

# Governing after the referendum

Future constitutional scenarios for Scotland and the UK

Akash Paun, Joe Randall  
Robyn Munro and Lucy Shaddock



## Foreword by Professor Charlie Jeffery

This constitutional scenarios paper is part of a programme of work undertaken against the background of the Scottish referendum, and led by the Institute for Government in collaboration with the Future of the UK and Scotland programme. It is an important paper for three reasons.

First, it looks beyond Scotland alone to include discussion of devolution reform debates in Wales and Northern Ireland.

Second, it looks at the implications of these debates for the co-ordination of UK government activity with that of the Scottish, Welsh and Northern Irish governments. With all eyes on what's happening in Scotland we too easily neglect the other parts of the UK, but also change – and the need for change – at the UK centre.

And third, while giving full consideration to a Scottish Yes, it also digs deeper into what a Scottish No might mean by setting out and comparing the various proposals made for further-reaching devolution for a Scotland remaining in the UK.

The message is clear: whatever happens in Scotland, constitutional reform will continue, and continue to have an effect in reshaping how Scotland and the rest of the UK are run.

Professor Charlie Jeffery  
Future of the UK and Scotland Programme Research Co-ordinator  
Vice-Principal (Public Policy and Impact), University of Edinburgh

## Foreword by Peter Riddell

The Scottish people will decide their future on 18 September. The Institute for Government is not taking sides on the referendum. Our task is to explore and clarify what lies behind the decision, not, at this stage, to make our own recommendations.

It is not a question of independence or the status quo. The consequences of a Yes majority would obviously be immense as separation would have wide-ranging constitutional, political and economic implications. But a No vote would open up a wide range of questions about the extent of further devolution – both what is already legislated but not implemented in the Scotland Act 2012 and what has been promised by all three unionist parties. Much is also changing in Wales.

This report is intended to broaden understanding of the aftermath of the referendum vote, whichever way it goes. This will be followed by a main report that will set out the Institute's proposals for implementing the result in the interests of all involved.

A handwritten signature in black ink that reads "PJR Riddell" followed by a horizontal line and two dots.

Peter Riddell CBE

Director  
Institute for Government

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## About the authors

**Akash Paun** is a Fellow of the Institute for Government, where he has worked since 2008. Since joining the Institute he has led research on coalition and minority government, civil service accountability, parliamentary candidate selection and the work of parliamentary select committees. He currently leads the Institute's project on devolution and the future of the Union, *Governing after the referendum*, which is being carried out in partnership with the Future of the UK and Scotland programme. This paper is the second output of that project, which will run until December 2014.

**Joe Randall** joined the Institute for Government as a Researcher in September 2013. His work at the Institute has focused on political decentralisation and open policymaking. In addition to working on devolution, he is the programme manager for the *Connecting Policy with Practice* programme, a partnership between the Institute and the Big Lottery Fund. He has a degree in History and Politics from the University of Oxford, and a Master of Public Policy from the Blavatnik School of Government. He spent his time between these two stints in education as Research Officer at the Baring Foundation, a charitable grant-maker.

**Robyn Munro** joined the Institute for Government as a Researcher in August 2013. Her work at the Institute has focused on coalition governments and how the Civil Service works with political parties. She is currently working on the Institute's *Whitehall Monitor* programme of work, as well as the *Governing after the referendum* project. She has a BA in History from the University of Oxford and an MSc in Public Policy from the University of Bristol.

**Lucy Shaddock** joined the Institute for Government as an intern in April 2014, contributing to the work on devolution. She has an undergraduate degree in Law and Politics from Queen Mary University and is shortly due to complete an MSc in Public Policy at UCL. Previously, she has worked for a political polling company and as an intern at the Constitution Unit researching the policy impact of Parliament.

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All errors are the responsibility of the authors.

## Summary

The UK has never been a unitary state. The British constitution incorporated different governance arrangements for its constituent nations long before devolution: Scotland's legal and education system, Northern Ireland's separate civil service and justice system, and (eventually) legal recognition of Wales' cultural and religious distinctiveness.

These differences were reflected in Whitehall and Westminster in the existence of separate government departments that administered many public services in Scotland, Wales and Northern Ireland, and in separate legislative and scrutiny arrangements in Parliament.

The reforms of the late 1990s were not therefore a matter of establishing new systems of administration or public service delivery for Scotland, Wales and Northern Ireland since these already existed. Rather, devolution created political institutions to provide greater democratic accountability for these different systems, and expanded the potential for policy differentiation across the UK.

Yet for the UK state itself, headquartered in London, devolution required minimal adaptation, especially since in the early years the same party dominated Westminster, Edinburgh and Cardiff (while Northern Ireland reverted to direct rule from Westminster for several years up to 2007). Relations between the four administrations were broadly untroubled, and rising public spending allowed each government to pursue favoured social policies within a budgetary framework tightly controlled by the Treasury.

Much has changed since 2007. Different parties are now in power in each of the four capitals and differ on the big question of the future of the UK, as well as on a range of economic and social policy questions and how to deal with the pressure of fiscal austerity. These pressures have opened up a set of debates about the powers of the devolved institutions and, since the Scottish National Party's (SNP's) electoral landslide of 2011, about the future of the UK itself.

### The current context

The Scottish independence referendum has divided Scotland and pitted the UK and Scottish governments in direct confrontation. As decision day has drawn closer, so too have the opinion polls. The implications of a Yes victory are wide-ranging, though the terms on which London and Edinburgh would disentangle their shared systems of government would depend in large part on post-referendum negotiations. It is not known how such negotiations would be conducted.

The implications of a No victory seem, at first glance, more easily identifiable. A No vote in a referendum usually implies maintenance of the status quo. But the current devolution settlement is not actually on the ballot paper on 18 September. The Scottish Government's powers are already being extended via legislation that is due to be fully implemented by 2016. A No vote is a vote for this 'moving status quo'.

Meanwhile, all the major British parties are also committed to further devolution following a No vote – particularly of tax and welfare powers. How the SNP would engage in the debate following defeat is at present unknown but could be decisive in how this process develops.

Amid this uncertainty, one thing that can be said with certainty is that the relationship between the UK and Scottish governments will remain deeply interconnected whatever the referendum outcome, and will require careful management on both sides.

A Yes vote will be followed by complex intergovernmental negotiations as well as continued sharing of assets and institutions for some of years to come (perhaps also on a permanent basis as the SNP proposes in some areas). And in any constitutional scenario the close economic, social and geographical links between Scotland and the rest of the UK will require continuing cross-border co-operation in a range of areas.

Constitutional change is highly likely in other parts of the UK too, and this process will itself be affected by which way Scotland votes. The UK Government is already legislating to grant some tax-raising powers to the Welsh Assembly, and an influential cross-party commission has proposed additional powers for Cardiff in areas including policing and justice.

More limited fiscal devolution to Belfast is under discussion, and there is a growing debate on devolution within England – to London and the large northern city-regions in particular.

## **Constitutional scenarios for the UK**

The UK never was a unitary state or political system. But it is now more pluralist than ever before with multiple centres of power, changing relationships between them and continuing pressure for change.

This paper – produced as part of the Institute for Government's *Governing after the referendum* project – is our attempt to make sense of the diverse range of future scenarios for the UK, and of the challenges that government will face in operating in this dynamic context.

In total we discuss 16 distinct scenarios (10 for Scotland, 4 for Wales and 2 for Northern Ireland – England is beyond the scope of our research). To enable comparison we map these 16 scenarios on a single chart that estimates the extent of taxation and spending power controlled at the devolved level in each case.

Our analysis in Chapter 1 illustrates the large gap between these two types of power at present: the Scottish, Welsh and Northern Irish administrations all have significant (though varying) control of public expenditure within their territories, but little revenue-raising capacity. Most of the current debate is about how far to close that gap and what further fiscal levers might be devolved. There is also a growing debate about the devolution of some additional policy responsibilities – particularly for police and justice to Wales and aspects of welfare to Scotland.

Having mapped the range of scenarios, we then analyse the governance challenges and implications of each of them, both for the devolved nations and for the remaining UK Government.

## **Effective government after the referendum**

In Chapter 2 we consider the main effects of a Yes vote on each Whitehall department, and also consider the nature of new administrative capacity that would be required in Scotland

and at the intergovernmental level. We show that the impact would vary significantly across Whitehall.

Some departments, like the Department for Education and the Department of Health, already have little to do with Scotland, so not much would change. Others – such as the Department of Work and Pensions (DWP) and Her Majesty's Revenue and Customs (HMRC) – provide services in Scotland at present and have large numbers of staff north of the border, many of whom provide services to people elsewhere in the UK. They would be significantly affected by independence as these systems are disentangled.

Departments like the Foreign and Commonwealth Office (FCO) and the Treasury operate on a UK-wide basis and have very little presence in Scotland. So here the Scottish Government would face a major task, as independence would require it to build up capacity in these newly-acquired domains (while the Whitehall departments would face pressure to downsize to reflect the smaller size of the 'Rump UK').

Chapter 3 considers the immediate effects of a No vote, as Scotland reverts to the 'moving status quo' of implementation of the Scotland Act 2012, and passage of the Wales Bill. This process will require the UK and the Scottish and Welsh governments to work together closely to ensure a smooth transfer of powers from Whitehall to the devolved level.

We also consider whether certain intergovernmental systems might be reconsidered, including how Whitehall takes devolved concerns into account when making policy, and what role is played by the Scotland and Wales Offices, and bodies such as the Joint Ministerial Committee. As fiscal devolution becomes a reality, the Treasury and HMRC will also face new challenges in managing divergence of the tax systems and potential constraints on future policy options.

In Chapter 4 we look further ahead at how the next phases of devolution might play out. For Scotland, we look at the proposals of the three main unionist parties (which principally concern the tax and welfare systems) as well as those of other independent bodies.

For Wales we consider the possible devolution of powers in areas such as policing, justice, energy and transport, as proposed by the Commission on Devolution in Wales. And for Northern Ireland we discuss the debate about devolution of corporation tax.

We also note the potential for more partnership working between the governments as an alternative to the binary debate whereby powers are either devolved or reserved to Westminster.

## **Our objective**

In this paper we make no predictions about Scotland's referendum result. Nor do we take a view on which constitutional option the people of Scotland or any other part of the UK should choose. Neither do we address questions such as what use Scotland, Wales or Northern Ireland might make of new powers acquired in the next phase of constitutional change.



Our focus is on government, and on how the Civil Service and systems of intergovernmental relations will need to adapt to make a success of whatever constitutional arrangements emerge in the years following 18 September 2014.

We hope this analysis will prove useful to those seeking to understand our country's complex system of devolution and territorial relations, and to those responsible for making that system work.

After the referendum, we will return to many of these themes in a final report that will set out some proposals for how, with the dust of the referendum battle gradually settling, the four governments should work together in future in the interests of all sides.

## Introduction

All eyes are on the referendum of 18 September and whether the people of Scotland will say Yes or No to independence. The campaign has been highly polarised, with facts contested, and emotions running high. As a result, it has often been less than illuminating as to what either result would mean for government in the different parts of the UK, or for relations between the different nations and territories.

Independence itself is something of an unknown quantity since much would depend on the outcome of negotiations. While a No vote is expected to be followed by further change to Scotland's devolution settlement, with all three unionist parties committed to transferring further powers from Westminster.

Change is also on the cards for the other devolved nations. The legislative process is embedding the recommendations of the first report of a cross-party commission on devolution in Wales, and discussions are taking place on the proposals of the second. There is also talk of further fiscal powers for Northern Ireland.

Though we do not discuss it here, the 'English Question' looms in the shadows too: will significant further devolution to the other nations finally lead either to substantial devolution in England, or to reform at Westminster so as to enable England-only matters to be dealt with separately from UK-wide business? Another big issue beyond the scope of this paper is whether Scottish independence or significant further devolution might put the idea of a codified constitution onto the agenda.

There is therefore a whole range of possible constitutional futures for the UK (or its successor states), each bringing different challenges for government across the country – including for the Civil Service as a whole, particular Whitehall departments, the devolved administrations, and intergovernmental systems and mechanisms.

Our interest lies not in which constitutional form the UK or any of its composite territories should opt for, but in how best to ensure that wherever the current journey of constitutional change leads us, effective government can continue to be provided across 'these islands'. To that end the Institute for Government is carrying out a project, running until the end of 2014, exploring how effectively Whitehall and the devolved governments currently work together and what new challenges will emerge following the referendum. The project, *Governing after the referendum*, is being run in partnership with the *Future of the UK and Scotland* research programme led from the University of Edinburgh.

In this paper we examine the range of scenarios for the future shape of the UK, and discuss the main issues and challenges the Civil Service and machinery of government will face to make them work. We draw on a parallel data-driven paper, *The Civil Service in Territorial Perspective*, which assesses the capacity and characteristics of civil service presence in each part of the UK. Our final report, due for publication in December 2014, will build on these two publications and set out conclusions and recommendations for how the UK and devolved governments could improve how they work together once the independence question has been settled one way or the other.

Below we outline the full range of possible constitutional scenarios for each of the three devolved nations. We illustrate how they compare to one another in the extent of fiscal and spending power controlled at the devolved level. We then discuss the likely implications of each of these scenarios divided into three sections. First, what would a Yes vote on 18 September mean for the Civil Service and wider machinery of government? Second, what does the 'status quo' look like for the Union, in the aftermath of a No vote? And third, over the longer-term, what would be the challenges involved in moving towards further devolution to any of Scotland, Wales and Northern Ireland?

## 1. What is the range of scenarios?

The choice facing the UK is not between the status quo and fragmentation, but between different constitutional models and patterns of interaction between the various territories. A Yes vote will lead to some shared institutions and systems being broken up, but in other areas new forms of co-operation and joint working are likely to emerge. A No vote will not mean a continuation of the status quo even in the short term – since the devolution settlements are already in flux as the Scotland Act is implemented and the Wales Bill proceeds. And in the longer run, it appears increasingly likely that there will be further constitutional change in Scotland and Wales. The picture in Northern Ireland is less dynamic though here too additional devolution is under consideration.

