

# The Devolution Distraction



How Scotland's constitutional  
obsession leads to bad government

Tom Miers



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## About the Author

After a career in finance and management consultancy, Tom Miers worked as Executive Director at the Institute of Economic Affairs in London. Between 2003 and 2007 he ran the Policy Institute, a Scottish think tank. He now acts as an independent public policy consultant specialising in Scottish issues.

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# Executive Summary

Since the Scottish Parliament was established in 1999, Scotland's politicians have neglected to address the deep-seated social and economic problems faced by the country.

Public services such as education and health have declined in performance relative to other countries despite big increases in funding. The economy has languished behind the rest of the UK and Europe, and the cultural opportunities on offer have not been seized.

Why has so little been achieved?

In response to a mix of different motives, the Scottish political establishment is deeply conservative in its attitude to reform. Only on constitutional matters is there any drive for change.

Yet the problems Scotland faces are political in nature, not constitutional. If the huge increase in 'accountability' that took place with devolution in 1999 did not improve matters, there is no reason to suppose that further constitutional change will help. Scotland in fact already has the powers it needs to undertake radical reforms.

This report calls for a new approach to politics in Scotland, based on honesty in measuring performance, radicalism in policy making and a generational truce on the constitutional issue.

## 1. How devolution has failed to solve Scotland's real problems

Scotland's social and economic problems are serious and persistent. Yet by any objective analysis the devolved administration has failed to address them, as the table below summarises:

**Table 1: Scotland’s Performance Since Devolution**

Economy	GDP Growth	1.9% 1997-2007. Lower than UK, EU, OECD and all comparable small European economies.
	Entrepreneurialism	18th out of 20 advanced economies.
Public Sector	Public Spending	12% higher than UK average. Total budget doubled since devolution.
Education	% of pupils getting good grades	Up 1% to 48% 2002-09. English equivalent up 8% to 50%.
	International studies	All studies show relative decline over the last decade.
Health	Cancer survival	18th out of 21 OECD countries for men, 21st out of 21 for women.
	Productivity	Studies and data show little return for extra spending (11% higher than UK average).

Yet there is almost no recognition in the political establishment of the failures of Scotland’s public services. On economic matters politicians do recognise the problems, but action is limited to minor adjustments to local taxes and the policies of the regional development agency.

**2. Why the answer isn’t more constitutional tinkering: Holyrood has the powers it needs, but fails to use them properly**

The Scottish Parliament already controls 61% of government spending, equivalent to 29% of GDP. Yet public discourse is dominated by calls for further powers to be transferred, particularly on fiscal matters. The argument is that by transferring more responsibility to the Scottish Parliament, it will become more accountable, and therefore more effective.

In fact there is no accountability problem because the Scottish Parliament is already autonomous in most of the important areas of policy.

- The Scottish Government controls taxes that raise more money than it will ever either cut or increase, and so determines the overall level of taxation. It is therefore in effect fiscally autonomous. It directly controls all local taxes and part of income tax, amounting to 14% of its spending.
- Like any tier of government that controls spending, it can also reduce taxes by returning the money to taxpayers. For example, the Scottish Government could reduce corporate taxes in this way.
- It also can (and does) raise taxes through imposing charges, licence fees and other levies.
- Some argue that the Scottish Government lacks an incentive to lower taxes, because it would not benefit from the additional tax receipts generated from resulting higher economic growth. This argument is back to front, and the social, economic and electoral rewards from lower taxes are surely incentive enough.
- Arguments about North Sea oil revenues and the Barnett Formula are another distraction. Although public spending in Scotland is higher than it should be on a 'needs' basis, Barnett is simply the mechanism by which Scotland receives its oil revenue. No change to the Formula is politically sensible in the short term.
- The Scottish Government has unlimited leeway to reform the main public services, including health and education. It could, for example move to European style social insurance systems. It can and does use its spending powers to implement welfare policy.
- The Scottish Government has powerful tools to affect economic growth. It controls higher and further education, the land use planning system, transport and infrastructure finance. With

public private partnership arrangements it effectively possesses more borrowing powers than it could realistically use.

- The Scottish Government could have a profound influence on the cultural and sporting life of the country. It could act to revive the Gaelic language, bid to host the World Cup, or nurture the architectural and natural heritage of Scotland.
- On policing and criminal justice, the Scottish Government is essentially sovereign.

If there is no impediment in the constitutional settlement, why have policy makers in Scotland been so timid since devolution? What is the motive behind this conspiracy of inaction?

### 3. The motive for inaction

The various political factions in Scotland each have a motive for avoiding meaningful reform. In addition there are other factors peculiar to Scottish politics that encourage a conservative approach.

- Nationalists have a powerful motive to avoid economic or social reform because it strengthens the case for constitutional change.
- For the architects of devolution, including many in the Labour Party, the Scottish Parliament was designed to insulate Scotland from reforms instigated by the UK government. There is a motive to maintain the status quo as the new institutions take root.
- The opponents of devolution who want to remain engaged in Scotland now crave acceptability. Many Conservatives and businessmen do not want to 'rock the boat' by suggesting a new approach.
- Inaction is encouraged by hostility to developments South of the Border. Reforms undertaken in London are rejected as being Thatcherite, even if implemented by a Labour government. Even ideas that originate in admired countries such as Sweden are abhorred if they subsequently gain credence in England.

- The vested producer interests that oppose reform are more entrenched in Scotland. 23% of workers are in the public sector compared to 19.8% UK-wide.
- For the senior commentariat, policy makers and opinion formers, it is more interesting to discuss grand constitutional issues rather than supply side economic and social reforms.

#### 4. A new approach

Until the political means of improving Scotland's lot have been fully explored, there is little need for constitutional reform. Reform of the key public services and institutional structures that underpin economic success would be the work of many political cycles. Scotland should not consider major constitutional change for at least a generation.

Furthermore, endless debate on the constitution draws political energy away from dealing with the real problems that afflict Scotland. This contributes to the prevailing inaction on policy-making on the economy and social welfare.

And the potential for the current arrangement has not been fully explored. With the devolved settlement, Scotland potentially holds a uniquely advantageous position. It has both global influence and reach as part of the UK with the ability for nimble self-government on domestic issues.

This report suggests three measures to find a new approach to politics in Scotland.

1. Scotland's political class should call a generational truce on constitutional matters. The new UK government and other parties should draw a line under the debate by accepting and implementing the Calman Commission proposals, which have the merit of emphasising Scotland's existing powers rather than extending them significantly.

2. The Scottish Government and public institutions should insist on a new honesty in assessing success and failure. Monopoly public services should be rigorously and systematically compared against equivalents in other countries.
3. Scotland's leaders should embrace a new radicalism. A new sense of optimism and ambition should be applied to the economy, with novel approaches to tax and benefits, planning reform, infrastructure investment and higher education. Public sector reforms should explicitly be modelled on the best systems from around the world.

The combination of economic and social decline, conservative policy making and endless constitutional debate in Scotland cries out for a new approach. Those who first articulate it persuasively will set the agenda for many years to come.

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# Introduction – A conspiracy of inaction

Since 1999, when the Scottish Parliament was established, the various governing administrations have neglected to address the many deep seated problems that confront Scotland.

The evidence is clear: the public services that are the prime responsibility of the devolved government have stagnated and even declined in performance compared to those in other developed countries.

As a result, Scottish society continues to experience very serious social problems, particularly in educational attainment, health, crime, drug misuse and social deprivation.

At the same time the political class, with all its new found resources and legitimacy, has failed to exploit the exciting cultural opportunities that are offered by a country of Scotland's immense traditions.

Both of these failures have contributed to Scotland's dismal economic performance, which still lags badly behind on most measures.

Why has so little been attempted to resolve these problems over the last decade?

This report argues that the Scottish political establishment is deeply conservative in policy terms, held back from serious institutional reform by a number of retrograde motives. For a variety of reasons to do in part with history and political positioning, most of the main political groupings perceive reform to be counter to their interests.

The exception to this is in constitutional matters. A large section of the political class sees constitutional reform either as a desirable end in itself, or as a means of achieving improved economic or social performance. If only the Scottish Government can acquire

more power and accountability, the argument goes, it will be able (or will be forced) to address the problems at hand.

This tendency reinforces the prevailing climate of inaction because it diverts intellectual and political energy from dealing with the real issues at stake. In effect Scottish politics is divided into two camps: those who do not see the need for reform, and those who think it can only be achieved after constitutional change. The result is inaction.

Such stasis is bad for Scotland. However, it is eminently avoidable. This report argues that the failure of devolution is not constitutional in nature. If the huge increase in ‘accountability’ that took place with devolution itself in 1999 did not improve matters, there is no reason to suppose that further constitutional change will help.

Instead, devolution’s failure is political. The mechanisms of devolved government have the potential to work well. This paper demonstrates that the Scottish Parliament already possesses the powers needed to pursue a radical, reforming agenda in most important areas, including the financial arena. And where power lies in elected politics, so does accountability.

The focus of public discourse in Scotland on the constitution is not just a red herring, however. It is much more dangerous than that. The constitutional distraction sucks political energy away from the reforming agenda that Scotland is crying out for, diminishing the life chances of countless Scots and undermining confidence in the political system.

So this report recommends a new political approach for all those – whether in the ‘denialist’ tendency or the ‘constitutionalist’ wing or neither – who wish to see Scotland flourish.

It calls for an end to inaction and an end to constitutional navel gazing. It suggests ways to set Scotland on a new path of healthy institutional reform and national self-confidence. The new UK Government has promised to follow the agenda of further constitutional reform, based on the recommendations of the Calman Commission. It must use this as an opportunity to draw a line under devolution and refocus political effort on the many serious issues that affect Scots in the real world.

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# 1. How devolution has failed to solve Scotland's real problems

Scotland's social and economic problems are serious and persistent. Yet by any objective analysis the devolved administration – now calling itself the 'The Scottish Government'<sup>1</sup> – has failed to address them.

This report is not primarily about Scotland's performance over the last decade, but about why the governing class has failed its people and what can be done about it. Nonetheless it is worth looking in brief at three main areas of devolved responsibility to emphasise the magnitude of this failure and therefore the importance of the task in hand.

The two primary functions of the Scottish Government are to administer Scotland's health and education systems. Together, these account for more than half of its annual spending. Neither has shown significant improvement in performance over the last decade, despite enjoying an enormous increase in spending. At the same time, comparable systems outside Scotland have improved. This adds up to a serious failure of policy, and a major waste of public funds.

Meanwhile the Scottish economy has not improved its lamentable growth rate, despite the exhortations of a series of political leaders.

