such as personal and residential care for older people may become more expensive as older people live longer and form a larger proportion of the overall population (Scottish Government, 2010). Third, the prospect of budget reductions has accelerated a shift in mindset during detailed negotiations, from a discussion of budget rises for organisations such as local authorities, health boards and Universities, to a discussion of their relative share of the Scottish Government budget. Fourth, many of the key decisions on budget cuts may come increasingly at the local level (see chapter 10 on the local government 'Improvement Service' and the 'post-Christie' agenda which seeks to promote 'preventative spending' to address the gap between local budgets and service demand).

Conclusion

Although public expenditure is one of the most important aspects of public policy, the system to allocate money to territorial governments has remained untouched for a considerable time. The same basic Goschen and Barnett method - of treating the base as a given and then amending at the margins - has been used since the nineteenth century!

The longevity of such arrangements can be explained with reference to three themes running through this chapter: agenda-setting, incrementalism (or, in many cases, inheritance and inertia) and power. The Barnett formula was introduced in relative secrecy as a tempo rary measure and only acknowledged publicly when it had enough support within Government. Then, the formula was used to keep the potentially controversial issue of territorial finance out of the spotlight. This was even achieved following political devolution in 1999. Although the election of the SNP and the prospect of independence (and perhaps the temporary existence of a Scottish Prime Minister/Chancellor) has ensured that Barnett is more in the public eye than ever before, there has been no serious attempt by the Government to replace it. For both the Scottish and UK Governments, it provides a mecha nism to simplify territorial funding and avoid the complex and angst-ridden discussions of finance that we find in the USA and a range of other countries. Therefore, it would take a lot for both parties to renounce a system that has served them so well in the past, particularly since the alternative is a needs-based system that will struggle for political consensus.

The experience of Scottish finance informs a broader discussion of power. These issues may be best described as absolute power, relative power and perspectives of power. The centrality of the Treasury to the level of taxation raised in Scotland, as well as its influence over how the money is spent (regardless of EU involvement) demonstrates its absolute power. It also qual ifies the idea of a 'Scottish Political System' since the ultimate decision-making authority resides elsewhere. Yet, for most of devolution, the Treasury oversaw a period of staggering public expenditure growth in Scotland. The ability of Scotland to go its own way and determine its own spending priori ties also demonstrates a high level of power relative to similar sub-national territories (Box 11.4). Further, from an English regional perspective, the ability of Scotland to command a systematic advantage in the face of MP and media criticism demonstrates a power not available elsewhere. It is therefore diffi cult to maintain this image of Treasury power as a shadow or a constraint to Scottish decision-making when there are so many envious glances from commentators in England and other countries.

This chapter also highlights the potential for confusion and agenda-setting in the use and abuse of public expenditure statistics. Heightened atten tion to Barnett and Scotland's 'advantage' suggests that hyperbole and media coverage of the issue may reach an all time high. Therefore students of Scottish public finance should reserve a particular degree of scepticism. This skill may be particularly important as we enter the new 'age of austerity' and much political and intellectual energy is devoted to a debate on the extent of public service funding reductions and, therefore, the hard choices that must be made.

Further reading

On budgetary incrementalism see Musgrave and Peacock (1958: 16-28) and Wildavsky (1975). On Goschen and Barnett see Mitchell (2003a, 2003b), McLean and McMillan (2003), Keating (2005a), Heald and McLeod (2002), Bell and Mitchell (2001), Christie and Swales (2006), Twigger (1998), SPICE (2000a), Ferguson *et al.* (2003), Bell (2001) and Midwinter (2004a and 2004b). On the fiscal autonomy debate see *Scottish Affairs,* issue No. 41, special edition on fiscal autonomy, Keating (2010), Bell and Christie (2001). On the history of the politics of public expenditure, see Heald (1983), Heclo and Wildavsky (1974), Hogwood (1992) and Peacock and Wiseman (1967).

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