Making sense of these numerous scenarios is a complex task. Building on the work of other researchers and organisations (notably Reform Scotland and McLean et al 2013<sup>1</sup>) we find that one useful way to comprehend the range of possibilities is through a fiscal lens that asks two questions: how much public spending in each territory is under the control of the devolved institutions? And how much revenue raised in each territory is likewise the responsibility of the devolved bodies? In Figure 1, we illustrate where the various devolution settlements rank on these two dimensions at present, and how implementation of the main proposed alternative constitutional visions would change the picture.<sup>2</sup>

Figure 1 illustrates first of all the asymmetric nature of the current devolution settlement – asymmetric both between the three devolved territories and between the degree of devolved control of revenue and spending. As Figure 1 shows, none of the three devolved administrations currently controls more than around 10% of revenue raised in its territory,<sup>3</sup> whereas the administrations in Edinburgh, Cardiff and Belfast respectively control approximately 60%, 50% and 80% of public spending within their territory at present.<sup>4</sup> As McLean et al note, all countries find it easier to decentralise spending rather than tax, and the UK is no exception. The disparity between revenue-raising and spending powers creates

<sup>1</sup> Reform Scotland, *Scotland's Future: The constitutional report card*, June 2014, retrieved 29 August 2014 from [www.reformscotland.com/public/publications/Scotlands\\_Future\\_The\\_constitutional\\_report\\_card2.pdf](http://www.reformscotland.com/public/publications/Scotlands_Future_The_constitutional_report_card2.pdf) and McLean, I., J. Gallagher, and G. Lodge, *Scotland's Choices: The referendum and what happens afterwards*, Edinburgh University Press, 2014.

<sup>2</sup> All figures for Scottish and Welsh scenarios are calculated using the most recent 2012/13 data, and all figures for Northern Irish scenarios are calculated using 2011/12 data. A full breakdown of these calculations is given in Annex 1. It is important to note that the lack of complete, comparable data sets for the three governments means that our figures, while comparable across different proposals for the *same* territory, are not strictly comparable *between* territories. This graph, and the calculations we cite in the text and in Annex 1, should be understood as an illustrative aid only.

<sup>3</sup> Exact figures: Scotland: 7.5%; Wales: 10.1%; Northern Ireland: 7.5%

<sup>4</sup> Exact figures: Scotland: 59.1%; Wales: 51.5%; Northern Ireland: 80.6%

a 'vertical fiscal gap' filled in the UK by transfer from the Treasury. Most of the proposals discussed in this paper are designed to close this fiscal gap to some extent – principally on the grounds that enhanced tax raising powers for the devolved governments would improve accountability.<sup>5</sup>

Below we present our analysis of the various scenarios for the three devolved nations along the two axes of devolved control of tax-raising and public expenditure decisions. Figure 1 presents the headline findings, mapping 16 distinct scenarios onto a single chart. The scenarios for Scotland and Wales are calculated using data for the 2012-13 fiscal year, while the Northern Ireland scenarios are based on 2011-12 data.<sup>6</sup>

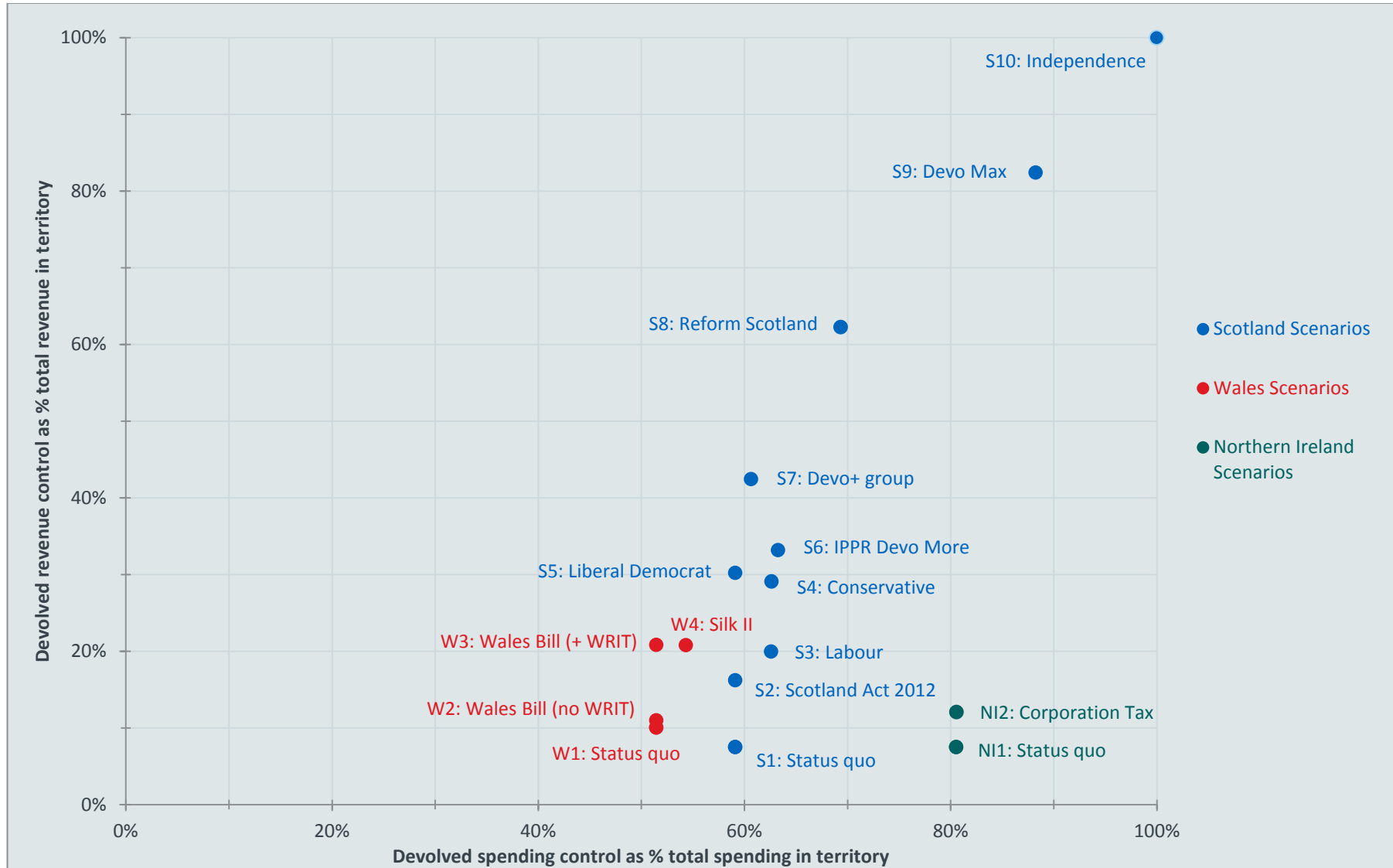
All scenarios assume no change in the current levels of tax and spending unless otherwise stated.

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<sup>5</sup> For instance, the terms of reference for the Commission on Devolution in Wales (the 'Silk Commission') were for the Commission to 'review the case for the devolution of fiscal powers to the National Assembly for Wales and to recommend a package of powers that would improve the financial accountability of the Assembly'. *Commission on Devolution in Wales: Terms of reference*, Commission on Devolution in Wales website, 2011, retrieved 29 August 2014 from <http://commissionondevolutioninwales.independent.gov.uk/files/2011/11/Commission-ToR-Final.pdf>

<sup>6</sup> The discrepancy is due to the latest version of the Department of Finance and Personnel NI's *Net Fiscal Balance report* covering only up to the 2011-12 fiscal year. For a full breakdown of the data, sources and methodology please see Annex 1.

Figure 1: Scenarios Map – Proportion of tax and spending within devolved areas controlled by devolved institutions



## Scenarios for Scotland

### Scenario S1 – Status quo

This is the current devolution settlement in Scotland. In revenue terms the Scottish Parliament controls few levers, with control over only council tax and non-domestic rates (we do not include the unused power to vary the basic rate of income tax by 3p in our model).

On the other side of the balance sheet, the Scottish Parliament currently controls the majority of public spending in Scotland, covering most domestic public services but not welfare, pensions or defence and foreign policy.

### Scenario S2 – Scotland Act 2012

This scenario models the effects of implementing the Scotland Act 2012. This Act contained no significant additional spending powers, but did devolve additional revenue raising powers.

The most significant was the creation of the Scottish Rate of Income Tax (SRIT). Under this system, the three income tax rates will be reduced by 10 pence in the pound and the Scottish Parliament will then have to decide whether to reinstate this 10p or to set at a different rate (with its budget adjusted accordingly). Therefore a 'Scottish rate' of 10% would mean no change from UK rates, but setting it at 5% would lower the rates paid by Scottish taxpayers to 15%, 35% and 40% for each of the three existing bands.

Two smaller taxes were also fully devolved to the Scottish Parliament through this Act – 'landfill tax' and 'stamp duty land tax'. With these additional powers, the Scottish Parliament would become responsible for raising almost a quarter of its own spending.

### Scenario S3 – Labour

Here we calculate the effects of implementing the Scottish Labour Devolution Commission proposals.<sup>7</sup> These include increasing the SRIT to 15p and enabling the Scottish Parliament to increase the rates paid by higher and additional rate taxpayers in Scotland independently of one another.

The Commission estimates that these powers would raise an additional £2bn of revenue per year, and it also recommends an additional £2.3bn of Scottish government spending by devolving attendance allowance and housing benefit.

### Scenario S4 – Conservatives

This scenario models the effects of the proposals of the Conservatives' devolution commission headed by Lord Strathclyde.<sup>8</sup> These proposals pledged Scottish Parliament control over attendance allowance and housing benefit on the spending side, and devolution of air passenger duty and significant further control of income tax rates and bands on the

<sup>7</sup> Scottish Labour Devolution Commission, *Powers for a purpose: Strengthening accountability and empowering people*, 2014, retrieved 29 August 2014 from [http://b.3cdn.net/scotlab/c07a7cdb97a522f4c5\\_h1m6vwh8l.pdf](http://b.3cdn.net/scotlab/c07a7cdb97a522f4c5_h1m6vwh8l.pdf)

<sup>8</sup> Scottish Conservatives, *Commission on the Future Governance of Scotland*, 2014, retrieved 29 August 2014 from [www.scottishconservatives.com/wordpress/wp-content/uploads/2014/06/Strathclyde Commission 14.pdf](http://www.scottishconservatives.com/wordpress/wp-content/uploads/2014/06/Strathclyde_Commission_14.pdf)

revenue side.

The Commission also suggests that there should be ‘serious examination’ of the case for assigning a share of VAT receipts in Scotland to the Scottish Parliament (not included in our model).

### Scenario S5 – Liberal Democrat

This scenario models the proposals of the Liberal Democrats’ Home Rule Commission, which argued that the Scottish Parliament should be ‘responsible for raising the taxes to pay for the majority of its spending’.<sup>9</sup> It proposed the devolution of inheritance tax, air passenger duty, capital gains tax and the aggregates levy, as well as control of all income tax bands and rates.

The Commission also proposed that corporation tax should continue to be controlled and collected at a UK-wide level, but that receipts from companies in Scotland (not including offshore oil and gas) should be directly assigned to the Scottish Parliament. This would be a significant addition to the Scottish block grant. Corporation tax raised £2.87 billion in Scotland in 2012-13 (5% of all tax raised).

Since this tax would not be under the **control** of the Scottish Parliament, we do not include it in our calculations.

The Commission did not propose devolving any additional spending responsibilities, but it did suggest the creation of a new category of ‘partnership’ powers (for instance on energy policy and employment and skills) between Holyrood and Westminster. With little detail provided on how these might work we are unable to factor these into our calculations.

### Scenario S6 – IPPR Devo More

This scenario estimates the effects of implementing the proposals of the Institute for Public Policy Research (IPPR) ‘**Devo More**’ project. We count as devolved what IPPR describes as ‘prime candidates’ for devolution: personal income tax; the aggregates levy; air passenger duty and taxes on alcohol and tobacco.<sup>10</sup> IPPR also recommend that a share of 10 points of VAT be assigned to the Scottish Parliament. This would have been worth £4.67bn in 2012/13 (9% of all tax raised in Scotland), but again we do not include it in our calculations as VAT would still be controlled from Westminster.

On the spending side, Devo More includes: the devolution of housing benefit (to reflect the strong interaction with devolved policy areas); attendance allowance; carer’s allowance; over-75s TV licences and winter fuel payments.<sup>11</sup> IPPR also moots the possibility of

<sup>9</sup> Scottish Liberal Democrats Home Rule and Community Rule Commission, *Federalism: The best future for Scotland*, 2012; Scottish Liberal Democrats Home Rule and Community Rule Commission, *Campbell II*, 2014, retrieved 29 August 2014 from [www.dropbox.com/s/h865fxbfsxg5j0/Campbell%20II%20report.pdf](http://www.dropbox.com/s/h865fxbfsxg5j0/Campbell%20II%20report.pdf)

<sup>10</sup> Trench, A. *Funding Devo More*, IPPR, 2013, retrieved 29 August 2014 from [www.ippr.org/assets/media/images/media/files/publication/2013/01/funding-devo-more\\_Jan2013\\_10210.pdf](http://www.ippr.org/assets/media/images/media/files/publication/2013/01/funding-devo-more_Jan2013_10210.pdf)

<sup>11</sup> Lodge, G. and A. Trench, *Devo More and welfare: Devolving benefits and policy for a stronger union*, IPPR, 2014, retrieved 29 August 2014 from [www.ippr.org/assets/media/images/media/files/publication/2014/03/Devo-more-and-welfare\\_Mar2014\\_11993.pdf](http://www.ippr.org/assets/media/images/media/files/publication/2014/03/Devo-more-and-welfare_Mar2014_11993.pdf)

IPPR suggest that ‘perhaps’ winter fuel payments should be devolved. We include them in our calculations.

devolving the childcare element of the working tax-credit but as a tentative recommendation, so we do not include it.

### **Scenario S7 – Devo Plus**

This scenario represents the devolution settlement that would result from the final recommendations of the cross-party ‘Devo Plus’ group.<sup>12</sup>

These proposals include the full devolution of income tax, non-North Sea corporation tax, and capital gains tax, as well as significant new spending powers in the welfare sphere – such as Attendance Allowance, Carer’s Allowance and Winter Fuel Payments.<sup>13</sup>

### **Scenario S8 – Reform Scotland**

Here we model the yet more radical set of proposals set out by the Reform Scotland think tank.<sup>14</sup> On top of the Devo Plus recommendations, Reform Scotland proposes transferring a number of significant areas of welfare spending including the entirety of housing benefit, Employment and Support Allowance, Disability Living Allowance, Income Support and Incapacity Benefit (over £6.5bn of spending in Scotland in 2012-13).

The Reform Scotland proposals would also devolve the geographical share of North Sea oil and gas receipts (approximately £5.6bn in 2012-13) and all duties collected on fuel, alcohol, tobacco and gaming.

The only major taxes that would remain reserved would be National Insurance contributions and VAT. As Figure 1 shows, these proposals would make the Scottish Parliament responsible for the overwhelming majority of both expenditure and revenue in Scotland, although there would be greater volatility on the revenue side than in the previous scenarios given fluctuation of North Sea tax receipts.