## School education – yesterday's pride and joy

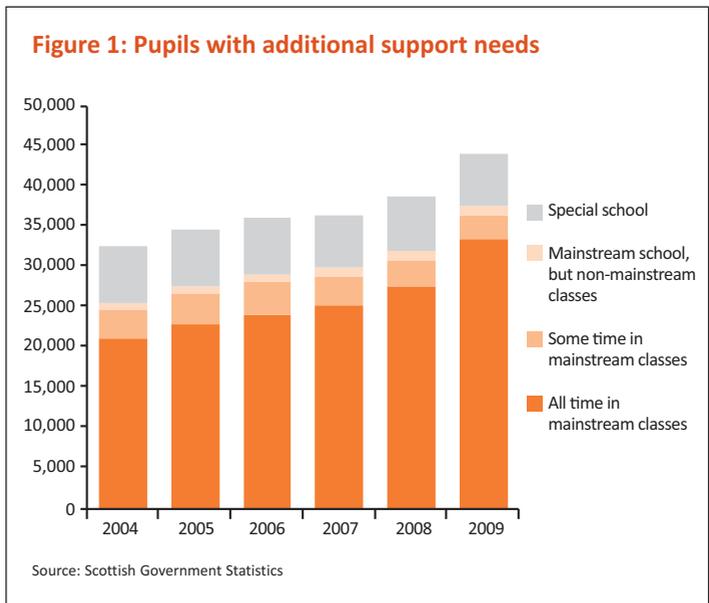
Scotland has a long tradition of educational excellence that goes back to the Reformation. Its basis was a network of parish schools that delivered one of the world's first mass literate societies, superimposed by a cluster of excellent universities established in the late middle ages.<sup>2</sup>

1 The formal name of the devolved executive, as defined under S.44 Scotland Act 1998 is 'The Scottish Executive'. Since 2007 the SNP minority government has rebranded this 'The Scottish Government'.

2 Originally St Andrews (founded 1413), Glasgow (1451), Aberdeen (1495), Edinburgh (1583), Marischal College (1593, and merged with Aberdeen in 1860).

A nationwide ethic still exists that takes pride in education and promotes its importance. It is all the more tragic, therefore, that the evidence points to educational outcomes that are mediocre and even falling behind.

Most recently, a 2009 report by the Literacy Commission, set up by the Labour Party, found that 18.5% of pupils leaving primary school were functionally illiterate<sup>3</sup>. Meanwhile, there has been an upward trend in the numbers of pupils needing ‘additional support’:



These figures are poor in absolute terms, and their deterioration over time is particularly worrying. They indicate that there is a large ‘tail’ of children who are being failed by the education system.

On their own, however, they do not tell us much about the state of Scottish schools relative to the normal conditions of childhood, or else to what happens in other educational jurisdictions. Without reference to past or place they are an inadequate guide to the performance of the Scottish administration as a competent purveyor of educational services.

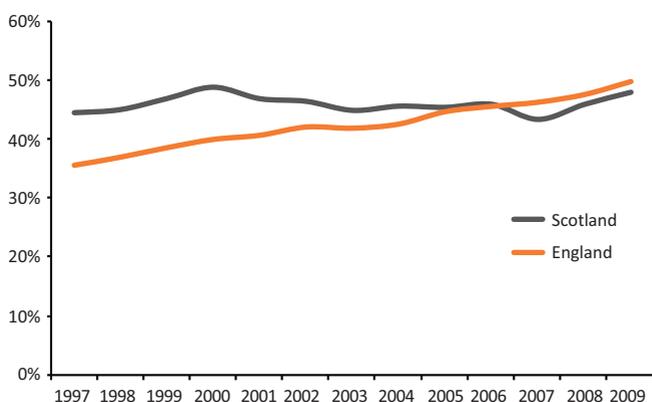
<sup>3</sup> A Vision for Scotland – The Report and Final Recommendations of the Literacy Commission.

It is evidence on the performance of Scottish schools relative to their counterparts elsewhere or over time that supplies the clearest picture, and this too gives cause for concern.

Although most Scots pupils take exams under the distinctive Scottish system, a widely accepted equivalence has been established between grades in the constituent parts of the UK. This is recognised by universities, employers and educational experts, and this gives a useful comparison of the output of Scottish schools with their UK counterparts.

The best measure, particularly when taken over time, compares the exams taken at the end of compulsory education and includes the core subjects of English and Maths.<sup>4</sup> This is used as a performance benchmark by educationalists and government in England, though tellingly the Scottish Government does not even publish it.<sup>5</sup> The following graph shows the performance of Scottish state schools against their English equivalents on this measure:

**Figure 2: % of pupils with 5 good grades including English and Maths at the end of compulsory education**



Source: Scottish Government and Department for Education.

4 So the chances of the sample being skewed by schools opting for easier courses, or to exclude weaker candidates, is minimised.

5 The data is collected at the behest of the Office of National Statistics, hence its availability.

Over the last decade Scottish schools have stagnated to a level where more than half of pupils are incapable of attaining five decent exam grades at the end of ten years at school. During the same period their English counterparts have improved steadily to the point where they are now superior.

Some Scottish commentators like to suggest that this data does not compare like with like, or is unreliable because the English figures suffer from ‘grade inflation’. There is, however, no reason to think that the Scottish data is inflated more than the English results.

“Over the last decade Scottish schools have stagnated to a level where more than half of pupils are incapable of attaining five decent exam grades at the end of ten years at school”

In addition to this UK evidence, a number of international bodies have attempted to measure the performance of schools and pupils in different countries. These studies are fraught with problems because they use different (and limited) samples and measuring techniques, and the participants treat the

exercises in different ways. Scotland takes part in three of these.

Like all the English-speaking countries, Scotland did well in the first of the OECD’s PISA series.<sup>6</sup> However, the trend since then is one of gentle relative decline over the last decade. In other studies the Scots have done badly. The PIRLS studies of 2001 and 2006 showed Scottish pupils falling to near the bottom of the sample, while the four yearly TIMMS study has Scotland consistently near the bottom of the group.<sup>7</sup>

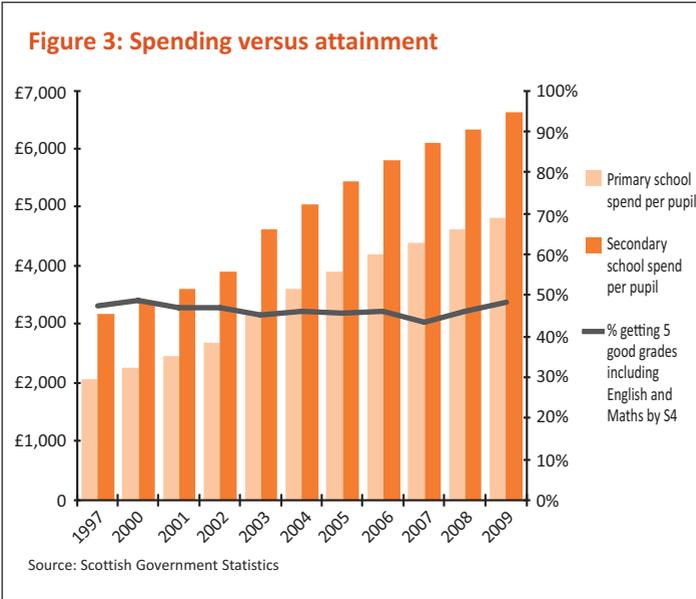
The stagnation in school performance has come at a time of enormous increases in the money put into Scottish schooling. Since devolution, spending per pupil has increased by more than 50% in real terms.

At the same time Scottish education continues to receive greater funding than that in England. In 2008/9 spending per capita on education was 9% higher north of the Border than the UK average.<sup>8</sup>

<sup>6</sup> See <http://www.scotland.gov.uk/Topics/Statistics/Browse/School-Education/PISA>.

<sup>7</sup> *Trends in International Mathematics and Science Study*. See <http://timss.bc.edu/>.

<sup>8</sup> *Government Expenditure & Revenue Scotland (GERS)*, the annual comparative study of public spending in the UK and Scotland, published by the Scottish Government.



So the best available data points not just to attainment rates that are stagnant, but to plummeting productivity that implies a waste of billions of pounds of taxpayers' money. What is more, the areas of lowest attainment are those with the highest levels of social deprivation<sup>9</sup>, which indicates that the comprehensive system is failing to address inequality. Educational outcomes seem to be a product of wealth, with the school experience almost incidental to success.

In terms both of public service provision and fiscal rectitude therefore, the successive devolved governments have failed in this, their most important undertaking – the education of Scottish children.

By contrast, in England real debate takes place on educational attainment, based on a cross-party recognition that standards are too low. Serious attempts at reform have taken place over the last two decades, from John Major's City Technology Colleges, to Tony Blair's Academy programme, to the current government's 'Free Schools' proposals. While there remain concerns about the quality

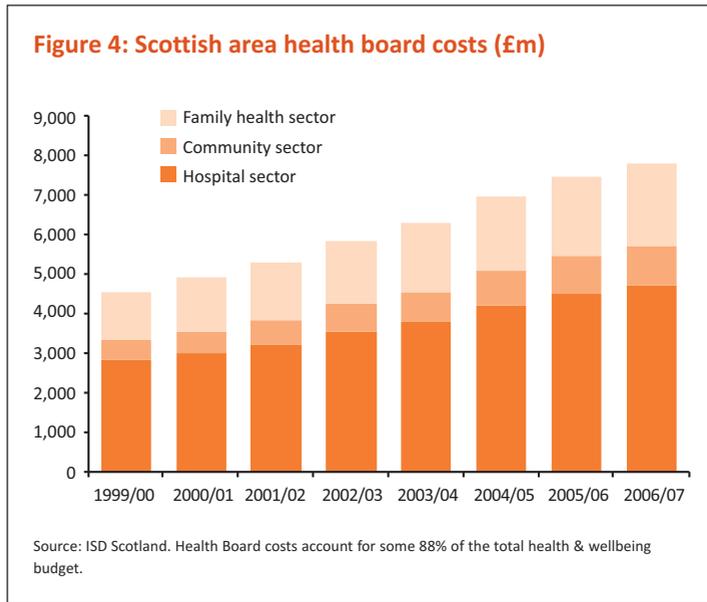
<sup>9</sup> In Glasgow only 37% of pupils attained the 5 grade minimum, and in Dundee 41%.

of education in England, there can be no doubt as to the dynamism of educational debate, based on a pragmatic analysis of real problems to be solved.

### Health – the people as scapegoats

Accounting for nearly £11.9 billion – 34% of the Scottish Government’s budget, healthcare is fiscally its greatest responsibility.<sup>10</sup>

Like the other public services, the NHS has seen an extraordinary rise in the financial resources directed at it since devolution, as the graph below shows.