### **Scenario S9 – Devo Max**

Our most radical non-independence scenario is a putative ‘Devo Max’ model. This term is often used as an undefined catch-all for significant additional devolution that may follow a No vote. Drawing on the analysis of McLean et al 2013, this encompasses the maximum possible devolution of spending and tax powers that could take place without effectively creating an independent Scottish state.<sup>15</sup>

On this basis we have imagined the Scottish Parliament with control of all taxes other than VAT, which must operate on a UK-wide basis under EU law.

It would also control all spending except ‘defence and international services’ – a category

<sup>12</sup> Devo Plus Group, *A stronger Scotland within the UK*, 2012; Devo Plus Group, *Improving social outcomes in Scotland*, 2012; Devo Plus Group, *A New Union*, November 2012, All retrieved 29 August 2014 from [www.devoplus.com/downloads](http://www.devoplus.com/downloads)

<sup>13</sup> The Devo Plus group recommend the devolution of a series of taxes in three ‘tiers’, grouped by ease of devolution. We have included only tier 1 and 2 taxes in our analysis.

<sup>14</sup> Reform Scotland, *Scotland’s Future: The constitutional report card*, 2014, retrieved 29 August 2014 from [http://reformscotland.com/public/publications/Scotlands\\_Future\\_The\\_constitutional\\_report\\_card2.pdf](http://reformscotland.com/public/publications/Scotlands_Future_The_constitutional_report_card2.pdf)

<sup>15</sup> McLean, I., Gallagher, J., and Lodge, G., *Scotland’s choices: The referendum and what happens afterwards*, Edinburgh University Press, 2013.



that includes FCO, Ministry of Defence (MOD) and Department for International Development (DfID) spending; existing public sector debt interest payments; and 'national schemes for public order and safety' including cross-UK functions such as the UK Border Force, the National Crime Agency etc.

### **Scenario S10 – Independence**

This shows Scotland as an independent country, which would therefore be responsible for 100% per cent of public spending and taxes raised within Scottish territory. Note that this does not mean that revenue and spending would be equal. Our model makes no claims about whether there would be a budget deficit or surplus under any scenario.

In Chapter 2 below, we discuss some of the implications of a Yes vote for Whitehall, the Civil Service as a whole, and for intergovernmental relations.

## **Scenarios for Wales**

### **Scenario W1 – Status quo**

This is the current Welsh devolution settlement. The Welsh Government controls a smaller share of public expenditure in Wales (51%) than does the Scottish Government in Scotland (59%), reflecting the non-devolution of spending areas such as police, justice and some transport functions.

On the revenue side, our figure includes the counterintuitive finding that the Welsh Government is responsible for a greater share of tax revenue in its territory (10%) than its Scottish counterpart (7.5%). This should be taken with a slight pinch of salt as the data sources used are not wholly comparable. Also, our calculations count non-domestic rates ('business rates') as devolved, although in the Welsh case this tax is only partially under the control of the Welsh Government. What is true however, is that overall per-capita tax revenue in Scotland is higher than Wales (due in large part to North Sea revenue) which helps explain the lower proportionate share of tax revenue under the control of the Scottish Government.

### **Scenario W2 – Wales Bill (no Welsh Rate of Income Tax – WRIT)**

For this scenario we calculate the effects of the implementation of the Wales Bill presently before Parliament. Its provisions are similar to those of the Scotland Act 2012, devolving landfill tax, stamp duty land tax and 10p in the pound of each rate of income tax.

The key difference is that the income tax powers in Wales would only come into effect after an affirmative vote in a referendum. We therefore divide these powers into two separate scenarios. Scenario W2 models the effects of the devolution of landfill tax and stamp duty land tax only, and as can be seen in Figure 1, the impact is small. These taxes raise relatively little money in Wales – £189 million (m) in 2012/13, equivalent to 1% of total tax revenue in Wales.

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### Scenario W3 – Wales Bill (+ WRIT)

Here we incorporate the devolution of the income tax powers in the Wales Bill which, following a referendum, would be transferred to Cardiff. In fiscal terms this is a far more significant reform.

The Silk Commission estimated that these powers would raise approximately £2 billion (bn) in Wales. This would mean that Welsh devolved and local government would be responsible for raising almost a quarter of their combined budgets through devolved and local taxation.

### Scenario W4 – Silk II

This scenario builds on the previous two scenarios but also includes estimates of additional spending responsibilities, proposed in the second report of the Silk Commission on devolution in Wales.

Some of the proposals made are tentative (for instance devolution of the legal system would be subject to a review). We have calculated a range where this scenario would fall depending on which additional powers were included. The data point in our chart marks the midpoint of those estimates. The recommendations in the report which would have the most significant impact on Welsh Assembly spending would be the devolution of policing, with the possibility of further devolution of probation, prisons and law courts too.

## Scenarios for Northern Ireland

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### Scenario NI1 – Status quo

This is the status quo in Northern Ireland. The significant difference between Northern Ireland and the other two devolved territories lies in the devolution of social security. In practice, the Northern Ireland Executive adheres closely to UK social security policy under the 'parity principle', by which Northern Ireland replicates DWP policy and is funded to do so by the Treasury.

Nonetheless, social security spending is formally under the control of the Northern Ireland Assembly (along with policing and justice and all other major domestic public services), and on this basis the Northern Ireland Assembly is calculated as controlling 81% of total government expenditure in Northern Ireland. Like the other two devolved administrations it has very limited fiscal powers, extending to local taxes only.

### Scenario NI2 – Corporation tax

NI2 shows the devolution settlement in Northern Ireland if corporation tax were devolved. Northern Ireland currently faces tax competition with the Republic of Ireland, which has a lower rate (12.5%) of corporation tax. Most political parties in Northern Ireland have publicly

stated their support for reform in order to be able to match the rate in the Republic.

In 2011/12 corporation tax raised £649m in Northern Ireland.<sup>16</sup> If devolved in full, this would provide a significant extra revenue stream for the devolved institutions. However, since the rationale for devolution is to reduce the tax rate in Northern Ireland, revenue would be expected to fall – in the short term at least. We do not model these dynamic effects of tax devolution, but some have estimated that equalising the corporation tax rate with the Republic could cost the North as much as £400m per annum.<sup>17</sup>

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<sup>16</sup> This is the estimate given in Department of Finance and Personnel NI, *Northern Ireland net fiscal balance report*, 2014, retrieved 29 August 2014 from [www.dfpni.gov.uk/ni-net-fiscal-balance-report-2011-12.pdf](http://www.dfpni.gov.uk/ni-net-fiscal-balance-report-2011-12.pdf) HMRC estimate this as £476m in HMRC, *Disaggregated tax and NICs receipts*, 2013, retrieved 29 August 2014 from [www.gov.uk/government/publications/disaggregation-of-hmrc-tax-receipts](http://www.gov.uk/government/publications/disaggregation-of-hmrc-tax-receipts)

<sup>17</sup> Campbell, J., 'Corporation tax: Cost of devolving tax to NI still not known,' *BBC News Online*, 2 July 2014, retrieved 29 August 2014 from [www.bbc.co.uk/news/uk-northern-ireland-28115409](http://www.bbc.co.uk/news/uk-northern-ireland-28115409) Other estimates include that of the Economic Reform Group, which said reducing the rate to 12.5% could cost £215m a year, or the equivalent of 2% in the block grant: Economic Reform Group, *The Case for a reduced rate of corporation tax in Northern Ireland*, 2010, retrieved 29 August 2014 from [www.ergni.org/reports/report\\_corporation\\_tax\\_may\\_2010.pdf](http://www.ergni.org/reports/report_corporation_tax_may_2010.pdf) and PwC, which estimated a cost of £280m: Staff, 'Cut in corporation tax "could cost NI £280m", PwC says,' *BBC News Online*, 7 January 2011, retrieved 29 August 2014 from [www.bbc.co.uk/news/uk-northern-ireland-12128999](http://www.bbc.co.uk/news/uk-northern-ireland-12128999)

## 2. Scotland says Yes

The most transformative scenario for government across the UK and for relations between the different nations and territories would be set in motion with a Yes vote on 18 September. This is Scenario S10 in Figure 1 above, in which the Scottish Government and Parliament would assume responsibility for all public expenditure in Scotland (as well as overseas spending on Scotland's behalf) and for all tax raised in Scotland.

There has been a huge amount of discussion and debate about the politics of the referendum campaign; public opinion and attitudes; how negotiations on the terms of independence would work; specific points of dispute such as Scotland's currency options; and what an independent Scotland might do differently.<sup>18</sup> Our own focus in this chapter is on the narrower issue of what a Yes vote would mean for the Civil Service (in both Whitehall and Edinburgh) and for mechanisms for facilitating effective intergovernmental relations.

### Breaking up the Home Civil Service

One of the distinctive design features of the current devolution arrangements is that – even as significant powers to allocate public spending and manage public services have been devolved to Scotland, Wales and Northern Ireland – the basic structure of the Civil Service has remained unchanged. A single Home Civil Service serves the UK, Scottish and Welsh governments, while Northern Ireland has its own Civil Service for historical reasons.

As far as Scotland is concerned, the non-devolved status of the Civil Service is entrenched in the Scotland Act 1998, which specifies that 'the Civil Service of the State is a reserved matter', and in the Constitutional Reform and Governance Act 2010, which makes plain that the UK Minister for the Civil Service (in practice the Prime Minister) is responsible for management of the whole Home Civil Service. There are however certain requirements to consult the devolved governments on matters such as publishing civil service codes for each of the administrations. On coming to power in 2007 the SNP was committed to seeking the devolution of the Civil Service, but did not subsequently make this reform a priority, after being pleasantly surprised at the ability of the Civil Service to switch allegiance and effectively support the nationalist government.

In the event of a Yes vote and transition to Scottish independence, the Home Civil Service would cease to exist, and a new separate Scottish Civil Service would be established. There are already around 16,000 civil servants working for the Scottish Government on devolved functions and these officials would presumably transition fairly smoothly to the new independent Scottish state. At present, there are also around 25,000 officials in Scotland

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<sup>18</sup> MacWhirter, I., *Road to referendum*, Cargo Publishing, 2013; the Economic and Social Research Council's (ESRC's) Future of the UK and Scotland programme, retrieved 29 August 2014 from [www.futureukandscotland.ac.uk](http://www.futureukandscotland.ac.uk) House of Lords Constitution Committee report, *Scottish independence: constitutional implications of the referendum*, HL Paper 188, 2014; National Institute of Economic and Social Research, *Scotland's Currency Options*, 2013, retrieved 29 August 2014 from [www.niesr.ac.uk/sites/default/files/publications/dp415.pdf](http://www.niesr.ac.uk/sites/default/files/publications/dp415.pdf) and polling on public attitudes by What Scotland Thinks, retrieved 6 September 2014 from [www.whatscotlandthinks.org](http://www.whatscotlandthinks.org) Also see range of research papers by the Institute of Chartered Accountants Scotland (ICAS) retrieved 29 August 2014 from <http://icas.org.uk/ScottishIndependence>

working for UK government departments, mainly for DWP, HMRC and MOD. The impact of independence on these people and the departments in question is less clear.

As far as these UK civil servants in Scotland are concerned, the main options would be:

1. Transfer to the independent Scottish Civil Service, which would need to build up its capacity to carry out its new functions in areas such as welfare and pensions, tax collection and macroeconomic policy, and defence/foreign policy. The precise nature of the capacity required however, would depend on the outcome of negotiations on issues like the currency and ongoing defence co-operation; the speed of disentangling UK or GB-wide systems; and decisions taken by the Scottish Government about how to organise the new state.
2. Continued employment by the UK government while remaining in Scotland. This would be an unusual arrangement. But in cases where there is existing infrastructure and capacity in place (as for the processing of pensions and benefits for English recipients in Scottish DWP centres) this might be a cost-efficient solution for the UK government, at least for a transitional period.
3. A combination of the above two options with the staff transferring to the new independent Scottish Civil Service but continuing to provide functions to UK government departments through negotiated outsourcing agreements. There is some precedent for this in that DWP sometimes contracts the separate Northern Ireland Civil Service to carry out benefits processing work on its behalf.
4. Relocation of jobs from Scotland to other parts of the UK, which would obviously incur some costs for the departments involved, but in some cases this might be the preferred option. For instance, in November 2013 the Secretary of State for International Development suggested that DfID's presence in Scotland would be reviewed and likely reduced in the event of independence.<sup>19</sup>
5. Job losses. Overall UK Civil Service headcount has been on a downward trajectory for some years under the pressure of fiscal consolidation. If this continues then UK departments are likely to downsize their Scottish operations as a priority. Departments like DWP and HMRC are likely to find themselves overstaffed post-independence irrespective of whether austerity continues (since their 'customer base' will have been reduced by nearly 10%) so would presumably need to reduce their wage bill one way or the other.

The Scottish Government has indicated that in the event of independence they favour a combination of the first and second options. In its *Scotland's Future* White Paper the stated intention is to 'preserve continuity of employment for all staff, either by transfer to the Scottish Government or through continued employment by the Westminster Government

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<sup>19</sup> Maddox, D., 'Scottish independence: Dfid "would leave" Scotland,' *The Scotsman*, 13 November 2013, retrieved 29 August 2014 from [www.scotsman.com/news/politics/top-stories/scottish-independence-dfid-would-leave-scotland-1-3185333](http://www.scotsman.com/news/politics/top-stories/scottish-independence-dfid-would-leave-scotland-1-3185333)

where it still requires their skills.’ The white paper suggests that ‘many’ of the UK civil servants currently working in Scotland will be transferred to a new Scottish Civil Service.<sup>20</sup>

From the Scottish Government perspective, one further complication is that UK governmental staff based in Scotland come disproportionately from lower grades – reflecting the fact that the functions decentralised away from London have tended to be administrative tasks such as benefits processing. As a result there is limited senior management or policymaking capacity in domains such welfare, pensions and tax policy based in Scotland. Additional senior staff would therefore be required in these areas, as well as in areas such as foreign policy and macroeconomic affairs.

But while independence would mean that the Home Civil Service ceases to exist, for any UK officials who were to transfer to a new Scottish Civil Service, the transition process may well be relatively smooth in terms of cultural adjustment. The Scottish Government has declared its intention to entrench in a new written constitution the existing civil service values of honesty, integrity, impartiality and objectivity, and to create a new Scottish Civil Service Commission to act as a regulator of the merit-basis of civil service recruitment. The new Scottish Civil Service would in other words be set up on the basis of the same principles that govern the Home Civil Service at present.

In terms of structure however, UK civil servants who do transfer to the new Scottish Government will have to adapt to a unified, non-departmental way of working. The Scottish Government has indicated that they will not adopt a Whitehall-style system of departments but will maintain a single, unified structure.<sup>21</sup>

In addition to this structural difference, independence would clearly create the potential for greater divergence over time, particularly in areas where the UK and Scottish administrations have already followed different civil service reform agendas – for example, on performance-related pay for senior officials, where the Scottish Government has not followed the Whitehall approach even within the context of a unified Home Civil Service. Interchange between Whitehall and Edinburgh, which is already seen to have declined significantly since devolution, might also be expected to fall further since officials in one administration would probably be treated as external applicants by the other. These trends would be likely to change the nature of intergovernmental interaction, which would be likely to grow more formalised and ‘transactional’ over time.

### **A differential impact across Whitehall and the Scottish Government**

A vote for Scottish independence would be a significant shock to the Westminster/Whitehall system, but its impact would be felt very differently by different parts of government. This is for the simple reason that there are large parts of Whitehall that already have very little or no responsibility at all for policy or public services north of the border. This is for the most part not a product of post-1999 devolution. Most of the major public services now under control of the devolved administration in Edinburgh were already administered separately by the old Scottish Office in the pre-devolution era. Other departments will face significant change as

<sup>20</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, p21

<sup>21</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, p.362



their responsibility for Scotland comes to an end, leaving questions to be answered about the future of their staff and other assets currently based in Scotland.

Meanwhile in Edinburgh, the transition to independence would require the Scottish Government to build up its capacity in many new areas of policy responsibility acquired from Westminster. In some cases, UK departmental staff based north of the border may be able to form the basis of new departments and agencies in the independent Scottish Civil Service. In other cases, as noted above, extra recruitment would be required. The Scottish Government's independence white paper recognises that 'additional roles will be created in Scotland to deliver some of the new services'.<sup>22</sup>

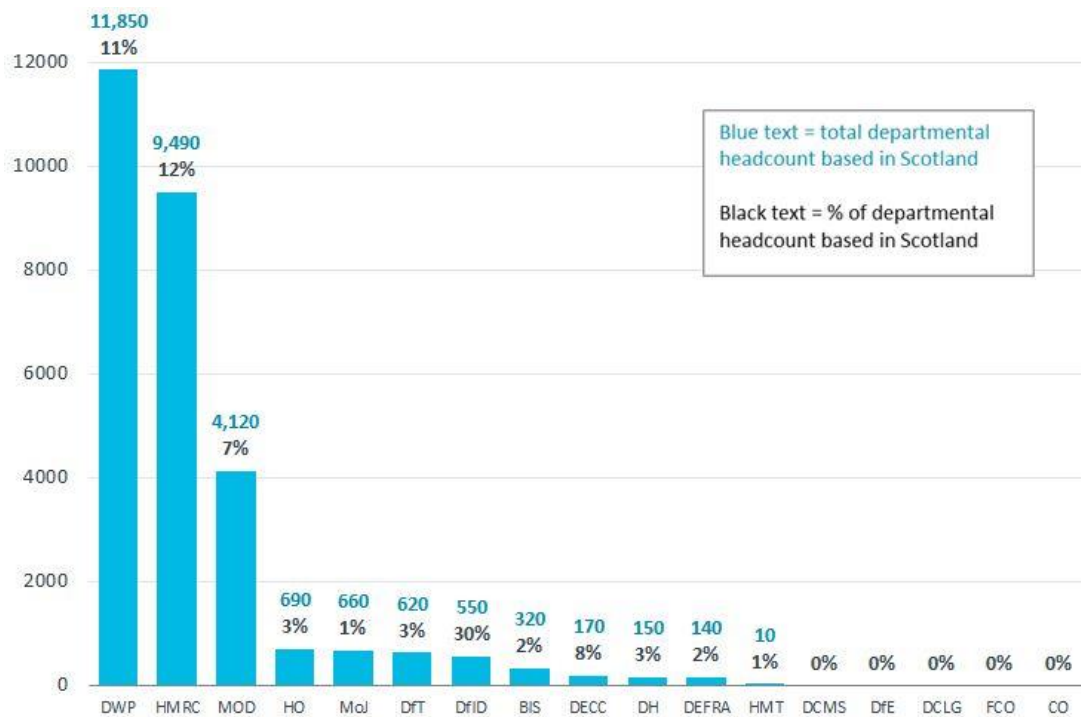
Below we discuss some of the major challenges that would face the different parts of Whitehall in the event of a Yes vote, as well as commenting on areas where new and separate Scottish institutions would be needed and areas where co-operative arrangements might prevail. Of course, there can be no certainty in most of these areas, since much will depend on the outcome of negotiations on the terms of independence. We also do not claim to provide comprehensive coverage of all the issues that would arise in the transition to Scottish independence, but merely to give a sense of the scale of change that Whitehall, as well as the Scottish Government itself, would face.<sup>23</sup>

The UK Government is often referred to as a single entity, which in constitutional terms it is. Yet in terms of its territorial coverage, Whitehall is in fact a hybrid of UK-wide, GB-wide, England-Wales, and England-only functions. Two charts can help to illustrate this complexity, highlighting those that would be more or less affected by a Yes vote on 18 September. Figure 2 shows the number and proportion of each department's employees who are based in Scotland, and Figure 3 shows the proportion of each department's programme expenditure that extends to Scotland.

<sup>22</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, p.344

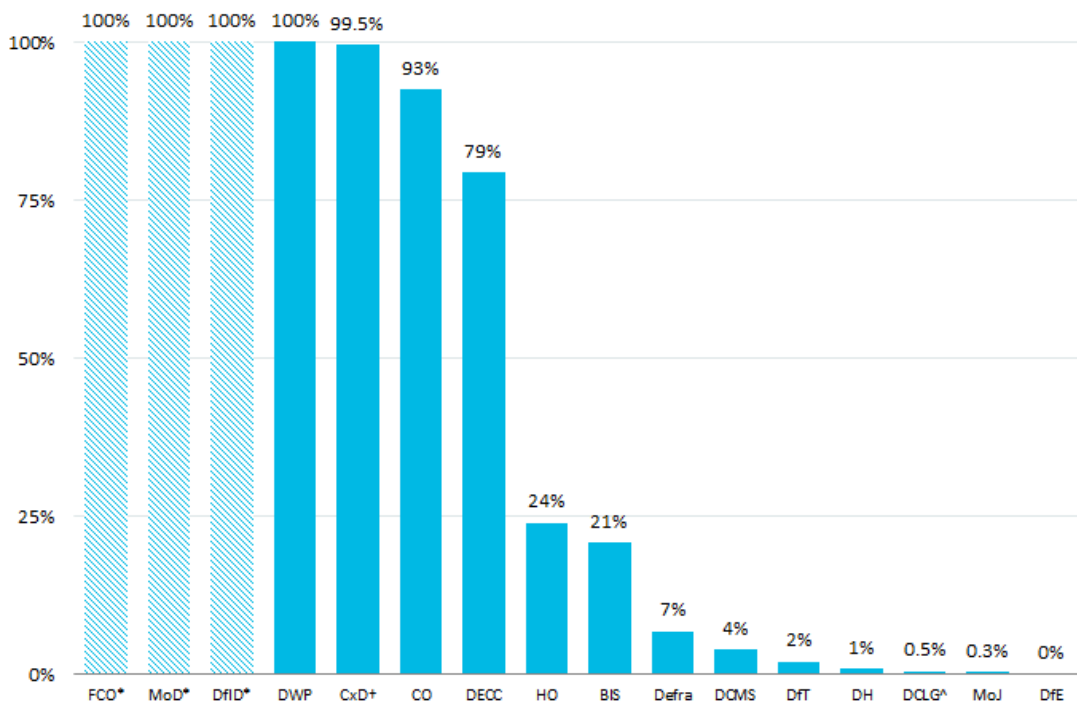
<sup>23</sup> Dunleavy, P., *Transitioning to a new Scottish state*, 2014, LSE, retrieved 6 September 2014 from <http://eprints.lse.ac.uk/57708/1/Transitioning-to-a-new-Scottish-state-PD-ebook.pdf> Professor Patrick Dunleavy has estimated that immediate set-up costs for creating and streamlining administrative bodies would be £200m, matching the claims of the Scottish Government. According to reports in the *Sunday Times*, the Centre for Economics and Business Research suggested there would be set-up costs of more than 10 times that amount (£2.5bn) with an additional £2bn needed to establish new currency arrangements: Allardyce, J., 'Setup cost for Scotland over £2bn,' *Sunday Times*, 31 August 2014, retrieved 6 September 2014 from [www.thesundaytimes.co.uk/sto/news/uk\\_news/scotland/article1453498.ece?CMP=OTH-gnws-standard-2014\\_08\\_31](http://www.thesundaytimes.co.uk/sto/news/uk_news/scotland/article1453498.ece?CMP=OTH-gnws-standard-2014_08_31)

**Figure 2: Number and share of departmental headcount based in Scotland**



Source: Institute for Government analysis of Civil Service Statistics 2013 (data at 31 March 2013). Data includes agencies

**Figure 3: Share of departmental programme expenditure that applies to Scotland**



\* DfID, MOD and DCO spending is 'non-identifiable' spending that is on behalf of the whole UK rather than programme spending within the UK. Data for all other departments relates to spending on policy programmes (DEL only), and the figures given are the share of that expenditure that is on programmes that cover Scotland. ^ DCLG data excludes spending by local government. † CxD refers to the Chancellor's Departments (HMT and HMRC). Source: HM Treasury, Statement of Funding Policy (2010).



Taken together, these charts illustrate where on the spectrum each department sits in terms of their current relationship to Scotland. At one end of the spectrum are departments such as the Department for Education (DfE), the Department for Environment Food and Rural Affairs (Defra), the Department of Health (DH), the Department for Communities and Local Government (DCLG), the Department for Culture, Media and Sport (DCMS) and the Ministry of Justice (MoJ). These have few or no staff in Scotland and few policy programmes that cover Scotland. Independence would therefore have a fairly limited impact on the size or budgets of these departments since their functions are already devolved matters under the control of the Scottish Government.

However, that is not to say that there would be no significant issues for these departments to adapt to in the event of a Yes vote. There would be many. For instance, **DCMS** is the parent department of both the BBC (which is expected to be replaced by a new Scottish public service broadcaster) and the National Lottery, which the Scottish Government wants to continue operating in an independent Scotland, but with new intergovernmental arrangements for the distribution of the proceeds in Scotland. DCMS would also cease to be responsible for media and broadcasting regulation more generally in Scotland, and under the Scottish Government's plans Ofcom would see its Scottish functions merged into a single integrated economic regulator requiring the two regulators to create new mechanisms for cross-border management of the spectrum.<sup>24</sup>

**Defra** is similarly a mostly England-only department, but is responsible for some GB and UK-wide issues, for instance around animal diseases, on which continuing cross-border co-operation would be needed. Defra would also cease to represent Scotland's large fisheries and agriculture industries at EU level (which has been a cause of intergovernmental tensions in the past), and would cease to have a role in disbursing EU funds in these areas in Scotland.

The **Ministry of Justice** is primarily an England and Wales department but does have a few hundred staff in Scotland. It would also be affected by independence in that important UK-wide bodies that it is responsible for – such as, the UK Supreme Court and Electoral Commission – would cease to have a role north of the border. The Scottish Government intends to establish a new Supreme Court of Scotland (made up of Scotland's existing highest courts), and Scottish Electoral Commission (some of whose staff might logically be drawn from the existing UK Electoral Commission office in Scotland). There would also be cross-border arrangements and agreements to be worked out on justice co-operation.

Likewise the expectation of the Scottish Government is that there would be cross-border operational agreements on healthcare, affecting the predominantly England-only **Department of Health**. For instance, the white paper states a preference for the continuation of UK-wide arrangements for blood and organ donation.

Further along the devolution spectrum are departments such as the Home Office, the Department for Business, Innovation and Skills (BIS) and the Department for Transport (DfT). Many of these have functions operating on an England or England-Wales level, but also have some important responsibilities that extend to Scotland, and some staff north of

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<sup>24</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, p.320

the border. Crime and policing are already devolved to Scotland and no transfer of staff or functions will be required on independence. But the **Home Office** is of course responsible for important non-devolved functions including immigration, borders and passports; counter-terrorism; and serious crime (including the National Crime Agency). It has some 700 staff in Scotland at present. In these areas the Home Office would face some restructuring challenges while the Scottish Government would have to build up (or acquire) new capacity to take on these responsibilities. (The Scottish Government has set out plans to establish several new bodies in this area including a Scottish Security and Intelligence Agency and a Scottish Borders and Migration Service).

Co-operative arrangements already exist in some of these fields. The Specialist Crime Division at Police Scotland, which has counter-terrorism as part of its remit, works closely with UK agencies and the Home Office to share intelligence.<sup>25</sup> And there is an expectation of continuing close co-operation between the UK and Scottish Governments in dealing with serious crime, and of continued intelligence sharing. All these arrangements would require negotiation between the two governments and the creation of new kinds of ongoing intergovernmental structures for Whitehall to manage.

**BIS** and **DfT** each have a few hundred staff in Scotland – mainly in agencies such as the Met Office and the Driver and Vehicle Licensing Agency (DVLA). The departments also have some important GB or UK-wide functions at present that would face changes in a post-independence context. On transport, Scotland would acquire control of shipping, aviation, rail regulation and ‘motor services’ from DfT. In some of these areas, close cross-border co-operation may continue to be needed. The Scottish Government intention, for instance, is that the Civil Aviation Agency and the Office of Rail Regulation would continue to operate in Scotland. However, presumably new intergovernmental governance and accountability arrangements would be required for such a model to be set up, requiring the agreement of the UK Government.

From BIS an independent Scotland would gain control of business regulation, competition and labour market policy (though in all these cases the ability to diverge from current UK policy would be restricted both by EU law and, probably, by the desire to minimise costs to business). In terms of governance structures, the Scottish Government plans to establish a single economic regulator instead of the UK model of separate sectoral regulators such as Ofgem, Ofcom and Ofwat. Scotland is already responsible for its own university system – which is the responsibility of BIS in England. But the Scottish Government intends to keep intact the UK-wide research councils that make up the bulk of BIS’s budget (from which Scottish universities secure about 15% of funds, compared with Scotland’s 8% of the UK population).<sup>26</sup> The maintenance of a ‘common research area’ would therefore be subject to negotiation and intergovernmental agreement with the UK government on how the research councils should be funded, governed and how they should distribute their budgets.