10 The ‘Health and Wellbeing’ element of the 2010/11 budget.

11 After 2005 the method of measuring staff numbers changed, making it difficult to extrapolate the trend further.

12 And therefore higher still than per capita spending in England, which is lower than in Scotland, Wales and Northern Ireland.

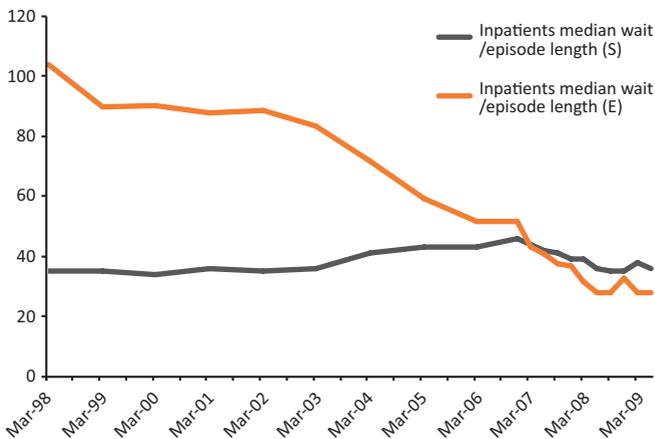
At the same time, numbers of NHS staff have risen commensurately, by 15% in the first six years of devolution.<sup>11</sup> Again, spending per capita is significantly higher than the UK average, 11% according to the latest GERS figures<sup>12</sup>.

Overall public health statistics show that Scots have lower life expectancy than the OECD average<sup>13</sup>, but that both the incidence of and mortality from the major diseases is declining<sup>14</sup>. None of this is comprehensive evidence for the efficacy of the NHS or of policy making by Scottish administrations, however, because it is mainly a product of lifestyle choices, geography, genetics and other outside factors.

The main data collected domestically for health service performance concerns waiting times. This shows that waiting in key target categories has declined dramatically. For example, the number of inpatients and day cases waiting for more than fifteen weeks declined from 1,956 to 40, and of patients waiting for an outpatient consultation fell from 4,578 to 28.

But the evidence shows that the total amount of waiting has not fallen under devolution. The mean wait has stayed roughly stable. At the same time rates in England have fallen significantly:

**Figure 5: Inpatient median waits in England and Scotland**



Source: ISD Scotland, Department of Health.

13 74.6 years for men compared to the OECD average of 75.7, and 79.6 for women (81.4). *Health at a Glance, OECD.*

14 Mortality rates have fallen by 20% for cancer between 1995 and 2008, 55% for coronary heart disease and 48% for strokes, according to Scottish Government Health Statistics.

What we see is a picture of maximum waiting times for a number of medical procedures falling to within targeted limits, but overall output on this measure not improving dramatically. This is arguably progress of a sort, and may contribute to the peace of mind of some patients, but it hardly speaks of a major breakthrough in health service effectiveness.

But even waiting lists in themselves do not reveal much about the performance of a health service. Waiting is not in itself necessarily bad for clinical outcomes. Sometimes, in a situation where resources are limited, it makes more sense to leave a patient waiting longer if that leaves more resources to invest in, say, new equipment. At best, waiting lists are a rough guide to quality of service. Nobody likes to queue.

Surveys of patient satisfaction show that those who use the NHS hold it in high regard. But since very few Scots have experience of any alternative, this sort of data carries little weight in isolation.

So what evidence is there to assess the performance of NHS Scotland in its central task of curing the sick?

To be fair, it is notoriously difficult to compare the performance of health services in different countries. Attempts are being made in international academic circles to identify measures such as ‘avoidable mortality’ (the rates of death once an illness has been diagnosed). Another effort focuses on defining units of additional life saved by medical procedures,<sup>15</sup> which can then be added up to arrive at an overall figure for health service output.

Both of these approaches are beset with problems of comparability across jurisdictions. Also, the data takes a long time to accumulate, so it is difficult to get either a recent picture or one which tells a story over time.

However, the available studies show Scotland’s NHS performing badly. In January 2010 the Nuffield Trust published a study of comparative performance across the four UK jurisdictions since devolution. It focussed on productivity and inputs rather than health service

<sup>15</sup> ‘QALYS’ – quality of life-adjusted years.

outcomes. The study found that, while resources per capita were highest in Scotland and Northern Ireland, in terms of staff as well as money spent, productivity as measured by medical activity per staff member was lowest on most measures, and universally lower than in England<sup>16</sup>.

Even compared to English regions with a similar demographic profile, such as the North East, the Scottish NHS suffered from poor productivity despite high inputs. For example, despite 6% lower funding, the service in the North East handled 18% more outpatient attendances, 40% more day cases and 50% more inpatient admissions. The report concluded that “Scotland is an outlier in almost all the domains of performance... it appears to perform less well than anywhere else on almost every measure examined.”

In June 2010, the Centre for Public Policy for Regions published a report looking at the effectiveness of health spending in Scotland<sup>17</sup>. It questioned the Nuffield Trust data, but arrived at a similar conclusion, that there was little evidence that the extra spending in Scotland was justified.

The most recent international studies of healthcare outcomes also show Scotland's NHS performing badly. A recent paper reported in the *Lancet Oncology* by the University of Milan, shows Scotland in 18th place out of 21 European and North American countries in terms of male cancer survival rates and 21st for females.<sup>18</sup>

Overall, the evidence points to a Scottish health service that suffers from declining productivity, inadequate levels of service and poor treatment outcomes by comparison with services in comparable OECD jurisdictions.

Yet these outcomes are barely recognised in Scottish political debate. Instead, discussion in political circles and the media focuses on lifestyle problems. The policy response in healthcare, aside from target management and greater resource allocation, focuses on coercive attempts to force Scots to lead healthier lives. Scotland was the first UK country to ban smoking in public places, has already banned the use of sun beds for under 18s, and increased the licence

*16 Funding and Performance of Healthcare Systems in the Four Countries of the UK*, Nuffield Trust January 2010.

Some of the data on staff numbers was subsequently revised, improving the productivity figures, but they remained poor on a comparative basis.

*17 Spending on Health*, CPPR June 2010.

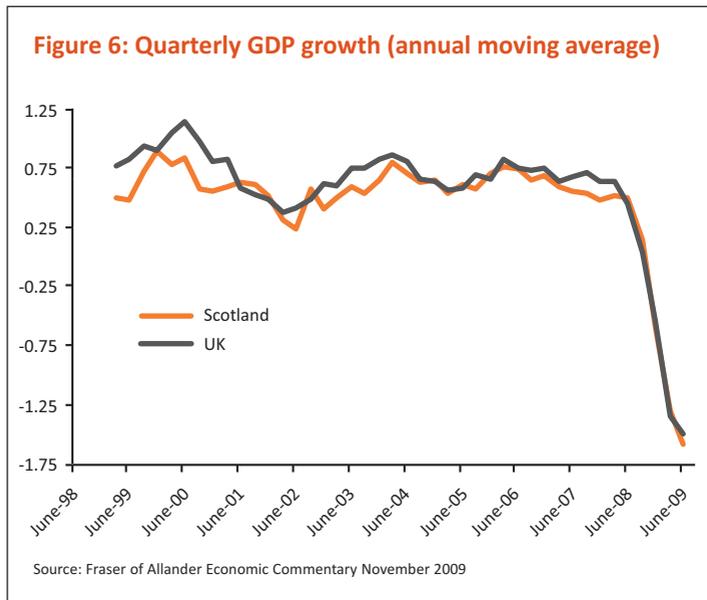
18 July 2008. The study looked at those diagnosed with cancer in Scotland between 2000 and 2002 and counted survivors after five years. It was conducted by the National Cancer Institute in Milan.

fees payable to serve alcoholic refreshments. The government wants to restrict cigarette displays in shops and introduce minimum pricing for alcoholic drinks. There are constant publicity campaigns exhorting Scots to exercise more and eat less fatty foods.

There is a huge focus on public health. It is almost as if the problems of the NHS were the fault of the Scottish people. For there is very little discussion about how to run an effective health service – a service which has barely changed in the last ten years.

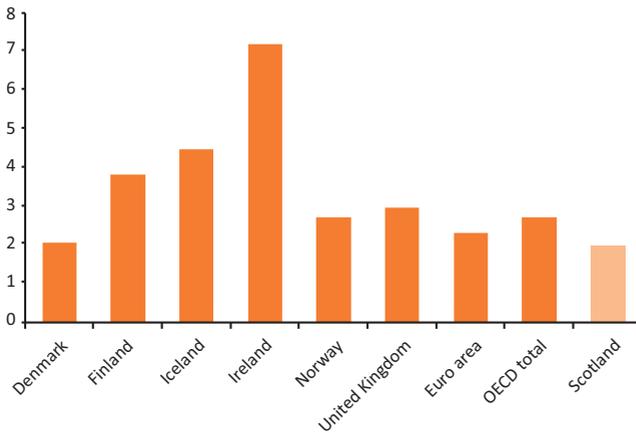
### Economic lack-of-growth

Unlike with public services, there is no lack of comparative data on overall economic performance. Despite the success of a couple of sectors such as financial services (at least until the recent recession), Scotland’s economy has done badly since devolution. Growth has been consistently lower than the UK as a whole:



Scotland has also failed to keep pace with other small OECD countries which many commentators hold up as examples to follow:

**Figure 7: Average annual GDP growth 1997-2007 (%)**



Source: OECD Statistical Compendium. The data does not extend to cover the exceptional effects of the credit crunch, which were particularly severe in Ireland and Iceland.

The search for the underlying components of Scotland's poor performance is something of a specialist interest among Scotland's economists. In some areas Scotland does quite well. As in the rest of the UK, unemployment rates (including long term and youth unemployment) declined dramatically after the recession of the early 1990s.

Yet high levels of employment in Scotland are probably as much a function of the high levels of public spending and public sector employment in Scotland, as of an efficient labour market. This itself is a subject of much investigation as a possible hindrance to growth.<sup>19</sup>

Productivity, earnings, investment and R&D are all below the UK average, though in line with other parts of Britain outside London.<sup>20</sup>

<sup>19</sup> For example, see the *Fraser of Allander Economic Commentary 2009*.

<sup>20</sup> For a succinct discussion of the data on the labour market, productivity, investment, earnings, R&D etc, a see *The Key to Economic Success in Scotland*, Profs Brian Ashcroft & David Bell, Policy Institute 2008.