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<sup>25</sup> Neal, A., *Assessing security governance in Scotland under current arrangements: Seminar report*, Future of the UK and Scotland, 2013, retrieved 29 August 2014 from [www.futureukandscotland.ac.uk/sites/default/files/papers/Assessing%20security%20governance%20in%20the%20UK%20and%20Scotland%20under%20current%20arrangements.pdf](http://www.futureukandscotland.ac.uk/sites/default/files/papers/Assessing%20security%20governance%20in%20the%20UK%20and%20Scotland%20under%20current%20arrangements.pdf)

<sup>26</sup> Matthews, D., ‘Scots fear losing access to UK research council system,’ *Times Higher Education*, 3 July 2014, retrieved 29 August 2014 from [www.timeshighereducation.co.uk/news/scots-fear-losing-access-to-uk-research-council-system/2014199.article](http://www.timeshighereducation.co.uk/news/scots-fear-losing-access-to-uk-research-council-system/2014199.article)

Further along the spectrum comes the **Department of Energy and Climate Change (DECC)**, the bulk of whose spending is at the UK-wide level, for instance on nuclear decommissioning. An independent Scotland would inherit responsibility for these decommissioning liabilities in Scotland. A post-Yes Scottish Government would also gain policy and regulatory powers in relation to energy markets, which it intends to use to support the growth of renewable industries. At the same time, the Scottish Government aspires to maintain a shared GB-wide electricity and gas market, and plans in the event of a Yes to 'seek a new energy partnership with Westminster to steer energy policy jointly and to ensure proper governance of the integrated market'. This is another area where the precise nature of co-operative intergovernmental arrangements will depend on negotiations between the governments.

Then there are the two largest departments in terms of headcount, **HMRC** and **DWP**, responsible for the major non-devolved areas of tax, welfare and pensions and with a large presence in Scotland. The two departments combined have over 21,000 staff based in Scotland (more than are employed by the whole Scottish Government). On a per capita basis, Scotland is over-supplied with tax and benefits officials at present. If Scotland had the same share of HMRC and DWP staff as its population share, it would have just 15,000 staff in these departments.

The reason for this is that many of these staff provide services for the rest of the UK. For instance, in large DWP centres such as those in Glasgow and Dundee, pensions and benefits processing for claimants in both Scotland and parts of England takes place.<sup>27</sup> HMRC is likewise organised on a functional basis rather than in terms of the location of the client base. In reference to administration of child benefit and tax credits, for instance, HMRC has stated that these are 'managed on a nationwide basis'. For example, calls from Scottish claimants may be answered at offices within Scotland or elsewhere in the UK and calls from claimants elsewhere in the UK could be handled in Scotland.

Post-independence, the two departments and the Scottish Government would face a choice about what to do with Scotland-based employees. Many of these staff could no doubt transfer to the Scottish Civil Service to perform similar functions for an independent Scotland. Revenue Scotland (which has recently been set up to manage the small devolved taxes under the Scotland Act 2012) would need to be significantly expanded and would look to HMRC expertise in so doing. The Scottish Government would also have to build its infrastructure for benefits delivery. However, since there may be more than were needed for new Scottish systems others might transfer to other parts of the Scottish Government where new capacity would be needed (though retraining would be required).

Other DWP and HMRC staff might continue to be employed by the UK government to provide services to English benefit-recipients, pensioners and taxpayers. There is also an intention on the Scottish side to negotiate new 'shared services' arrangements and maintain

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<sup>27</sup> Department for Work and Pensions, *Scotland analysis: Work and pensions*, 2014, p.77-78, retrieved 29 August 2014 from [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/306086/scotland-analysis-work-and-pensions.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/306086/scotland-analysis-work-and-pensions.pdf)

necessary IT and other systems for shared administration for delivery of benefit payments – at least for a transitional period while separate Scottish systems are established.<sup>28</sup>

One additional issue to note is that while DWP and HMRC have more staff in Scotland than an independent Scottish tax and welfare system would be likely to need, there are at present few managerial and policymaking staff in those departments north of the border. DWP for instance has just 10 senior civil servants compared with over 10,000 operational and administrative staff in Scotland. So recruitment would particularly be needed at the senior end.

Next are the three international-facing departments: **FCO**, **MOD** and **DfID**. These are all fully reserved in terms of their policy responsibilities (meaning the Scottish Government has limited capacity in these areas at present) but differ in terms of their current presence in Scotland and in terms of the likely thorny issues in negotiations and the transition to independence. There would therefore be different kinds of issue to be worked through in these three areas for the departments themselves, for the Scottish Government, and in setting up any ongoing intergovernmental arrangements.

**DfID** is the most heavily represented department in Scotland in proportionate terms. Its offices in East Kilbride employ around a third of the department's total workforce. Scotland already has a small international development policy capability and runs small-scale aid projects in a few countries. Post-independence, the Scottish Government aims to become a 'global leader in the field of international development' and would look to build its capacity further (alongside a new diplomatic service).<sup>29</sup> The Scottish Government is therefore likely to seek to acquire DfID's Scottish resources, as well as establishing a close working relationship with DfID, both during the post-referendum transition phase and beyond. But given the large proportion of DfID staff based in Scotland, the UK department would itself find itself short-staffed should all its Scottish staff transfer over. The UK government could opt to retain some of its own staff in Scotland. However, in November 2013 the Secretary of State for International Development suggested that DfID's presence in Scotland would be reviewed and likely reduced in the event of independence.<sup>30</sup>

The **MoD** also has a considerable number of both staff in Scotland. 'Over 11,100 regular armed forces (7.5% of the UK total) and 4,000 MOD civilian personnel (7.6% of the UK total)' are based at around 50 defence bases across Scotland, according to the UK Government.<sup>31</sup> As with DfID and DWP, some of these staff may be transferred following independence into new Scottish defence capabilities. The Scottish Government's white paper states that on independence arrangements will be made for the transfer of 'units and personnel wishing to serve in Scottish defence forces'. The white paper also foresees a period of transition and

<sup>28</sup> Singh, D., et al, *Expert Working Group on Welfare Report*, 2013, retrieved 29 August 2014 from [www.scotland.gov.uk/Resource/0042/00424088.pdf](http://www.scotland.gov.uk/Resource/0042/00424088.pdf) Scottish Government, *Scotland's Future*, White Paper, 2013, p.165.

<sup>29</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, p.230.

<sup>30</sup> Maddox, D., 'Scottish independence: Dfid "would leave" Scotland,' *The Scotsman*, 13 November 2013, retrieved 29 August 2014 from [www.scotsman.com/news/politics/top-stories/scottish-independence-dfid-would-leave-scotland-1-3185333](http://www.scotsman.com/news/politics/top-stories/scottish-independence-dfid-would-leave-scotland-1-3185333)

<sup>31</sup> Ministry of Defence, *Scotland Analysis: Defence*, Gov.UK website, 2013, p.30, retrieved 3 September 2014 from [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/248654/Scotland\\_analysis\\_Defence\\_paper-FINAL.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/248654/Scotland_analysis_Defence_paper-FINAL.pdf)

negotiation following independence where the transfer of defence assets and bases will be agreed and arrangements put in place for longer-term 'collective defence arrangements'. These would include the potential for UK and Scottish 'joint facilities' at some key sites such as Lossiemouth. The UK Ministry of Defence may therefore retain some staff in Scotland but how many, and what role they would perform, depends on the outcome of these negotiations – most significantly on the future of the Trident nuclear base.<sup>32</sup>

The third of the international departments, **FCO**, currently has no presence at all in Scotland. In one sense then, following a Yes vote, the FCO would not face any direct restructuring challenges and FCO staff could simply continue fulfil their role as representatives of the successor 'rest of UK' state. However, a post-independence UK would have lost around 8% of its population and tax base, and UK-wide departments such as FCO may well need to slim down their workforce accordingly. At the same time the Scottish Government would be seeking to build up its own international service, with an aspiration of establishing a network of 70 to 90 offices around the world. In so doing it might well seek to recruit from the ranks of experienced British diplomats. It also expects, subject to negotiations, to acquire a share of the UK diplomatic service's overseas assets, as well as to build on its existing network of Scottish Development International offices (which promote trade with and investment into Scotland).

The two large central departments in Whitehall, the **Treasury** and the **Cabinet Office**, have very limited presence in Scotland in terms of staff or policy programmes. HMT would be heavily involved in negotiations about currency arrangements, liability and ongoing management of the UK public debt burden, and any joint arrangements for financial services regulation. The Scottish Government would again need to build up its capacity in these areas, either through the transfer of staff from Whitehall to Scotland, through the hiring or training new staff, or through co-operative arrangements with the UK Government.

As for the **Cabinet Office**, the Scottish Government of course already has its own equivalent in terms of its cabinet secretariat machinery and its corporate leadership function for HR and other matters. One big change for the Cabinet Office would be the dissolution of the Home Civil Service, which we discussed at the outset of this chapter. As parent department of the secret and intelligence services the Cabinet Office would be directly affected by the Scottish Government's plan (noted above) to establish its own Security and Intelligence Agency.

Finally, in the event of independence, the future of the **Scotland Office** is unclear. In its present form, as a Whitehall voice in Scotland and a Scottish voice in Whitehall, it would presumably be abolished. However, the discussion above has noted the wide range of complex intergovernmental issues that would still need to be managed between Whitehall and Edinburgh – both in the transition to independence and potentially (subject to agreement on both sides) in the longer term too in certain areas. This may require the UK government to maintain some kind of central capacity to manage relations with Scotland, which would be of a different order to its relations with any other country.

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<sup>32</sup> Scottish Government, *Scotland's Future*, White Paper, 2013, Chapter 6 – *International Relations and Defence*



### 3. A No victory – Reversion to the moving status quo

#### The ‘status quo’ in Scotland

Above we have discussed some of the implications for the Civil Service and wider machinery of government of a vote in favour of independence in Scotland on 18 September. Here we examine the alternative scenario – the more likely, according to almost all opinion polls – of a rejection of independence by Scottish voters.

Referendums usually offer a choice between a specific change and the status quo, but one of the interesting things about this referendum is that the status quo is not actually on the ballot paper. Setting aside plans (such as those outlined by the three unionist parties) for further devolution, which we discuss in the next chapter, a No vote on 18 September will not result in maintaining existing arrangements because changes to the devolution settlement are already in motion via the partly-implemented Scotland Act 2012 and other recent transfers of power.

While the division of responsibilities has not remained entirely static since the start of devolution (for instance, power over railways transferred to Edinburgh in 2005), the 2012 Act marks a significant moment in Scotland’s constitutional evolution as it devolves considerable financial powers to the Scottish Parliament. Its implementation will increase the proportion of Scottish tax revenue under the control of the devolved administrations from 7.5% to 16% – moving Scotland up the y axis of Figure 1 (on page 12) from Scenario S1 to Scenario S2. While the legislation was passed in 2012, implementation is still under way and there appears to be fairly-low awareness of the fact that a No vote will be followed by these extra powers being acquired by the Scottish Parliament and Government. For instance, a recent TNS poll reported that less than a third of people asked were aware of the additional powers due to be devolved.<sup>33</sup>

The most eye-catching provision in the Scotland Act is for a Scottish Rate of Income Tax (SRIT). This will reduce the basic, higher and additional rates of income tax by 10 pence in the pound for Scottish taxpayers, with the Scottish Parliament then having to take a decision about what rate of SRIT to add on top to the three rates set in Westminster. The Scottish Government budget will reflect the income tax revenue collected in Scotland for the first time. The three rates will only be able to be varied ‘in lockstep’, so the difference between the three rates (as well as the thresholds and the personal allowance) will all continue to be set in Westminster. This power will come into force in April 2016. A year prior to that, two smaller taxes – stamp duty land tax and landfill tax – will be devolved in their entirety. The Scotland Act also gives the Scottish Government limited borrowing powers and has devolved some other small functions.

Since enactment, there have been joint official and ministerial implementation efforts between the two governments. A bespoke intergovernmental architecture has been established to manage the implementation. This includes an official-level Intergovernmental Assurance Board which oversees the planning and implementation of the financial

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<sup>33</sup> TNS, *Scottish Independence Referendum Survey*, 2014, p. 61, retrieved 29 August 2014 from [www.scotlandseptember18.com/wp-content/uploads/2014/07/125385\\_Independence\\_Poll\\_FINAL\\_Media.pdf](http://www.scotlandseptember18.com/wp-content/uploads/2014/07/125385_Independence_Poll_FINAL_Media.pdf)

provisions; a Programme Board to supervise the implementation of the SRIT in particular; a Joint Exchequer Committee – comprising ministerial representatives from the two governments – to provide political oversight; and a forum in which to resolve more tricky points of negotiation. Both governments have signed a Memorandum of Understanding which sets out these arrangements and apportions the parties' liabilities for the costs of introducing the tax powers.

While interviewees on both sides reported that this machinery was working well and that there were good and cooperative working relations, there remain some sticking points to be resolved. The block grant adjustment for income tax has been agreed by a process of iteration towards a mutually-preferred position, but the adjustment methodology for landfill tax and stamp duty is still under negotiation. One unanswerable question is whether a No vote might change the dynamics of these negotiations, for instance by encouraging the UK Government to drive a harder bargain on such matters.

As far as Whitehall is concerned, the Scotland Act 2012 primarily affects HMRC – which will manage the SRIT on behalf of the Scottish Government – and the Treasury, which will be required to oversee the Scottish Government's use of its new borrowing powers as well as to continue to oversee the Barnett Formula and block grant allocations. The Scotland Act also includes a general provision to create new devolved taxes with the agreement of the UK Government, which in practice means the Treasury.

North of the border, the changes have resulted in the establishment of new machinery including Revenue Scotland – already created and due to be placed in statute next year as the independent authority responsible for the administration of Scotland's devolved taxes. The Scotland Act did not prescribe a particular collection body for these taxes, but neither did it compel HMRC to take on this role. In the event, the Scottish Government chose to establish its own tax collection body, partly with a view to being ready to take on wider tax-raising powers if and when they are transferred. There will also be a Scottish Fiscal Commission, initially to provide independent commentary on the Scottish Government's revenue projections for the newly-devolved taxes, but with the potential to adopt a wider remit of public finance forecasting, similar to that of the Office for Budget Responsibility.

Other changes included in the Scotland Act 2012 have already been implemented. The Scottish Parliament gained powers over airgun regulation, road speed limits and drink-drive legislation in July 2012. Full control of landfill tax and stamp duty land tax will follow in April 2015, the Scottish Government having pre-legislated to replace the latter with a land and buildings transaction tax.

Separate to the Scotland Act, and further illustrating that the status quo is now a 'moving target', there have also been changes to the devolution settlement in the reserved area of welfare. Partly as a result of opposition to the UK Government's welfare reform agenda within Scotland, the UK government has opted to devolve particular aspects of welfare policy. The discretionary social fund became the Scottish Welfare Fund, administered by local authorities, who also have the power to provide council tax reductions in place of the council tax benefit abolished by the UK reforms. Next year it will become easier to mitigate the effects of the 'spare room subsidy', or 'bedroom tax', as Scottish Ministers will be able to vary the cap on topping-up discretionary housing payments from DWP. Though the changes

are minor within the context of the huge DWP budget, these are significant signs of how even in the area of welfare and benefits (seen as a prerogative of Westminster/Whitehall) the boundary between reserved and devolved powers is to some extent a matter of ongoing negotiation, rather than permanent constitutional fact.