Perhaps most telling is a lack of new business formation in Scotland, particularly in the old industrial heartlands around Glasgow. This is measured in a number of different ways, including the Global Entrepreneurship Monitor, produced by the University of Strathclyde. This examines ‘Total Entrepreneurial Activity’ in 43 sovereign nations plus Scotland, with countries divided into groups by income and stage of development. The 2009 study ranked Scotland 18th out of 20 ‘innovation-driven’ economies.

None of these measures show any significant improvement in Scotland’s relative performance since devolution, despite the intense political and media focus on the economy. However the policy response to this state of affairs has been very limited. It is remarkable how little has been attempted on the economy as on the other great domestic issues, compared to the potential that exists for action.

### See no evil, hear no evil

What is most striking about the story of devolution so far is that there has been no serious attempt to address these problems since power was devolved to the Scottish Parliament in 1999. Not even the politically dramatic switch from a Labour-led to a Nationalist administration in 2007 resulted in meaningful changes in policy.

Problems with the welfare state, including education and health are largely unrecognised. The only policy responses have been legislative (such as the ban on smoking in public places) and increases in resources directed at the relevant departments. These increases have been significant, resulting in a doubling of the Scottish Government’s budget between 1999 and 2008.<sup>21</sup> But even this has been more a functional result of increases in UK spending, rather than any deliberately formulated strategy.

In the case of the NHS, there is little recognition of the comparative weakness in quality and performance, and there has been

21 Scottish Government statistics tend to be reported in absolute terms. A 100% increase between 1999 and 2008 is equivalent to an 80% increase in real terms.

almost no discussion at the governmental level of the alternative approaches to healthcare deployed in other countries. The media dutifully reports the latest data on waiting times or outbreaks of hospital acquired infections, but these are seen purely within a Scottish context.

In school education, the concerted efforts of a small group of academics and commentators<sup>22</sup> have led to a grudging recognition in some quarters that all might not be well. Indeed, the recent demotion of the Education Minister<sup>23</sup> is some indication that the government is coming under pressure to improve performance, though again the immediate cause of the crisis was an argument about inputs (class sizes and teacher numbers), not actual performance.

Economic weakness is a major topic of debate, with both the media and the political classes taking a keen interest in Scotland's disappointing performance. The current First Minister has an ambitious goal of matching the UK's growth rate by 2011, and that of smaller EU countries by 2017. But again, in policy terms little has been attempted. The major policy lever that is tugged, and tugged again, is the Regional Development Agency, Scottish Enterprise (SE).

The budgets of SE, and its smaller sister Highlands and Islands Enterprise, stand at £377 million, 0.4% of GDP, and double<sup>24</sup> the per capita budget for economic development in the UK as a whole. The agency has been revamped on numerous occasions, with a current focus on business start-ups, attracting investment, and promoting key sectors. SE conducts impact assessments on its projects designed to show that it adds value. But it is impossible to tell whether overall the agency adds to economic growth or detracts from it. Anecdotally, businessmen report that the time and effort consumed in applying for SE's help often outweighs the assistance received. 30% of SE's budget goes on salaries, and it is entirely likely that the Scottish economy would benefit more from a £377 million tax cut than spending the money in this way.<sup>25</sup>

22 See, for example, successive reports by the Policy Institute and Reform Scotland, or the work of former Labour adviser John McLaren.

23 Fiona Hyslop was replaced by Mike Russell in December 2009. Russell has in the past expressed interest in a reforming programme of encouraging competition, though the Scottish Government denied that this agenda would be followed. Since his appointment he has been supportive of a project undertaken by East Lothian Council to look at reforming schools to increase their operational independence.

24 Spending per head in England is £35, compared to £75 in Scotland (see Scottish Enterprise and Department for Business, Innovation & Skills data).

25 Indeed, regional development bodies and funding are early targets for the new UK government's programme of retrenchment.

Aside from this there have been numerous minor initiatives in areas such as skills training, a small reduction in non domestic rates<sup>26</sup>, and minor subsidies for promising industries such as the renewable energy sector<sup>27</sup>, none of which could be expected to have much impact even if they were implemented faultlessly.

<sup>26</sup> Now once again at the same level as in England.

<sup>27</sup> Including a rates discount and the £10 million Saltire Prize for advances in wave and tidal energy.

Beyond this, the subject of economic performance, as with many other matters, is addressed to a large extent in the context of constitutional reform. The main purpose of this report is to explain why this is an unnecessary distraction, and what can be done about it.

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## 2. Why the answer isn't more constitutional tinkering: Holyrood has the powers it needs, but fails to use them properly

The Scottish Parliament controls 61% of public spending in Scotland, accounting for 29% of non-oil GDP. Yet greater devolution, particularly on tax powers, is promoted by a broad spectrum of the political establishment in Scotland, and is now to an extent supported by the new UK coalition government. 'Fiscal Autonomy' – the idea that the Scottish Parliament should raise more or all of the money it spends, is advocated by numerous economists, think tanks, media commentators, politicians and business figures on the grounds that it will encourage greater fiscal rectitude and redress perceived imbalances in the way Scotland is funded.

Various other groups support constitutional change for different reasons, whether to create a more logical settlement across the UK<sup>28</sup>, or as a tactic to undermine nationalism<sup>29</sup>, or simply as an easier route to tackling a particular issue.<sup>30</sup>

On the question of accountability, inspection of the Scotland Act actually reveals that the Parliament already possesses near sovereign powers on most issues. Of course, only independence would yield control over foreign and defence policy. But since the influence and military clout of an independent Scotland would be nugatory, on these matters independence would in fact surrender real power to influence global and regional affairs in Scotland's interest.

28 Such as a federal structure across the UK nations and English regions, promoted at various times by the Liberal Democrats.

29 On the grounds that a better settlement would 'satisfy' public appetite for more self-determination.

30 For example the current clamour to ban airguns in Scotland would be more easily assuaged if the relevant powers were devolved.

There is, therefore, no accountability problem. The Scottish Parliament is already autonomous in the important areas where government of a small European country can plausibly make a difference. This section looks at the powers of the Scottish Parliament in more detail and explains how they could be used to engender radical change in most fields.

It concludes by explaining why the twin issue of North Sea Oil and the Barnett Formula is a further red herring that distracts attention in Scotland from the real business of government.

### **Powers over tax – a wilful misunderstanding**

If any government controls taxes that raise more money than it will ever either cut or increase, it is fiscally autonomous. This is because it determines the overall level of taxation in its jurisdiction. If it is also elected, it is by definition fiscally accountable.

The Scottish Government fits into this category. It is both elected and is capable of setting the overall level of taxation in Scotland. It is therefore fiscally autonomous and accountable.

So the continued debate about fiscal autonomy in Scotland, which consumes an enormous amount of Scotland's political energy, is a red herring. It is as if the whole discussion is based on a wilful misunderstanding of the powers granted under the Scotland Act. Why this has come about is discussed in the next section. But it is worth exploring those powers in some detail here.

### **The Scottish Parliament's Formal Tax Powers**

A glance at the figures shows that the devolved Scottish government possesses formal tax powers that, in aggregate, account for more revenue than would be foregone by even the most aggressive of tax-cutting administrations.

We know that the Scottish government can (and does) manipulate the level of Council Tax by adjusting the responsibilities of local

councils and changing the amount granted to them by central government. The current 'concordats' between central and local government, whereby local authorities have agreed to freeze council tax in return for greater discretion over spending, demonstrate that. A tax-cutting administration could induce local councils to cut Council Tax in return for a bigger grant.

Under the Scotland Act, the Scottish Government has wide powers over local taxation, and recently attempted to replace Council Tax altogether with a local income tax. The reform foundered because it lacked sufficient support in the Scottish Parliament, and would have caused complications with the payment of Council Tax benefit in Scotland. However, the debate highlighted the devolved administrations competence in this area. A tax cutting administration could simply legislate to scrap local taxation altogether, for example.

The Scottish Government also sets the non-domestic rate poundage, the local property tax levied on businesses and other institutions. Notionally, this is another local tax, but in practice it is pooled centrally and then redistributed, so is in effect set and collected at the behest of the Scottish Government.

Finally, the Scottish Government has the power to vary income tax by 3p in the pound. This power, dubbed the 'Tartan Tax' on its inception by the opponents of devolution, was added late in the debate on devolution to add some more fiscal accountability to the Scottish Parliament's responsibilities. It has never been used.

Council Tax, non-domestic rates and the 3p's worth of income tax yielded £2.0 billion, £1.7 billion and £1.1 billion<sup>31</sup> respectively in 2008/9, in total accounting for 9% of total government spending in Scotland, or 14.2% of the Holyrood government's spending.

Reducing taxes by this amount would be the theoretical equivalent of halving income tax. It is nearly impossible to envisage

“A tax-cutting administration could induce local councils to cut Council Tax in return for a bigger grant”

<sup>31</sup> The latest figures are for 2008/9 according to Government Expenditure and Revenue Scotland (GERS) June 2010. In the case of the Tartan Tax based on a previous estimate that it would account for around 10% of the income tax yield.

any Scottish government, of whichever political hue, cutting its expenditure by that amount. Experience shows that in western democracies, taxation rarely falls below 40% as a proportion of GDP. In socialistic Scotland, where government spending accounts for around half of GDP<sup>32</sup>, even that threshold is inconceivable.

Similarly, the scope for raising taxes is greater than could realistically be contemplated. Local taxes can in theory be raised indefinitely, and the 3p income tax rules goes either way.

Contrary to received wisdom therefore, the Scottish Government has more leeway than it would realistically use just taking into account its formal tax powers.

It therefore effectively sets the overall level of tax, and so is fiscally autonomous.

### The Scottish Parliament's Informal Tax Powers

But in theory a radical Scottish Government could go even further than its formal powers, because its discretion on spending is unlimited. It could therefore reduce expenditure on its various programmes by whatever amount it wanted to cut taxes by, and simply hand the money thus saved back to taxpayers, effectively allowing it to reduce all sorts of business and personal taxes as well.

For example, economic commentators in Scotland often point to the apparent Irish success in reducing corporation tax as a way of attracting inward investment. Some bemoan the fact that Scotland cannot follow a similar path.

But in fact, because the devolved government controls spending, it could replicate that policy almost exactly, by rebating Scottish companies the proportion of their corporation tax liability that it wanted to cut. So if the Scottish Government decided to halve corporation tax, it would simply invite Scottish companies to submit the previous year's audited tax statement and refund 50% of it.

32 The latest GERS figures show public spending at 48% of non-oil GDP. This has almost certainly increased further as a result of the recession.