Reflecting the changes to the settlement, the Scottish Government has recently established a dedicated policy division for welfare policy, whose staff oversee the Scottish Welfare Fund; seek ways to mitigate the effects of UK welfare reform; and carry out thinking about more fundamental changes that would follow from a full transfer of control of welfare policy – such as those discussed in the previous chapter.

### **Wales and Northern Ireland after a No vote**

The result of the Scottish referendum of course has no direct bearing on Wales or Northern Ireland, though as we have discussed, a Yes vote is likely to spur serious consideration about the nature of the relationship between the remaining parts of the UK.

As for a No vote, the constitutional status quo in Wales at least is in the process of change already, just as in Scotland, and this will continue (and perhaps accelerate) once the referendum question is settled. Wales has in fact been on a more or less continuing cycle of renegotiation of its settlement since the dawn of devolution in 1999. The initial local government inspired model – of a ‘single corporate body’ without a traditional executive-legislative separation – was quickly deemed to be flawed (and was indeed simultaneously falling out of favour in local government too). This led in 2002 to the Assembly resolving to make distinct the Cabinet’s role within the Assembly. Following the first of several reviews of Welsh devolution (the Richard Commission), the Government of Wales Act 2006 formalised this legal separation between legislature and executive, and legislated for the Assembly’s legislative competence within 20 defined areas to be enhanced (but in a complex system that required Westminster approval for each small incremental addition to the Assembly’s competence). This new model of devolution itself lasted just a single four-year term before, in 2011, a referendum enabled the Assembly to make laws on all matters within those areas.

The Wales Bill currently proceeding through the UK Parliament devolves similar powers to those contained in the Scotland Act 2012, including landfill tax and stamp duty land tax, but makes the creation of a Welsh Rate of Income Tax (WRIT) contingent on a referendum. As far as the machinery of government is concerned, the provisions of the current Wales Bill would principally affect HMRC and the Treasury. Negotiations about how to implement the bill are naturally at an early stage, since it is yet to complete its passage through Parliament, but it would certainly be the responsibility of HMRC to administer the WRIT (if that comes into effect).

As for the fully devolved taxes – that is, stamp duty and landfill tax – one option is for the Welsh Government to establish a new Revenue Wales along the lines of that in Scotland. But with a non-nationalist party in government in Cardiff the desire to set up new institutions may be weaker, so if deemed more cost-efficient, an alternative model under consideration is that HMRC would administer these taxes on behalf of Wales too. However this raises the question of how willing the UK Government and HMRC would be to administer taxes in very different ways in Wales and England, or even to operate taxes with an entirely new structure



on behalf of the Welsh Government. Complexities for HMRC in so doing might extend beyond the administrative burden of simply operating a different tax regime. There might also need to be additional measures such as ‘Chinese walls’ put in place to reflect the more complex accountability relationships.

The Treasury will continue to be involved in negotiating and calculating the effects of fiscal devolution on the block grant, and will also oversee any use of the limited borrowing powers that Cardiff will acquire. The Wales Bill gives the Welsh Government capital borrowing powers with a limit of £500m, and it initially also gives it a limit of £500m for revenue or current borrowing (although this is limited to £200m per year). The UK Government has indicated that the latter will rise to approximately £1bn if and when the WRIT is implemented.<sup>34</sup>

The Wales Bill can plausibly be regarded as a ‘minimum offer’ given the fact it has cross-party support and backing from both governments, so in terms of our scenarios framework we consider it to be part of the ‘moving status quo’ (represented as scenario W2 in Figure 1 above). However, the bill may yet be amended after the Scottish referendum. In particular, in the event of a No victory, if further fiscal or other devolution to Scotland is placed firmly on the agenda, some in Wales are almost certain to advocate similar additional powers for the Welsh Government. These more speculative future scenarios are discussed in the final chapter of this paper.

As far as Northern Ireland is concerned, there are currently no agreed plans to transfer significant new powers to Northern Ireland, though debate on this is likely post-referendum (in particular relating to corporation tax – discussed below). One small and largely-unnoticed measure of fiscal devolution to Northern Ireland has already happened. The Northern Ireland Assembly (NIA) now has control of long-haul air passenger duty (APD) rates (again the rationale was competition from south of the border), though in fiscal terms this was a small change, representing just £5m of revenue in 2012.<sup>35</sup> On acquiring this new power, the NIA immediately set the long-haul APD rate to £0. Therefore, although HMRC technically remains the collection agency, there were no real challenges to resolve about how to administer a separate fiscal system.

Northern Ireland also already has the power to diverge from policy in Great Britain in the more significant sphere of social security. Benefits and pensions in Northern Ireland are administered by the Northern Ireland Civil Service itself, rather than by DWP as in Scotland and Wales. In practice however, Northern Ireland has adhered strongly to the principle of parity, by which it replicates DWP policy and is provided with the funds to do so by the UK government. But as the UK government’s welfare reform agenda proceeds, this principle has come under strain and the Treasury has taken the rare step of imposing penalties of £5m a month as a result of the Northern Ireland Executive’s inaction on the Welfare Reform Bill.<sup>36</sup> While it was the subject of lively debate on the floor of the Assembly in October 2012, it has

<sup>34</sup> House of Commons Welsh Affairs Committee, *Pre-legislative scrutiny of the draft Wales Bill*, HC 962, 28 2014, Para. 92, retrieved 29 August 2014 from [www.publications.parliament.uk/pa/cm201314/cmselect/cmwelaf/962/96205.htm](http://www.publications.parliament.uk/pa/cm201314/cmselect/cmwelaf/962/96205.htm)

<sup>35</sup> HMRC, *Air passenger duty: Cut in Northern Ireland rate*, TIIN 876, 2011, retrieved 29 August 2014 from [www.hmrc.gov.uk/tiin/tiin876.pdf](http://www.hmrc.gov.uk/tiin/tiin876.pdf)

<sup>36</sup> Staff, ‘Alex Attwood: Sinn Féin pulled out of welfare reform deal,’ *BBC News Online*, 6 April 2014, retrieved 29 August 2014 from [www.bbc.co.uk/news/uk-northern-ireland-26910819](http://www.bbc.co.uk/news/uk-northern-ireland-26910819)

now stalled following the committee stage with disagreement among the parties as to whether Northern Ireland should abandon the parity principle on this issue.<sup>37</sup> On some specific elements of welfare reform, the UK Government has accepted that the two welfare systems should be allowed to diverge. Notably, housing benefit will still be paid directly to landlords in Northern Ireland (rather than being rolled into the Universal Credit as is planned in the rest of the UK).<sup>38</sup>

### The Civil Service after a No vote

The 'moving status quo' is not restricted to powers and policies. It extends to questions about the future form of the institutions which support the UK Government and devolved administrations. A No vote would see the Civil Service largely unchanged in terms of its basic constitutional structure – a Home Civil Service supporting the governments of the UK, Scotland and Wales, and a separate Civil Service in Northern Ireland. But with the noise of the referendum behind it, it may be a good time for the Home Civil Service to reassess what it means to be a single organisation in the context of devolution and political divergence.

To some extent, the referendum campaign has already triggered some consideration of this question. For instance, the House of Commons Public Administration Select Committee launched an inquiry to examine claims that civil service impartiality (in both Whitehall and Edinburgh) had come under pressure to make the case for the two governments' respective preferred referendum outcome. However, most evidence provided to the committee has argued that the Civil Service Code – which codifies the values of impartiality, objectivity, honesty and integrity – has not been breached, though certain specific actions (such as the publication of advice in the name of a specific named official – the permanent secretary at the Treasury) have raised eyebrows. This has led some to conclude that the Code was indeed 'showing the strain'.<sup>39</sup>

The consensus in both governments, however, is that UK and Scottish officials have simply been fulfilling their duties to support their respective ministers in working towards their (directly contrasting) policy ambitions. That civil servants in the three capitals covered by the Home Civil Service have different political masters is a natural and unavoidable consequence of devolution, but only in the heat of the referendum battle have the full implications of this become apparent.

Post-referendum, if the No campaign is triumphant, nothing will change in this respect. But as the normal business of government is resumed, there may well be more thought put into how the three separate administrations that form the Home Civil Service relate to one another, and to what extent they still function as a single organisation.

<sup>37</sup> Clarke, L., 'Northern Ireland welfare reform row lands on David Cameron's doorstep', *Belfast Telegraph*, 3 July 2014, retrieved 6 September 2014 from [www.belfasttelegraph.co.uk/news/politics/northern-ireland-welfare-reform-row-lands-on-david-camerons-doorstep-30403464.html](http://www.belfasttelegraph.co.uk/news/politics/northern-ireland-welfare-reform-row-lands-on-david-camerons-doorstep-30403464.html) and Assembly Business, *Welfare Reform Bill 13/11-15*, Northern Ireland Assembly website, retrieved 29 August 2014 from [www.niassembly.gov.uk/Assembly-Business/Legislation/Primary-Legislation-Current-Bills/Welfare-Reform-Bill](http://www.niassembly.gov.uk/Assembly-Business/Legislation/Primary-Legislation-Current-Bills/Welfare-Reform-Bill)

<sup>38</sup> Department for Social Development, *Report on Progress on Welfare IT Systems*, 2012, retrieved 29 August 2014 from [www.dsdni.gov.uk/statement-to-assembly-welfare-it-systems.htm](http://www.dsdni.gov.uk/statement-to-assembly-welfare-it-systems.htm)

<sup>39</sup> Gallagher, J., *Oral evidence: Civil service impartiality and referendums*, House of Commons Public Administration Select Committee, HC 1149, 2014, retrieved 29 August 2014 from <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-administration-committee/civil-service-impartiality-and-referendums/oral/8480.pdf>

Interviewees and published literature on this question emphasise that the three administrations remain bound by a set of embedded shared values, systems and frameworks. There is the common (and statutorily required) commitment to the Civil Service values embedded in the three governments' (nearly identical) civil service codes, and to the process of appointment on merit. And indeed, these values are shared in the separate Northern Ireland Civil Service as well, illustrating their well-entrenched status.

Within the Home Civil Service (HCS), there is also a standardised grade structure and pay framework at senior levels, as well as a shared pension scheme and some HCS-wide leadership and talent development activities. Senior devolved officials participate in initiatives such as the 'Top 200' gatherings and the High Potential Development Scheme. The heads of the Scottish and Welsh civil services attend the 'Wednesday Morning Colleagues' gatherings of Whitehall permanent secretaries. There are also inter-administration activities related to functional groups within the Home Civil Service, such as the Policy Profession.

Senior civil servant (SCS) development and appraisals in the three capitals are also all based around the 'nine-box grid' mapping potential against performance and, particularly at the most senior tiers, there is continuing involvement of the Cabinet Office in the appraisals process for devolved officials. The Whitehall-based Senior Leadership Committee also ratifies director-general and permanent secretary appointments for all territories, while the single Civil Service Commission regulates recruitment (especially of external figures into the Civil Service) across Great Britain.

At the same time, despite these shared frameworks, there are signs of a trend towards divergence between the UK, Scottish and Welsh administrations in terms of structure, culture and ways of working. For instance, the Scottish Government's National Performance Framework brings together the whole Civil Service and wider public sector in pursuit of a single set of strategic objectives. No equivalent exists in Whitehall.

The respective governments have also pursued different civil service reform agendas that over time lead to increasing differences between the three administrations. For example, although they have matched the pay freezes imposed by the UK Government, the Scottish and Welsh Governments have opted not to subscribe to the same system of performance-related pay for senior officials. In Scotland, similar strands of work are being done on civil service reform to the UK, but they are tailored to the needs of Scottish Government. For example, its capability plan is entirely separate, focusing on specific skills required in Scotland.

Another important issue is the (anecdotally-reported) decline in the interchange of personnel between the territories, with fewer staff moving from Whitehall to the devolved administrations or vice versa than in the pre-devolution era. This leads to diminished intergovernmental networks and relationships. One senior official recalls how in the pre-devolution period, the HR department in the old Welsh Office would have arranged a 'level transfer' or secondment to a Whitehall department, but that this is far more difficult today, and that recruitment processes undervalue experience gained in the devolved administrations. Other possible barriers include the reduction in relocation packages to civil servants and the simple fact that potential candidates are not made aware of suitable

vacancies in other administrations. Such data as there is suggests that there is greater interchange between the Scottish Government and the wider Scottish public sector than with Whitehall departments. Likewise in Wales, there have been attempts to encourage the emergence of a more integrated 'Welsh public service'.

Such trends and developments may lead to a different kind of relationship between parts of the Home Civil Service even in the event that nothing formal changes in terms of the constitutional relationship between Westminster, Holyrood and Cardiff Bay. This will be something to keep under review at least, even if in the short term nothing fundamental will change. In the long term, there may be further calls for devolution of the Civil Service (in order to integrate better with local government etc) particularly if there is a move to significant further devolution more broadly (as we discuss in the next scenario).

### **Intergovernmental machinery and processes**

As we have discussed in the previous chapter, Scottish independence would manifestly require a fundamental reconsideration of intergovernmental machinery as the relationship between London and Edinburgh became that of two sovereign states. However, even in the event of a No vote and continuation of the (moving) constitutional status quo, it is likely that there will be a degree of debate about how best to operate the machinery of intergovernmental relations between the different administrations of the UK.

One spur to this is that there will still be four governments with very different political complexions. Tensions around economic and welfare policy will continue and there will be an ongoing need for cross-border co-ordination in many sensitive areas (such as energy policy, fisheries and agriculture, policing and justice). All this will require the maintenance of effective 'intergovernmental relations' (IGR) machinery to facilitate discussion and co-ordination. Such machinery already exists, but opinions are mixed as to its effectiveness.

A central piece of the IGR system in the UK is the Joint Ministerial Committee (JMC), which meets in plenary, domestic and EU formats, as well as in a more occasional 'dispute resolution' format. There are also separate 'quadrilateral' meetings of finance and agricultural ministers. Some observers see the JMC as primarily an opportunity for political grandstanding and others report difficulties in finding enough subjects of common interest to fill the agenda. Nonetheless, other interviewees highlighted some specific positive effects that can come out of JMC meetings. For instance, the devolved administrations are able to use the plenary and domestic formats to bring items of concern directly to the attention of the senior UK minister present (the Prime Minister or Deputy PM). This can lead to resolution of difficult policy issues that officials themselves have been unable to find way through.

The JMC Europe format also plays a particular function in providing space for dialogue between the devolved administrations and the UK government in advance of each meeting of the European Council. Devolved concerns can be aired (if not always with any visible effect) before the adoption of a common UK line for Brussels negotiations.

In addition to the JMC machinery is the British-Irish Council (BIC), which also provides a forum for intergovernmental dialogue between the UK and devolved administrations, as well as the governments of the Republic of Ireland, Jersey, Guernsey and the Isle of Man. A rather different institution, the BIC has an important symbolic function as the 'east-west'

strand of the 1998 Northern Ireland peace settlement. It was put in place in response to unionist unease at the creation of 'north-south' links with Dublin (for instance through the North-South Ministerial Council). BIC is served by a small permanent secretariat in Edinburgh and serves primarily as a conduit for sharing lessons and creating networks (at both official and political levels) around particular policy areas such as control of drugs and management of cross-border environmental challenges. Unlike the JMC, UK-devolved disputes are rarely aired or resolved at BIC summits. Given the presence of the non-UK governments, the atmosphere tends to be more formal and diplomatic.

The set-piece multilateral intergovernmental meetings, in both JMC or BIC formats, are likely to continue more or less unchanged in the event of a No vote. However, alongside this formal machinery, much of the real business of intergovernmental relations is conducted through bilateral channels, with the territorial offices having some involvement in facilitating relations between the rest of Whitehall and the devolved administrations.

However, the role of the territorial offices does appear to have changed over the years. The then Scottish Office lost an empire in 1999 as its policy responsibilities were devolved to the new Scottish administration. It only really found a new role and became more political after the rise of the SNP – particularly during the long referendum campaign, with the Scotland Office centrally engaged in co-ordinating the UK Government's campaign against independence.

In the event of a No victory the Scotland Office will need a new *raison d'être*. The current thinking is that it will seek to facilitate greater co-ordination of UK Government activities in Scotland, joining up departments like DWP, MoD and DfID which have significant presence in Scotland, and helping the UK Government as a whole to develop a greater profile and presence north of the border.

The Wales Office plays an important part in overseeing the current phase of further devolution and the passage of the current Wales Bill – which one interviewee contrasted with the previous Government of Wales Act 2006, in which the Welsh Government played a more central role. It is prioritising passing that legislation by the end of this Parliament and resisting calls from some in Wales for some Silk II recommendations to be included now, such as moving to a reserved powers model. As with the Scotland Office, there is a perception that the Wales Office has become more political in its function in this period of political divergence between the different capitals. Interviewees describe its role as one of 'holding the line' of the devolution settlement against potential encroachment by the Welsh Government. Post-referendum, the underlying political dynamics will be the same (at least until the 2015 UK general election). Although it may also be that with the Union saved, the UK Government will become more relaxed in its dealings with all the devolved administrations.

As for Northern Ireland, the Northern Ireland Office (NIO) will retain its function in overseeing the fragile political settlement there. But the nature of the devolution settlement in Ulster means that Whitehall's interaction with the Northern Ireland Executive will continue to be at a lower level to its interaction with the Scottish and Welsh Governments.



After the referendum, Whitehall as a whole may also wish to assess how effectively it deals with the devolved territories. Interviews we have conducted, as well as past studies of this subject, point to a mixed picture of how well different departments (and different policy teams within them) perform in this respect. Officials at the devolved level typically report perfectly amiable and open relationships with their Whitehall peers. But at the same time they encounter poor awareness of the devolution settlements (or an assumption that the different settlements are the same) and failure to consult early enough in the policy process even where there is a clear devolved interest. The Welsh Government put these frustrations on record in its submission to the Silk Commission, describing 'our working relationships with the UK Government as professional, business-like, constructive, numerous, complex and sometimes frustrating'.

Since in complex cross-cutting policy areas, the UK government often requires the consent of the devolved institutions before legislating, Whitehall can also undermine its own effectiveness by failing the devo-awareness test. In recognition of this, the Cabinet Office clearance guidance clearly states the need to consider devolved implications and the territorial extent of proposed policies before cabinet committees take decisions. There are also devolution co-ordinators in all departments with a responsibility to facilitate relations between their departmental colleagues and devolved counterparts. At the centre of government there are a number of units responsible for co-ordinating Whitehall's devolution activities including: a Devolution Strategy Team; the Scotland Analysis Team; a devolution-focused section of the Cabinet Secretariat; a fiscal devolution unit in the Treasury; and, of course, the territorial offices themselves.

In the event of a No victory, the UK government may well wish to assess the effectiveness of such arrangements, and whether greater joining-up at the centre could be achieved. Officials we spoke to reported greater awareness of the need to think about the devolved administrations because the referendum context had triggered internal reminders to maintain relationships with counterparts and engage early on policy. But there is also a risk that post-referendum, this awareness will fade as the General Election 2015 (and then perhaps an EU referendum) becomes the new focus. Continuing work is needed to embed 'devolution thinking' well beyond September, and the Institute for Government will continue work in this area.

## 4. The next phase(s) of devolution

Above we have discussed the things that are more or less certain in the event of a 'No' vote in the referendum: the implementation of the Scotland Act 2012; the passage of a new Wales Bill (in some form at least); continuing issues caused by the effects of the welfare reform agenda at the devolved level; and the need for some rethinking of how Whitehall deals with the territories, including the future role of the Territorial Offices.

Here we discuss the things that are far less certain. All the political parties in both Scotland and Wales are already engaged in debates about the next phases of devolution in those two countries. This is mirrored in Northern Ireland, where there is an ongoing set of conversations about the future of certain taxes and elements of welfare reform. It would be impossible to capture all the different possible changes to cross-territorial government in the UK that are currently being proposed and discussed, but here we attempt to cover at least the main areas for which Whitehall and the wider machinery of government should be prepared.

### Scotland

The three unionist parties have set out proposals for additional devolution to Holyrood in the event of a 'No' vote in the referendum. Each of these parties' national and Scottish leaders has signed a pledge to strengthen the powers of the Scottish Parliament, particularly in areas of 'fiscal responsibility and social security'. This pledge included a commitment to publish these plans before the 2015 general election, and a 'guarantee to start delivering more powers ... as swiftly as possible in 2015'. The parties have also each set up a commission to examine the existing balance of powers and set out more detailed proposals for further devolution, particularly in the area of tax-raising powers.

#### Further fiscal devolution

Fiscal devolution has become the focus of the debate about where the process of Scottish devolution goes next. As set out in the introductory section of this paper, the three unionist parties have each proposed a different package of additional fiscal powers for Holyrood, which if implemented would move Scotland to different positions on our map of constitutional scenarios (represented in Figure 1 by scenarios S3 for Labour, S4 for the Conservatives and S5 for the Liberal Democrats).

If implemented, these proposals would have wider effects on the machinery of government. Because the focus has been predominantly on further fiscal devolution, the Whitehall departments that face the most significant changes are the Treasury and HMRC, while at the devolved level it is the fiscal and budgetary functions that will need expansion in terms of staff and expertise if the path of fiscal devolution is followed.

The scale of the adaptation required by governance structures depends on the scope of the different parties' proposals, which vary significantly. All the unionist parties favour some further transfer of income tax, but while the Conservatives and the Liberal Democrats propose its complete devolution, Labour only propose an extension of capacity to vary the

new Scottish Rate (from 10 to 15 pence in the pound), and a new power to create additional 'progressive rates'.

The most significant task facing HMRC in implementing the current changes to income tax is that of identifying Scottish taxpayers. So the devolution of some additional rate-setting powers, as proposed by Labour, could presumably be administered by HMRC with relative ease by extending the mechanisms that are currently being created.

However for the more extensive plans put forward by the other two unionist parties, this is not so clear. Both the Conservatives and Liberal Democrats advocate extending the Scottish Parliament's powers to all tax rates and bands, although both would retain for Westminster the right to: define 'income'; set rates on investments, dividends and savings; and set uniform allowances and reliefs across the whole of the UK.<sup>40</sup> Such a shared income tax system might need more complex intergovernmental arrangements to be designed and maintained between Whitehall and Edinburgh.

One key question that the two governments would have to work out in the event of either of these scenarios coming into effect is whether the new system could be easily implemented as an extension of current arrangements, with HMRC administering Scottish rates and bands on behalf of Holyrood. This would have the advantage of maintaining the existing UK-wide 'pay as you earn' (PAYE) architecture. But since there would be far greater scope for divergence in the tax system between Scotland and the rest of the UK, this would be a more complex operational task requiring careful system design and further contractual negotiations between HMRC and Scottish Government – with the latter paying the former for operating the system on its behalf (as will happen if the SRIT comes into effect).

The alternative option would be for the devolved tax administration body, Revenue Scotland, to take over from HMRC the administration of all or part of the income tax system in Scotland. Going down this path would require the governments to deal with two major challenges: capacity and co-ordination.

On capacity, HMRC already seems to be working closely with Revenue Scotland to transition the two Scotland Act devolved taxes by April 2015, but these are very small taxes in fiscal terms. A larger change such as this would require Revenue Scotland to build up its capacity on a larger scale. It would naturally look to HMRC as a source of advice and potential employees as it did so. Since major fiscal devolution might well leave HMRC overstuffed, a transfer of HMRC capacity in Scotland to Revenue Scotland (as is expected in the event of independence, though on a smaller scale) might end up being in the interests of both governments.

Co-ordination is a more difficult issue altogether. The administration of income tax within the UK by two separate bodies would require new arrangements between the different jurisdictions to ensure for example that taxpayers identified as Scottish in one jurisdiction are not identified as English or Welsh in another. Given that all three unionist parties propose to retain a UK-wide system of income tax for investments, dividends and savings, there would

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<sup>40</sup> The two parties do differ on the treatment of the initial income tax threshold or 'personal allowance'. While the Strathclyde Commission recommends that it remains under Westminster control, the Campbell Commission recommends that it moves to a shared responsibility, requiring 'partnership work' between the different governments of the UK.



also be a set of operational challenges for HMRC and the Scottish Government in joining up the two systems to incorporate rates set by different bodies.

Income tax is not the only tax on the agenda for further devolution to Scotland. While Labour's commission proposed changes only to income tax, the Conservative commission proposed the devolution of air passenger duty, which the Liberal Democrats also included in their future devolution package, alongside the aggregates levy, inheritance tax and capital gains tax. Although not insignificant, none of these taxes raised more than £300 million in 2012/13.<sup>41</sup> Therefore in Figure 1, the distance between S3 (Labour) and S4 and S5 (Conservative and Liberal Democrat respectively) is due mainly to the proposals relating income tax, rather than these more minor taxes. It remains unclear from the two commissions' reports whether current proposals are for the full devolution of these tax regimes (effectively abolishing the current taxes and granting the Scottish Parliament the ability to raise different taxes in these areas), or simply greater control over their rates, with revenue still collected by HMRC and allocated to Scotland directly.

As far as the Treasury is concerned, one major task would be to calculate and negotiate the 'block grant adjustment' that would apply when new tax powers were brought into effect and started to be used. In other words, by how much should Scotland's block grant funding be reduced to reflect the enhanced ability of the Scottish Government to raise its own revenue? Even for the fairly small-scale fiscal devolution in the Scotland Act 2012, these negotiations have run into some difficulties. With more extensive powers to vary income tax devolved, agreeing the block grant adjustment would become a more complicated process, although to some extent the existing methodology could be extended. For more volatile taxes such as capital gains tax (or indeed oil and gas revenue, the devolution of which is proposed by Reform Scotland, in our Scenario S8), calculating a fair grant adjustment may be more challenging still.

A further implication for the UK government of significant fiscal devolution is that its ability to rationalise the tax system as a whole could be reduced. In particular, wholesale devolution of income tax would make it difficult to integrate income tax and national insurance, which the Chancellor is reportedly considering and organisations such as the Institute of Fiscal Studies have recommended.<sup>42</sup>

Another issue that would be close to the Treasury's heart is that of borrowing powers. The Scotland Act 2012 gave the Scottish Government the power to borrow up to £500m to even out fluctuations in tax receipts (so-called 'revenue borrowing' as distinct from 'capital borrowing' for infrastructure investment which the Scotland Act also authorises the Scottish Government to conduct, including via the bond markets). An extension of Scotland's power to raise its own revenue via taxation (particularly in volatile areas) would logically lead to an extension of these borrowing powers too, which the Treasury would need to oversee.

<sup>41</sup> Air passenger duty raised £234 million in Scotland in 2012-13, equivalent to 0.44% of total tax raised in Scotland. The aggregates levy raised £45m (0.08%); capital gains tax, £292m (0.55%) and inheritance tax £243m (0.46%). By contrast income tax raised £10.87bn in Scotland in 2012-13, 20.44% of total tax raised in Scotland.

<sup>42</sup> Hall, N., 'Britain's Osborne may merge income tax and national insurance - the Times,' *Reuters*, 30 June 2014, retrieved 29 August 2014 from <http://uk.reuters.com/article/2014/06/30/uk-tax-idUKKBN0F501O20140630> and Institute for Fiscal Studies, *Tax by Design*, Oxford University Press, 13 September 2011, p. 495, retrieved 29 August 2014 from [www.ifs.org.uk/publications/5353](http://www.ifs.org.uk/publications/5353)

## Towards a devolved welfare system?

Of all identifiable spending in Scotland, by far the largest section that remains under the control of Westminster covers welfare and pensions, comprising 95% of UK government identifiable expenditure in Scotland.<sup>43</sup> As discussed in Chapter 3 there have been some recent changes to the devolution settlement in Scotland in this still-mainly reserved area. To date, these changes have been minor and focused on areas that mirror changes in central-local relationships across the rest of Great Britain – such as the localisation of council tax benefit – or give the Scottish Government more freedom over the use of its own funds to mitigate some of the impacts of Westminster-led welfare reform.

Given their relative size and reserved status, it is hardly surprising that further devolution of welfare powers is now on the agenda and that all three unionist parties propose changes in this area should there be a ‘No’ vote in the referendum. Some of these proposals build on the changes we have already seen. For example, the Strathclyde Commission advocates that the Scottish Parliament be given the ability to supplement any welfare benefit that remains under the legislative competence of Westminster. This would avoid the necessity for case-by-case negotiation, as was necessary to enable the Scottish Government legally to top up discretionary housing funding (as discussed above).

The Liberal Democrats propose to maintain a UK-wide system of pensions and social security in the absence of a federal solution to the UK constitution. The Conservative and Labour devolution commissions set out similar visions for the territorial distribution of welfare policy. Both cite a principle that the strongest case for devolution of cash benefits occurs when these closely relate to a devolved policy area. Accordingly, both conclude that because housing, social care and health policy are devolved matters, there is a strong case for devolving both housing benefit and attendance allowance.