Rebating tax liabilities may go against the grain of how the authors of the devolution settlement imagined that its powers would be used, and in today's terms would be politically controversial, but that would nonetheless be in the nature of such a radical tax cutting programme.

In legal terms such a move is in line with existing government payments to industry, which, as long as they are universally applicable, do not contravene competition rules. And an equivalent rebate paid to personal taxpayers would be similar to other personal benefits awarded by the Scottish Government.

Curiously, a precedent for using rebates as a proxy for tax cuts was set by the former Prime Minister and Labour leader Gordon Brown when he was Chancellor. He circumvented EU rules on VAT by rebating religious organisations their tax on building repairs.

Ironically the process would be simpler and cheaper than a new 'treasury function' advocated by fiscal autonomy enthusiasts<sup>33</sup>, because the tax assessments would have already been undertaken to comply with UK HM Customs and Revenue requirements.

On top of this the Scottish Government also possesses additional tax raising powers that go well beyond the usually recognised trio of Council Tax, non-domestic rates and income tax. It can in some areas invent new taxes.<sup>34</sup> And it has rediscovered an old trick used by governments throughout history that have lacked formal authority to raise taxes. The Scottish Government can licence certain activities and charge what it likes for the granting of those licences. For example, the cost of a licence to sell alcohol in restaurants, pubs and cafes was increased under the new Licensing Act, which came into force in 2009.

It is true that the range of tax powers is somewhat limited in scope. The Scottish Government cannot, for example, increase inheritance tax thresholds or VAT rates. And it would be complicated to adjust the detail of income tax bands using a rebate system.

33 A paper released by the Scotland Office in November 2009 estimated that compliance costs under a separate Scottish tax system would rise by £500 million.

34 For example, it has been encouraged to introduce a 'plastic bag' tax on disposable shopping bags.

However, the devolved administration's range of tax powers is much greater than is usually assumed by commentators and the wider public, as the box below illustrates.

### **The Celtic Lion – Scotland as a Low Tax Economy**

It's 2015 and the chickens have finally come home to roost. Fed up with high unemployment, and a bloated public sector, the electorate have chosen a new Scottish Government with a remit to scrap the high tax, high spend model that has seen the country rise to the top of the public spending charts and sink to the bottom of the growth league table.

The new government can't change the Barnett formula, which was kept after a new commission on the constitution told the politicians to stop arguing about devolution and roll their sleeves up. But it doesn't need to.

In its first budget it reduces income tax by 3p, and the poundage on non-domestic rates to zero, saving businesses and employees £3 billion. Then it legislates to reform local government finance – by scrapping council tax, which means £2 billion more returned to taxpayers.

After an OECD report drew a clear correlation between corporation tax rates and inward investment, the next step is obvious. The Scottish Government announces that all Scottish companies will be rebated on the corporation tax on Scottish earnings as defined by the usual internationally agreed definitions. All they need to do is make an audited submission once their annual tax liability has been determined. The effective rate is reduced to 33%, saving Scottish companies a further £1 billion.

The total cut of £6 billion reduces tax as a proportion of Scottish GDP from 48% to 42%, moving Scotland into the lowest quartile of OECD countries. The government's poll ratings soar alongside disposable incomes, as Honda-Fiat announce a major new manufacturing plant in Renfrewshire and HSBC moves its global HQ to Edinburgh.

Figures approximated from Government Expenditure & Revenues Scotland 2008/9

Moreover, more important economically than the levels of individual taxes is the overall burden of tax on the economy. So the fact that the Scottish Government is limited in the range of taxes at its disposal is relatively unimportant. What counts is that it can set the overall level of tax in the economy using a broad range of different levies that could be targeted at the full range of taxpayers.

The two main arguments of those who advocate greater 'fiscal autonomy' – that the Scottish Government lacks sufficient tax powers to affect economic growth, and that it cannot gain electoral reward from changing tax rates – are manifestly untrue, therefore.

### Fiscal Autonomy and the Laffer Curve

Reformers often cite a third reason for fiscal autonomy, however. They state that the Scottish Government cannot benefit from higher revenues generated by the additional economic growth stimulated by lowering taxes, and so it has insufficient incentive to do so.

It is a maxim among some enthusiasts for lower taxes that a virtuous circle, known as the Laffer Curve, is achievable whereby the growth in economic activity caused by lower taxation causes tax revenues to rise in aggregate terms. The argument in favour of fiscal autonomy is that, without the prospect of higher revenues, the Scottish Government would have less incentive to cut taxes.

The logic of this is surely back-to-front. A government's prime motive in cutting taxes is not to increase its own revenues but to lower the tax burden and reap the economic and electoral rewards of doing so.

Besides, this beneficial effect on revenues is unreliable because it depends on the circumstances of the economy in question, especially the scope for the tax base to increase quickly. At best any revenue rewards are delayed, and provide further opportunity for tax cuts in the future, rather than a financial incentive in itself.

The Scottish Government has plenty of opportunity for economy-boosting, vote-winning tax cuts as it is. It is most unlikely that the Laffer Curve effect would be a primary motivation for a tax-cutting Scottish Government.

### Powers over public services

The main activity of modern democratic governments, certainly in terms of treasure and effort expended, is in managing the redistribution of wealth. We have already seen how the Scottish Government is capable of setting the overall level of tax. On health and education, two of the main pillars of the welfare state, the

“On health and education, two of the main pillars of the welfare state, the Scottish Government has complete discretion. The full range of policy options is available to it, from the current centralised approach all the way through to complete privatisation, and every form of social democratic model in between”

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For example, the Scottish Government could undertake radical supply-side reforms to remodel the health and schooling systems along continental European lines. It could award institutional independence to providers of health and education, and allow different forms of ownership of schools and hospitals. It could redirect finance along social insurance lines, or else simply provide Scots with cash accounts from which they would buy their own health and education packages.

Or else the Scottish Government could go in the opposite direction, removing schools from local council control and centralising the NHS further into a ‘command and control’ model. It could nationalise universities, amalgamate them, or grant them full independence.

In other words, the Scottish Government is effectively sovereign on health and education matters.

The picture of other aspects of welfare policy is more complex. The Scotland Act reserved power over existing welfare benefit programmes because the architects of devolution wanted to maintain broad unity in the tax and benefits systems across the UK, for fear of encouraging cross-border movements motivated solely by the cash advantages on offer from exploiting different tax or benefit systems.

So power over certain benefits payments such as Jobseekers' Allowance and the state pension has not been devolved.

However, as with tax, the Scottish Government's discretion in this area is much greater than is normally assumed, for the same reason, that its powers are unlimited in terms of how it spends its budget.

So while the Scottish Government cannot change the current rate of cash benefits, it can supplement them or create new ones. One of the main innovations of the devolved administration has been to provide universal free residential care for the elderly. Whatever the implications of this in terms of affordability or equity, this initiative demonstrated the Scottish Government's capability in terms of welfare.

The Scottish Government also controls important benefits in kind such as social housing and social work services.

In combination, the absolute power over benefits in kind with the power to increase or introduce cash payments, adds up to considerable leeway in benefits policy. It is not just a question of being able to distribute more lavish welfare payments. A more nuanced policy approach is also possible. A radical administration could, for example, reduce social housing availability and replace it with cash payments designed to encourage work, or marriage, or more mixed residential areas. Or it could work to establish a minimum income designed to eradicate poverty traps and smooth out the income gradient.

Besides, modern thinking on welfare reform focuses not so much on cash hand-outs as on direct interventions and incentives

to prevent deprivation and its associated conditions. These are often delivered by non-government organisations such as charities and private companies, with the state as facilitator.

The Scottish Government could become fully engaged in these kinds of programmes, working either in isolation, or in conjunction with its UK counterparts. For example, it could provide incentives and funding for successful charities to bring more people into work and away from benefit dependency. Alternatively it could work with the financial sector to provide universal unemployment insurance, harnessing market incentives and know-how to address the problems of worklessness.

At the UK level, politicians from all parties take a serious interest in these matters and the intellectual process of devising solutions to our welfare problems is well advanced. There is no reason why Scotland's devolved government should not inform and co-operate with this process. A co-ordinated approach might make sense.

Enlightened welfare policy in most areas is well within the remit of the devolved government in Scotland, therefore, and yet it is hardly mentioned in the context of devolved politics.

### More powers over the supply side of the economy

Alex Salmond is fond of the analogy that Scotland has the potential to become a 'Celtic Lion' economy, if only it were unfettered by the shackles of the Union. But on close inspection many of the policy levers that would make a real difference to growth are either already controlled by the Scottish Government, or would not be available even with full independence<sup>35</sup>. Constitutional tinkering would make little difference to growth, therefore. Much could be achieved with the existing powers under devolution.

As we have seen, Holyrood controls the two most powerful levers of economic policy. As we have seen, taxation could be cut (or raised) in Scotland by 5% of GDP or more. We have also seen that

35 Many aspects of monetary policy, competition policy, labour market regulations and trade policy are held at the EU level.

Holyrood has the power to reform public services which account for a large part of Scotland's economy.

But there are a number of other policy reforms – sometimes called the “supply side” reforms – that Holyrood could enact tomorrow:

1. *Higher education and skills.* Scotland's universities still attract students from all over the world, and have a strong research reputation<sup>36</sup>. However, they are falling behind UK and international competitors because of their reliance on government funding. Together with further education colleges, they play an important role in producing a skilled workforce, undertaking innovative research, and commercialising new technology.

All of this comes under the remit of the devolved administration. Yet the policy response to the opportunities and challenges faced by higher education has been limited to a replacement of student fees with an extended loan system.

Partly this lack of action, despite the pleas of university principals, has been in reaction to developments in England, an unfortunate feature of Scottish public life that is discussed in more detail below.

Yet it should be possible to forge a distinctive model of higher education finance that would allow Scottish universities to compete globally in financial terms while retaining universal access.<sup>37</sup>

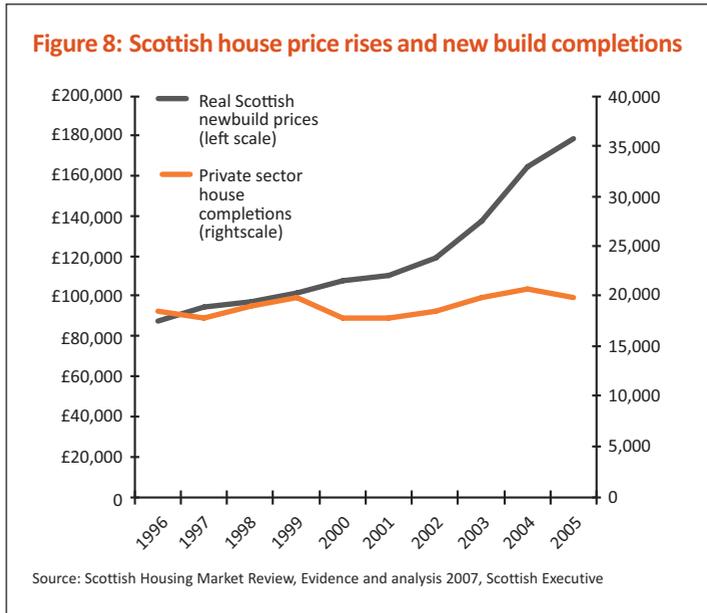
Scotland's universities already have the tradition and global appeal that makes them perfect raw material to become among the top universities in the world, if only they could be unleashed financially. The opportunity is there, but the desire to exploit it is sadly lacking in political circles.

2. *Land use planning.* Scotland is one of the least densely populated countries in Western Europe. Despite this, the regulations on land use planning are still very similar to England's, one of the most densely populated. As a result, the supply of land for development

36 The QS ranking (until this year produced in conjunction with *Times Higher Education*) ranked Edinburgh at 20th out of 547, Glasgow 79th, St Andrews 87th and Aberdeen 129th.

37 One innovative idea had universities issuing bonds backed by their graduates' future incomes. See *University Bonds*, Policy Institute 2006.

is very restricted, leading to high prices and severe delays in property and infrastructure development. Right up until the recent recession, the housing market rose in line with the rest of the UK. The following graph shows how the planning system does not allow investment in new housing to respond to these price signals:



Scotland’s planning laws are a major drag on economic growth, while public dissatisfaction at the quality of development remains. The previous Scottish administration commenced a lengthy process of reforming the planning regime, which has now been completed. The main focus of this has been to shift responsibility for planning decisions from one tier of bureaucracy to the next, and there is little evidence so far that a radical improvement in either build quality or quantity has been made possible.

3. *Public Borrowing, Infrastructure Investment and Transport Policy.* Scottish nationalists and fiscal autonomists often point to the lack of borrowing powers held by the Scottish Government as a major impediment in the drive for economic growth. A cursory examination of the situation reveals how misleading this is. Public borrowing has three legitimate functions. One is to provide automatic cyclical adjustment for the social consequences of an economic downturn. So borrowing rises as tax revenues dry up and social welfare payments stay the same or increase. This function is already performed on Scotland's behalf at the Westminster level, and it is hard to see how things would be done differently, even in an independent Scotland. A second function is to provide emergency fiscal support for the economy in the event of a crisis of the kind the UK has been through recently. Again, it is hard to see what a fiscally autonomous Scotland could have added here. If anything, Scotland's greater fiscal leverage as part of the UK allowed its banking system to be rescued. Certainly taking on further debt for either of these two functions at the Scottish level would be unwise.

A third function of public borrowing is to invest in capital projects that deliver a return over time and are not usually delivered by the private sector. Examples include schools, hospitals, roads, railways, bridges and motorways. Control of such investment effectively also gives government leverage over transport policy. Yet the UK has pioneered the outsourcing of such investment by contracting private companies to raise the necessary capital and manage the construction and maintenance of the infrastructure in question, in return for government guaranteed usage fees. Until recently the Scottish administration was an enthusiastic employer of such mechanisms, which act as a perfectly workable proxy for formal borrowing. In the end, with this as with all forms of borrowing, the limit is set not by constitutional mechanisms but by the government's ability to pay its annual dues<sup>38</sup>.

38 The Scottish Executive's use of these 'Public Private Partnership' type borrowing mechanisms reached a crescendo of £1.36 billion of contracts agreed in 2006/7. As the SNP's John Swinney pointed out, the annual payments on these deals were projected to reach a point where they placed serious constraints on the Scottish Government's other budgetary commitments. In 2010/11 these are expected to be £794 million. It seems a little strange, therefore, for the nationalists to be calling for yet more borrowing power, whose use would presumably be unaffordable.

The obvious alternative to such financing methods is to take infrastructure providers out of the public sector altogether so that they can access capital markets directly. Scottish Water and the ferry companies servicing the Northern and Western Isles are examples of companies that are still owned by the government. There is no reason, apart from innate political conservatism, why these cannot be sold off or otherwise reformed so that they can make use of private capital.

### Powers over culture, tourism and sport

Scotland has a very distinctive cultural and geographic character that gives it an enviable heritage with international appeal. There are several features of Scottish life that are unique, and such attributes not only attract visitors but provide internal vibrancy and diversity that add to the quality of life and economic opportunity for Scots. These include Highland culture and the Gaelic language, Scottish football, the architecture of Edinburgh, the rural landscape, and Scotland's medieval castles and ecclesiastical buildings.

Yet most of these are under threat, diminishing in some way, or at best are not exploited to the full. In each field private individuals or organisations who are devoted to their welfare regularly come forward with ideas that require government encouragement in one form or another. Devolution is an ideal opportunity for a new focus by government on enabling these cultural treasures to fulfil their potential. But the response by Scotland's politicians has been strangely unambitious.

Gaelic is in continued decline, for example, and no parish now has more than 75% of its inhabitants speaking the language. Education is a key medium for the survival of the language, yet the numbers of pupils taught in Gaelic are still below the replacement rate.

Scottish football is the passion of the people, and has an appeal that goes well beyond Scottish shores. Its decline is well recognised,

but the government does little to help. One way of providing a powerful stimulus to the game would be for Scotland to host the European Championship or co-host the World Cup. Yet after a lacklustre bid for the former in conjunction with the Irish Republic, the Scottish Government appears to have given up, focussing its attention on the Commonwealth Games.

The government's approach to architectural heritage is a conflicting mixture of conservatism (when it comes to adapting old buildings to new uses) and vandalism (allowing the integrity of Edinburgh's urban landscape to be undermined).

Scotland's cultural strengths feed into a vibrant tourism sector, but even here the Government's attempts to promote it appear cack-handed. The 2009 'Year of Homecoming' ran at a financial loss.

### Powers over criminal justice

Perhaps the primary domestic function of government is the maintenance of internal security, justice and the rule of law. Scotland's distinct legal system was preserved in the Union of 1707 and has remained separate from that in the rest of the UK ever since. It has its own legal hierarchy, statutory basis, and principles of resolution. Until 1999 changes to Scots law required separate legislation by the UK Parliament. This function has been devolved in its entirety to the Scottish Parliament, in effect allowing sovereign reforms to be undertaken by the Scottish Government.

So in all matters to do with courts, criminal law, policing and the prison service, the Scottish Government has full powers.

There is much work to be done. Scotland's recent record on criminal justice show a mixture of high and increasing crime rates, much higher spending, and a growing prison population<sup>39</sup>.

A reforming administration could implement changes to the penal code, for example, as part of a programme to tackle the problems of social depredation that afflict parts of Scotland. To his credit,

<sup>39</sup> A good summary of performance can be found in *Powers to Protect, Reform Scotland 2008*. In the last ten years, spending on criminal justice has increased by 44% in real terms, with total crime up by 4% and the prison population by 22%. Scotland is near the top of the European table in drug crime, homicide and overall crime.

the current Justice Minister is floating ground-breaking ideas to limit short term incarceration for minor offences in an attempt to disrupt the cycle of crime.

On the negative side of the ledger, a radical independent initiative to establish a prototype young offenders institute – the Airborne Initiative – was rejected by the previous Labour led executive, a decision upheld by the SNP government in 2007.

In practice, recourse to changes in the law has been the major policy tool used by the various administrations since 1999. Many of the flagship initiatives undertaken since devolution have involved changes to the law rather than institutional reform – the botched attempt to ban foxhunting, the ban on smoking in public places, the current effort to introduce minimum pricing for alcohol.

While these measures may signal an unfortunate tendency to resort to coercion as a substitute for meaningful reform, they do demonstrate the enormous power that control of the legal system gives the Scottish Parliament.

### Conclusion: a missed opportunity

In the aftermath of devolution, the Fraser of Allander Institute commissioned a series of studies<sup>40</sup> by renowned international economists in different fields to look at the Scottish economy. They recommended policy in the light of their experience of the factors that stimulated growth globally. Of the ideas they came up with – on encouraging innovation, the importance of competition in the delivery of public services, the role of universities, tax incentives, planning reform, infrastructure investment, social reform, education – nearly all are possible to implement using the existing powers of the Scottish Government. Yet almost none have been attempted<sup>41</sup>.

If there is no impediment in the constitutional settlement, why has policy in Scotland been so timid since devolution? What is the motive behind the conspiracy of inaction?

40 Authors included William Baumol, Paul Krugman, Edward Glaeser and Nicholas Crafts.

41 There is one area of economic policy where a quite startlingly radical agenda is being implemented. The Scottish water industry has been liberalised and opened up to wholesale competition for the corporate market. This restructuring is ahead of England and puts the Scottish water industry at the forefront of global innovation in this sector, and there are plans to go further. This is a tribute to the industry's enlightened regulators and appears to have been achieved without the understanding or complicity of most of Scotland's media, the public or the politicians, which is probably the only way that it could have been passed. The reforms show what is possible if radical thinking is applied in Scotland.

### North Sea Oil and the Barnett Formula

Advocates of independence often bemoan the waste of North Sea Oil taxes and claim that these could have been used to boost the economy or saved in some kind of investment fund, instead of being squandered on the UK's deficit.

Seemingly in isolation from this, another group promote constitutional reform on the grounds that Scotland receives more than its fair share of public spending because of the outdated 'Barnett Formula'.

Both arguments in fact cancel each other out, and together constitute another diversion of Scotland's (and the UK's) political energy from the proper task in hand.

The Barnett Formula was indeed designed in 1970s to provide a public spending settlement for Scotland<sup>42</sup> relative to UK spending that took account of the additional needs of a country with a dispersed population, lower incomes and so on. Spending per capita under the formula converges with the UK average over time.

In practice, however, *ad hoc* additional settlements have over the years ensured that spending has remained consistently higher in Scotland.

This arrangement has its flaws. But to criticise it on the grounds that other parts of the UK are now just as needy as Scotland misses the point. The reason why Scotland's funding has been kept so high is now political, not needs-based. The 'Barnett Formula' is essentially the mechanism whereby Scotland takes its North Sea Oil revenue.

Although oil revenues have fluctuated over time, they have on average approximated to the Barnett 'premium'. According to the latest figures, public spending in Scotland is some 12% higher than the UK average, and is £12.3 billion higher than non-North Sea taxes raised in Scotland. The Scottish element of North Sea income to the Treasury is £11.8 billion<sup>43</sup>. So in effect Scotland receives every penny and more of North Sea Oil revenue in a form that does not fluctuate wildly over time.

42 As well as Wales and Northern Ireland.

43 GERS 2008/9 figures. Oil revenues jumped from £7.3bn in 2007/8, just in time to counter lower tax receipts from other sources.

So long as oil revenues hold up (perhaps another twenty years or more) calling for a reduction in government funding in Scotland is one-sided. It is equally nonsensical to argue that under independence Scotland could build up an 'oil fund'. All the money would have to be used to plug the deficit that resulted from the mismatch between ordinary tax revenues and government expenditure in Scotland.

Like many oil-rich countries, Scotland has in essence decided (with every main political party complicit) to spend its oil dividend on higher welfare payments rather than on economic development.

Healthy debate should surely focus on whether the North Sea windfall is being wisely spent, rather than on exactly how it is transferred to the nation's coffers.

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## 3. The motive for inaction

The main actors in the Scottish political class all have a motive for avoiding a reforming agenda that uses the devolved powers to their potential. In addition, there are a number of general traits in the political economy of Scotland that encourage a cautious, conservative approach to change.

This section looks at some of these in turn. None of this analysis is scientific, and students of Scottish politics all have their own theory as to the main factors at play. Most important is the fact that little has been attempted or achieved in Scotland since devolution. The reasons why are open to discussion. But it is worth bearing in mind that political elites do not always respond to problems in society. They sometimes maintain a consensus for many political generations in favour of policies that in hindsight seem manifestly counterproductive. Even the most accountable democracies are prone to this phenomenon, as have been governments throughout history.

This in itself should recommend caution to those who espouse constitutional change as a panacea to Scotland's problems. If it didn't work in 1999 it probably won't next time, and we should look for other reasons for the absence of serious reform. So it is certainly worth thinking about the kind of incentives that might be holding back the political establishment in Scotland from change.

### The nationalist motive

One reason for avoiding a reforming agenda is that it would undermine arguments for independence. For some nationalists, inaction strengthens the argument for more powers. If it can be demonstrated that the reason for Scotland's poor performance is a lack of devolved

power, then the case for more powers – and indeed independence – becomes stronger.

This is not to say that all politicians in the nationalist parties – the SNP, the Greens, the Scottish Socialists and so on – are deliberately attempting to thwart meaningful policy reform for this reason. Some espouse radical policies. But there is a clear conflict of interest between adopting a distinctive programme of economic and social reform on the one hand, and claiming that independence is necessary to cure Scotland's ills on the other.

### The 'parental' motive

For those politicians and civic leaders who gave birth to the devolution settlement, the motivation is more complex. For this group, devolution was supposed to re-establish the legitimacy of government in Scotland after the perceived injustice of the Thatcher and Major era, when between 1979 and 1997 the UK Government ruled with a declining minority of representation in Scotland.

It was a response to nationalism that was designed to accommodate the Scottish sense of identity with continued membership of the UK. In practical terms that meant inoculating Scotland from the reforming policies generated by the UK government.

After 1997, and the establishment of the Scottish Parliament in 1999, this group, which includes many in the Labour and Liberal Democrat parties, as well as in the civil service, the unions, the churches and the media, had an interest in stability, therefore. It wanted devolution to bed down, to prove politically workable, and to succeed in rejecting reformist tendencies from South of the Border. Inaction suited both these goals.

### The 'acceptability' motive

A third group of politicians, business leaders and other commentators rejected devolution and opposed its implementation on the grounds that it threatened the integrity of the UK. Their two political

defeats, in the election of 1997 and the devolution referendum two years later, was a chastening experience for many in this group.

A typical response has been to rebuild political credibility in Scotland by embracing the devolved settlement and the political consensus that goes with it. Many of those who continue to oppose devolution have left the political scene in despair. Thus have many of those who might be expected to offer a radical alternative to the domestic policy consensus in Scotland become muted.

### A culture of conservatism

Underlying these current motives to inaction, the Scottish governing class operates within a prevailing political culture that is inimical to radical change.

One reason is that the Scottish political establishment seems to suffer from an inferiority complex which sees public policy through the prism of what is happening in England.

At the UK level, political discourse is informed by global intellectual trends, so that new ideas are systematically imported from abroad through media such as think-tanks, academics, the press and the politicians themselves.

By contrast, new ideas in Scotland are weighed in the balance of public debate according to what is happening in England. Such is the suspicion of England-gestated reforms that they are usually rejected, and those who espouse them accused of trying to import Thatcherism.

This has very deleterious effects on the policy process. For example, the 'choice agenda' reforms in health and education adopted across the political spectrum in England were inspired (in terms of their practical application at least) by ideas and policies generated in Scandinavia. Yet because they have been implemented (however partially) in England, they are condemned by the political establishment in Scotland. The irony is that the Scandinavian nations are

otherwise upheld by many of the same critics as being models of small, successful independent Northern European countries that Scotland should emulate.

In addition, the 'forces of conservatism' in Scotland present a more formidable barrier to reform than in other parts of the UK, which is another reason why political change is so difficult.

As well as accounting for half of GDP, the public sector employs 23% of the workforce (compared to 19.8% UK wide<sup>44</sup>), and the influence of the producer interest in public service is commensurately stronger. The public sector, the unions and local authorities combine to present a formidable barrier to social reforms in particular, because they present a potential threat to their monopoly positions and associated rent-seeking opportunities.

These factors all contribute to the state of inaction in post devolution politics. It would perhaps have been too much to expect the government in Scotland, newly elected in 1999, to adopt a radical approach to institutional reform in Scotland when many of its members had cut their teeth opposing it.

However, in England the same scruples that bound the Blair administration in its first term were cast aside after three or four years. In Scotland no such transformation took place. The Scottish political establishment is less critical of itself and the welfare state.

The flip side of this is that those who might be expected to support a reforming agenda, such as the business lobby, toe a more cautious line and hope to influence the political agenda through 'engagement' rather than 'confrontation'<sup>45</sup>. A further aspect of this is that the broader business sector, including businessmen themselves, their representatives, and the business media tends to compartmentalise public policy in to 'economic' matters (on which they feel entitled to have a say) and 'social' matters on which they feel it prudent to stay out of the debate.

This provokes a final thought about the problems facing reformers in Scotland.

*44 Fraser of Allander  
Economic Commentary  
November 2009.*

*45 The six main business representation bodies (CBI, IoD, SCC, SFE, SCDI, FSB) are also wary of radical change if it threatens to create major differences in trading conditions between Scotland and England. They therefore tend to oppose major constitutional change as well.*

## Is real reform boring?

It is not just the business community that compartmentalises the activities of government. The general media does it as well, not just in Scotland, but everywhere else too.

Yet many of the tools of economic change that affect a small regional economy like Scotland's are 'micro' in nature. We have seen how they involve infrastructure investment, local government, social and educational reform, planning matters and so on.

Each media outlet has a specialist team or correspondent to deal with these matters, but for the senior commentariat, who write the opinion pieces, hob-nob with the great and good of business and politics, are these matters just a little bit too boring to spend much time on? These influential writers are much more interested in the market fluctuations, the big budgets, the massive deficits, the global trade deals, the wars and dramatic political clashes that concern their peers in the UK and international media.

For them, as for the international audience generally, the main interest in Scotland itself is the intriguing possibility of Scottish independence and the associated constitutional shenanigans.

Similarly, for many academics in the field of political economy, it is much more interesting to talk about sweeping constitutional change than the minutiae of Council Tax. There is something of the spirit of the founding fathers to be found in dreaming up an ideal constitution for Scotland. And the idea of a neat half-way-house – trying to fit the tax numbers into a satisfactory box called 'fiscal federalism' or 'fiscal autonomy' is an even more intriguing puzzle than independence itself.

To confront the fact that the Scottish government already possesses more tax powers than it would ever use, and is therefore

“To confront the fact that the Scottish government already possesses more tax powers than it would ever use, and is therefore already financially autonomous, is an inconvenient truth... It threatens to ruin the fun, and so is ignored”

46 The messiest part of it is the so called 'West Lothian Question' – the problem of Scottish MP's continuing to vote on matters in England that are devolved in Scotland. But since this issue is easily soluble at the Westminster level without having to change anything in Scotland it does not need to come into this story.

already financially autonomous, is an inconvenient truth. The idea provokes blank stares. It threatens to ruin the fun, and so is ignored.

And, to be fair, the constitution of Scotland is a bit of a mess<sup>46</sup>. Its financial provisions in particular are bitty. Rebating taxes and adjusting non-domestic rates is not the stuff of founding fathers.

So those who have a reforming instinct, who want to promote change, have a twin reason to steer away from a complex domestic policy agenda and onto constitutional change. It is politically less controversial, and is a more satisfying easier intellectual hit.

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## 4. A new approach

Now is a time of political flux. We have a minority Scottish Government and a new coalition UK government with limited electoral support in Scotland. Labour, historically dominant, is in opposition at both levels. It is particularly important that Scotland's leaders, from whatever political background, choose the right strategic direction even as they seek tactical advantage against each other.

This report has tried to demonstrate that further devolution is not necessary in order to improve the Scottish Parliament's accountability – the devolved institutions have almost all the powers they need and, being elected, are therefore accountable.

Instead, Scotland's problems are political in nature, so until the political means of improving Scotland's lot have been fully explored, there is therefore little need or 'upside' to constitutional reform.

An overhaul of the key public services, and reform of the many institutional structures that underpin economic success would be the work of many parliaments, and many political cycles. Until this process has run its course, further significant devolution of powers is unnecessary. The political establishment, and the Scottish public as a whole, should not seriously consider major constitutional change for at least a generation.

However, it is not just a question of not *needing* further change. There is also considerable downside risk to keeping the constitutional question as the centrepiece of Scottish political debate.

Endless debate on the constitution draws political energy away from dealing with the real problems that afflict Scotland. This contributes to the prevailing inaction on policy-making on the economy and social welfare.

The combination of severe economic and social problems, political inaction, and frenzied debate on the constitution leaves many Scots voters and commentators to conclude that change can only come through more devolution, thus further clogging and prolonging the policy making process.

It also diverts Scotland from exploiting and enjoying what could well turn out to be a highly beneficial situation. Instead of hankering for full independence, or harking back to a lost age of unity, Scotland's leadership should pause to explore what appears to be a uniquely advantageous position among the nations of the world. As we have seen, Scotland has domestic self government with all the powers necessary to formulate distinct approaches to the economy, the welfare state and cultural matters that are appropriate to Scotland's peculiar circumstances, enhanced by the connectedness of a small society.

But Scotland also enjoys global power and reach that would be lost for ever through independence. Through its leverage on the UK, Scotland possesses international clout. This means that it can use its influence to fashion global trends in a way that fits Scotland's culture and interests.

An interesting recent example of Scotland's dual identity is the Megrahi case. Scotland made an independent judicial decision to release the Lockerbie bomber. At the same time its status as part of a great power protected it from pressure, intimidation or sanctions from outside. Regardless of the merits of the case, the current arrangements gave Scotland's politicians considerable room for manoeuvre.

Scotland also has a greater say internationally on specific matters of national interest. Scotland can use its leveraged influence in all sorts of areas that are of strategic interest, such as the banking, fishing and spirits industries, where it would be ignored as just another small independent Northern European country.

The argument that a country's influence is magnified by being partly subsumed in a larger entity does not always apply, of course.

There is a balance to be struck – does the greater influence gained outweigh the distinctiveness lost? This is a question that the UK as a whole faces constantly in its relationship with the EU, for example, or its alliance with the US.

Yet in the case of Scotland and the rest of Britain, the interests are so closely aligned, particularly on international matters, that the dilemma arises much less often than it does between the UK and the EU or US. If there is a difference of emphasis between Scotland and the rest of the UK, the argument is often so finely balanced that Scotland's weight tips the balance in its favour<sup>47</sup>. With devolution allowing a separate domestic agenda, Scotland really may be able to have its cake and eat it. Again, this situation merits at least a generational pause to test if the balance plays in Scotland's favour.

Moreover, membership of the UK gives Scotland preferential access to the institutions and opportunities of what is still a great power. It is easier for Scots to enter the worlds of international business, top level diplomacy, the military, academia or even culture, because many of the most influential institutions in these fields are still British.

The 'Social Union' which is referred to by some nationalists may be harder to maintain without formal political links. Of course if you are Irish or Danish it is still possible to make it in the City or in Oxbridge or in the pop charts. But the subtle and inevitable barriers that exist between different countries make it harder.

Arguably Britain as a whole is at a crossroads. The decisions made by her leaders over the next decade or two will decide whether the UK as a whole recovers from the recession to retain its first rank status, or will decline into mediocrity. Again, it is too early to judge the price of jumping ship. Let's leave it for a generation at least.

Scotland since devolution has failed to exploit the economic, social and cultural opportunities available to it. But as this paper demonstrates, this is not because of an 'accountability' problem with the constitution. Instead there are political reasons why policy makers have been so timid.

<sup>47</sup> Labour governments in particular are usually dependent for their parliamentary majority on MPs with Scottish seats.

A political problem requires a political response, and this final section suggests a new approach for the Scottish political leadership, with three main elements to it.

### 1. The constitution – a generational truce

Most importantly, Scotland would benefit from a consensus position that the constitution should be made to work rather than endlessly changed. A promising recent political development was the outcome of the Calman Commission, formed by the unionist parties to consider how to improve on the devolution settlement, and now largely adopted by the new UK Government.

Following the logic outlined in this book, the formation of the Calman Commission in the first place was a mistake. It ascribed too much importance to constitutional change, and focussed much of the political agenda on the constitution, particularly at the Commission's formation and at the time it reported. It therefore followed the existing trend for an agenda of constitutional obsession that so blights political debate in Scotland.

However, in the event Calman's report was surprisingly subtle. Instead of recommending a major new raft of powers to be devolved, it emphasised the existing range of powers that the Scottish Parliament possesses. Its central recommendation was that the level of income tax set and collected by Westminster would be reduced by 10p, requiring the Scottish Government proactively to set the rate it wants to fill the gap.

In practice this makes little difference<sup>48</sup>, since the Scottish Government already has the unused power to vary income tax by 3p in either direction. However, the very fact of an annual announcement will focus political attention on the tax powers of the Scottish Government.

Calman also recommends the devolution of a few additional minor powers and levies, on the regulation of airguns and the like.

48 In theory the amount the Scottish Government receives for that 10p will reflect the amount raised in income tax in Scotland, whereas before it was effectively based on a UK calculation, so this provides the Scottish Government with an incentive to maximise income tax receipts in Scotland. In practice the difference this makes to the Scottish budget will be nugatory, and any such incentives surely dwarfed by the existing rewards of higher growth as discussed earlier.

These are so trifling by comparison with the existing remit of healthcare, education and the rest that it is as if Calman is saying to Scotland's politicians 'look what is already there under devolution. Before you get more, let us see you use the powers you already have to good effect.'

The unionist parties co-operated on the Calman Commission, and they should use it to draw the line under the debates of the past and to introduce to a new era of consensus on the constitution.

With the formation of the Conservative – Liberal Democrat coalition, the UK government has limited representation in Scotland – twelve out of fifty nine seats and 35.6% of the vote. The temptation will be there for its opponents to exploit this for political gain within Scotland. This approach should be avoided. For its part, the Westminster Government should be careful to respect and encourage a distinctive devolved approach.

Take the debate about public spending cuts, for example. It is clear that the deficit problem – of reduced revenue stemming from the recession – affects government across the board. Just as the UK's tax revenues have fallen, so must the Scottish Government's revenues, whether collected directly or from the 'block grant'. To claim that the UK is inflicting 'cuts' on Scotland would be disingenuous, therefore. In fact, devolution allows the Scottish Government to choose an alternative approach if it wants because, as this report demonstrates, it is capable of setting the overall level of tax in Scotland. So instead of cutting spending to meet the revenue shortfall, it could raise taxes. The 'cuts' are inflicted as much by Scottish Government's decision making as by outside circumstances.

The various political factions in Scotland also have a choice, therefore: to respond maturely to a situation that is universal, using the extensive powers that exist. Or to seek political advantage by attempting to inflame the constitutional debate on specious grounds.

The more mature approach is not just a unionist prescription. For nationalists whose prime motivation is the welfare of Scotland, there are clear merits in this approach too. The devolution era provides an opportunity to explore a new kind of nationhood, enhanced from the cultural / sporting nationhood of the recent past, but distinct too from the raw independence that brings with it the complications of separation and the loneliness of small statehood.

Nationalism need not be dogmatic. It should respond to circumstances, and the circumstances of geopolitics are changing quickly. Other nations around the world are finding comfort in a new kind of national hybrid. Scotland has the identity and influence to exploit this trend more than most. Devolution should at least be given a proper chance.

Political agreement on matters of national importance is nothing new. In many countries cross party co-operation is extended to other foreign policy matters so that domestic division cannot be exploited by international rivals. This is why the Germans and French always seem to have such consistent and successful dealings with their EU partners, for example. The issue of Scotland's constitution is of such vital national importance that a broad cross party position on the constitution should be seen as desirable and achievable.

Labour and the Conservatives are quite happy to present a united front when the country is involved in conflict. The SNP was happy to campaign for devolution as designed by its opponents, and should stick by it for a good while. During the credit crunch, the priority for all parties became the economy rather than the constitution. But Scotland's economic and social crisis is entrenched and long term, and will take many long years to tackle. Despite this, with the new government the siren voices for radical constitutional change are in full cry once again. They should be ignored. There are more important matters to deal with.

## 2. Measurement – a new honesty

One of the problems with the politics of public service provision in the UK is that it is hard to measure performance. Most public services are delivered by state-owned national monopolies, so there is little opportunity for users to benefit from like-for-like comparison with alternatives, as there is with most private sector goods and services.

In Scotland, the government makes little effort to remedy this by attempting to measure the outcomes of the institutions it runs against those in other jurisdictions. This contributes to the complacency about the state of Scotland's institutions and acts as a major barrier to reform.

Scotland's political class should be much more honest with itself and its electorate. The Scottish Government should seek to establish consistent comparisons over time between the public services it provides and those elsewhere in the UK and around the world.

In Audit Scotland and Her Majesty's Inspectorate of Education, Scotland already possesses two admirable bodies that have shown themselves capable of independent assessment of government activity, if within a domestic context. These should be given the remit and resources to examine performance thoroughly from an international point of view.

Such an approach would not only act as a spur to improved performance. It would also act to counter the inward looking tendency of Scottish political debate, where the only outside reference is to what is happening in England.

## 3. Reform – a new radicalism

Unshackled from constitutional navel-gazing, and exposed against the best performers from around the world, Scotland's leaders should embrace a new radicalism to attack the social, cultural and economic problems faced by the country.

From their different philosophical starting points, all the parties should seek to recast their policy positions from a foundation of

recognition of the problems faced and genuine intellectual curiosity about solutions tried elsewhere or even in our own history.

The unexpected coalition at the UK level may prove a spur to more enlightened thinking. The two coalition partners appear to have agreed a reforming programme which presumably will be defended and promoted by their Scottish partisans, encouraging new thinking within the Scottish milieu.

A new sense of optimism and ambition should be applied to the economy, with novel approaches to tax and benefits, planning reform, infrastructure investment and higher education.

Public sector reforms should explicitly be modelled on the best systems from around the world, or, even better, on Scottish precedent. Scotland's innovative heyday in the 18th and 19th Centuries is full of examples of social enterprise, educational organisation, service provision, development planning, finance and so on that provide inspiring models for modern institutions.

The inevitable comparisons with England should be kept to a minimum so that the full range and variety of policy approaches on offer, often from countries that often have a social democratic tradition at least as strong as Scotland's, are not rejected simply because they are being considered South of the border.

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## Conclusion

A new emphasis on reform, and agreed settlement on the constitution. Scotland's unique position could come to be appreciated as a source of strength, a special status to be cherished, or at least fully tested, not lightly cast aside.

Politics in the UK is in a period of flux. Public disillusionment with formal politics coincides with economic crisis and a new policy debate on social welfare. Scotland faces another crucial election in 2011, where this instability will present opportunities for those with the right approach to grab them.

History tells us that those who set the agenda eventually win the critical political battles, in terms of elections and referenda. The combination of economic and social decline, conservative policy making and endless constitutional debate in Scotland cries out for a new approach. Those who first articulate it persuasively will set the agenda for many years to come.





Scotland's economy and public services are performing badly, and the establishment of the Scottish Parliament a decade ago has not improved matters.

But further constitutional change is not the answer. Indeed, the endless arguments over the constitution act as a distraction from much needed reform. Scotland's problems are political in nature, not constitutional.

*The Devolution Distraction* argues that the powers of the Scottish Government are already extensive. The scope for radical change already exists in taxation, education, health, infrastructure and culture. Scotland's political establishment would do much better to focus on using the powers they have, rather than arguing for more.

As a result of this analysis, Tom Miers concludes that the UK government and others interested in the welfare of Scotland should seek to use proposals made by the Calman Commission to draw a line under the arguments over devolution for the next generation.

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