The Labour commission also proposes the localisation of welfare-to-work programmes, with the Scottish Government ‘playing a partnership role and providing strategic oversight’. Again, the rationale here is that welfare-to-work and employment, as reserved policy areas, closely relate to skills policy, which is devolved. The ‘jagged edge’ between these two policy areas creates intergovernmental co-ordination challenges, particularly when (as in both Wales and Scotland at present) there are political differences between the governments in these policy areas.

All three unionist parties conclude overall that a UK-wide system of universal social rights underpinned by a common social security system, is of great importance to maintaining a social union between Scotland and the rest of the UK. The proposals made by the three parties are therefore fairly small changes in fiscal terms, compared with the overall size of the welfare budget. Nonetheless, even to implement the limited changes suggested would not be without challenges for DWP and the devolved bodies.

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<sup>43</sup> Government Expenditure and Revenue Scotland (GERS) Table 5.8 (Figs = 16430/17256); ‘Identifiable expenditure’ is expenditure that can be clearly allocated to a country or area of the UK, where it has been spent to the benefit of residents and/or enterprises in that area. ‘Non-identifiable expenditure’ on the other hand is that which cannot be allocated to a country or area of the UK but which has been spent for the benefit of the UK as a whole.

One question is around the level to which welfare powers should be devolved. Some of the recent changes involved devolution from DWP not to the Scottish Government but to local authorities (such as council tax localisation and access to DWP funds to help manage the impact of welfare reform). This led to concern at the Scottish Government level that they had insufficient ability to co-ordinate provision and to align with needs (particularly in the case of 'discretionary housing payments', which the Scottish Government wished to use to fully mitigate the effects of the controversial 'spare room subsidy' reform). The UK Government eventually conceded this point, granting the Scottish Government the flexibility to top up these budgets according to local needs. Devolution of significant additional welfare powers might also require a transfer of expertise and capacity from DWP to the Scottish Government.

An issue for the UK Government is that devolution of certain elements of the welfare state could cut across its ability to join up different policy levers and achieve wider goals. The clearest example of this is housing benefit, which is currently being rolled into the single Universal Credit payment across the UK. Disentangling the housing benefit portion of Universal Credit in certain areas of the UK could raise the complexity of an already-troubled policy.

Another point to note is that further devolution of welfare powers would raise the spending power of the Scottish Government, further widening the 'fiscal gap' between revenue and expenditure power at the devolved level, when a stated ambition of all three parties is to narrow it. The two benefits proposed for devolution by the Scottish Labour and Conservative commissions totalled £2.28bn in spending in 2012/13, or almost 6% of the total expenditure of Scottish devolved and local government. Evidently there would need to be significant tax devolution if these powers were transferred, simply to keep the current fiscal gap constant let alone to narrow it.

### **Partnership between governments?**

Debates about Scottish devolution have always tended to centre round the binary question of whether power should be held at the UK or the Scottish level. The devolution settlement itself reinforces this conceptual framework, with the legislation specifying a list of reserved powers, with the Scottish Parliament fully empowered to legislate in all other areas.

However, the practice of devolution has frequently highlighted that maintaining a clean separation between reserved and devolved domains is often impossible, which can lead to intergovernmental tensions and a more complex policy environment. For instance, employment policy is controlled by the UK government but skills is a devolved matter – leading to overlaps between welfare-to-work and devolved training programmes. Other areas, such as energy strategy and management of the Scottish seas, also cross the boundary between reserved and devolved making coherent policy sometimes challenging to achieve.

In this context, it is interesting to note that both the Labour and Liberal Democrat parties have raised the idea of greater and more formalised partnership working between the two tiers of government. The Liberal Democrats, for instance, have advocated creating a third constitutional category of 'partnership powers' including in the areas of: skills and

employment; strategic planning of welfare services; energy resources; marine policy; and cross-border transport. Labour's devolution commission meanwhile spoke of creating new 'partnership arrangements in meeting policy objectives such as full employment, a highly skilled workforce, an innovative science-based economy, and cross-border transport, where powers are shared between the different parliaments'. There was also a call for a 'joint poverty commission' between the governments and for entrenching in law mechanisms for working in partnership.

Little detail has been set out about how such partnership arrangements would work (in either the Lib Dem or Labour visions) but what is clear is that there could be ramifications for how both the Scottish Government and a number of Whitehall departments (including DWP, DECC, DfT, Defra and BIS) operate and make policy. There may be a need to develop new and innovative intergovernmental machinery. Partnership working would also imply a move away from the idea of intergovernmental relations as a matter of mere 'negative co-ordination' or dispute resolution, towards a more expansive concept of facilitating 'positive co-ordination' between governments in pursuit of shared goals (though with sufficient flexibility to function even when there is political divergence between the two administrations).

### **More radical future visions**

We have mainly focused in this section on the proposals for further devolution put forward by the three unionist parties. However these are not the only conceivable models for further devolution following a 'No' vote in the referendum. As outlined in the opening section, there are a number of alternative scenarios that have been put forward which go further in the powers (both over welfare and taxation) than those proposed by any of the unionist parties.

At the theoretical far end of these alternative 'No' scenarios is one that we have characterised as 'Devo Max' (scenario S9 in Figure 1). This term is often used loosely to cover a wide set of options for further devolution, but which we have followed McLean et al in understanding as a 'full fiscal autonomy' model, in which the Scottish Parliament is responsible for the vast majority of revenues and spending in Scotland, with the exception of certain UK-wide functions such as defence and international relations. Depending on which taxes and spending powers were included, this model might reverse the current funding arrangements, necessitating a transfer from Holyrood to Westminster to cover these common goods and services.

For the purposes of our analysis, we have defined a 'Devo Max' package in which the Scottish Parliament would have control over all taxes other than VAT – which it could not retain under EU law (though assignation of VAT revenue as proposed in the IPPR Devo More scenario S6 would be an option) – and all spending except defence and 'international services' (FCO and DfID), existing public sector debt interest, and national schemes for public order and safety (such as counter-terrorism and serious crime work). According to our analysis (see Figure 1) this would result in a devolution settlement in which Scottish devolved and local government control approximately 90% of total expenditure in Scotland, and around 80% of total revenue.

No-one significant in politics – either at the UK or sub-national levels – is currently calling for such a radical transfer of powers, although some groups such as the IPPR (scenario S6) Devo Plus (scenario S7) and most of all Reform Scotland (scenario S8) have proposed packages of powers that begin to approach this. However it is as yet unclear how the Scottish National Party would respond to a ‘No’ vote, and it will be interesting to see how far towards this or some alternative vision of ‘Devo Max’ they advocate moving. At this extensive level of devolution, the relationship between UK and Scottish governments would surely move onto a very different footing indeed, raising questions about the future of the unified Civil Service and about Scottish representation at Westminster.

None of the main parties are currently calling for the devolution of control of the Civil Service. Indeed even the SNP have deprioritised this as an objective since taking power in Edinburgh. However, significant further devolution to Scotland would shift the balance between reserved and devolved civil servants in Scotland. At present just under 40% of civil servants north of the border work for the Scottish Government, with most of the rest employed by either DWP or HMRC. In the event of large-scale tax and welfare devolution, Scotland might start to become more like Northern Ireland, where 80% of all officials are directly employed by the devolved administration. This might raise the question of whether it becomes logical to devolve control of the Civil Service to Scotland (as there is in Northern Ireland, for longstanding historical reasons).

## Wales

We have already discussed the (changing) status quo as it relates to Wales, and the current Wales Bill proposals for limited fiscal devolution (implementing recommendations made by the cross-party Commission on Devolution in Wales – known as Silk I). To some extent Wales is already playing catch-up with Scotland in this process, but it seems likely that if the offer to Scotland is significantly extended along the lines discussed above, it may well lead to pressure to do likewise in Wales.

At present, the debate around further devolution for Wales centres on the proposals in the second report of the Commission on Devolution in Wales (‘Silk II’), which reviewed the powers of the National Assembly for Wales and recommended constitutional changes. The main proposals for the devolution of particular policy areas in this report relate to the justice system which, unlike in Scotland, has always been shared across England and Wales. Silk II advocates a phased approach – recommending the devolution of policing and youth justice now, with reviews to follow on devolving the probation and prisons systems. It does not recommend the immediate creation of a Scottish-style separate jurisdiction or standalone legal system, but instead argues for a larger review of the case for this kind of full legislative devolution – to be held within the next 10 years. Silk II also proposes devolution of some more minor powers already devolved to Scotland, including over transport strategy and regulation, and planning consents for larger energy projects (at present, the Welsh Government has consenting powers only for small-scale energy projects of under 5MW). Most of these recommendations were subsequently accepted by the Welsh Government



itself, although unlike Silk II the Welsh Government favours full devolution of all energy consenting powers except for nuclear energy.<sup>44</sup>

In the context of a Scottish ‘No’ vote, and setting aside the financial powers included in the Wales Bill, the big questions around the future of Welsh devolution will probably concern the issues of policing and justice, which have already been the site of some intergovernmental disputes between Whitehall and Cardiff.<sup>45</sup> The degree to which these impact on inter-governmental relations and the non-devolved machinery of government depends on how far this debate progresses. Devolving powers over policing will certainly necessitate close ongoing co-operation between the Welsh Government, Home Office and Ministry of Justice. In part the need for this is geographical: the Welsh-English border is more densely populated than the Scottish borders, and this means that there would be more work needed to co-ordinate efforts to tackle cross-border crime. It is also about scale: Wales is small, and it may not make sense to lose the economies of scale gained from schemes such as the National College of Policing.

Any additional devolution of energy or transport powers would of course have implications for DECC and DfT – limiting these departments ability to create integrated energy and transport strategies across England and Wales and requiring new forms of intergovernmental relations to ensure effective co-ordination in these unavoidably cross-border policy domains.

In the medium term, the devolution of powers over probation and prisons raises some more difficult questions around the need for shared capabilities, and the control of existing infrastructure. For example Wales currently lacks any female or category-A prisons, so processes would be required to enable the continued cross-border management of offenders. On capacity, with the completion of the Wrexham ‘super-prison’, Wales will almost certainly have a surplus of prison places, which would presumably need to be filled by English prisoners. Working agreements between the Welsh and UK governments in these areas could mirror the type of arrangements that are currently in place to manage cross-border access to complex and specialist healthcare services.

Equally significant to the individual policy areas proposed for devolution in Silk II is the suggestion of a structural shift to the Welsh devolution settlement – moving away from the current *conferred powers* model to a *reserved powers* model of devolved government. At present, the National Assembly can exercise only those powers specifically conferred to it by the UK Parliament. However in a reserved powers system, as operates in Scotland and Northern Ireland, all powers would be held by the National Assembly unless specifically reserved to the UK Parliament.

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<sup>44</sup> Welsh Government, *Devolution, democracy and delivery: Powers to achieve our aspirations for Wales*, Welsh Government website, 2014, retrieved 29 August 2014 from <http://wales.gov.uk/docs/caecd/publications/140701-silk-2-response-en.pdf>

<sup>45</sup> For instance, as the Welsh Government’s submission to the Silk Commission details, there were disagreements about legislative competence during consultation and drafting of the Anti-Social Behaviour, Crime and Policing Bill, and about the appropriate mechanism for obtaining powers of entry for protecting adults at risk. Jones, C., *Letter to Paul Silk*, Commission on Devolution in Wales, 2013, retrieved 29 August 2014 from <http://commissionondevolutioninwales.independent.gov.uk/files/2013/07/Welsh-Government-additional.pdf>

The view of the Commission, and of the Welsh Government,<sup>46</sup> is that this would not only increase the fairness and coherence of the UK's constitutional arrangements by putting Wales onto a similar footing to Northern Ireland and Scotland, but it would also lead to clearer, better government by reducing some of the messiness and overlap between devolved and non-devolved policy areas. This could potentially facilitate smoother intergovernmental relations and reduce the chances of formal disputes such as a recent case that revolved around the question of whether the Welsh Government had the power to set wages for farmworkers (agriculture being devolved, employment being non-devolved). The Supreme Court decided that it did have the power.<sup>47</sup>

The Commission is also the latest review to propose changes to the structure and processes of the National Assembly for Wales. To ensure that the new powers it recommended for the Welsh Government are matched by adequate scrutiny and accountability mechanisms, Silk II recommends increasing the size of the Assembly from 60 members, and notes that many feel the ideal size of the chamber would be 80 members. Silk II and the Welsh Government also backed the retention of the GB-wide Home Civil Service, rejecting the idea of creating a separate Welsh Civil Service.

The Silk Commission (and now the Welsh Government itself) also proposed the creation of a new bilateral intergovernmental body, a Welsh Intergovernmental Committee, to work alongside existing multilateral bodies. This reflects the view that many challenging intergovernmental issues are bilateral, involving only the Welsh and UK governments, and therefore not the most suitable items for discussion at the JMC, which all four administrations attend. Examples include cross-border issues between Wales and England on health services and water. A further rationale for a specific UK-Wales body is that Welsh powers and institutions remain much more interconnected and entangled with Whitehall and England than do Scottish or Northern Irish equivalents.

The UK Government has yet to state its position on the Silk II recommendations, and no response is expected until after the Scottish independence referendum. The timetable for any further change to the devolution arrangements is therefore very uncertain. The Welsh Secretary has already stated that there will be no further primary legislation beyond the current Wales Bill before the 2015 General Election. The prospects for further devolution in Wales therefore are unlikely to become clear until the political parties' manifestos are published.<sup>48</sup> In any case, given the scale of the technical and administrative challenge, it seems unlikely that we would see policing devolved to Wales before 2020. And although the Leader of the Labour Party has already committed to a reserved powers model in Wales, he made no definite commitments on a timetable for its introduction.<sup>49</sup>

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<sup>46</sup> Welsh Government, *Devolution, democracy and delivery: Powers to achieve our aspirations for Wales*, Welsh Government website, 2014, retrieved 29 August 2014 from <http://wales.gov.uk/docs/caecd/publications/140701-silk-2-response-en.pdf>

<sup>47</sup> Henry, G., 'Welsh Government 2-0 Attorney General: UK Government suffers second Supreme Court defeat over powers to set wages for farm workers,' *Wales Online*, 9 July 2014, retrieved 29 August 2014 from [www.walesonline.co.uk/news/wales-news/agriculture-wages-bill-uk-government-7394743](http://www.walesonline.co.uk/news/wales-news/agriculture-wages-bill-uk-government-7394743)

<sup>48</sup> 'Devolve policing to Wales' call by landmark Silk Commission report,' *Wales Online*, 3 March 2014, retrieved 29 August 2014 from [www.walesonline.co.uk/news/wales-news/devolve-policing-wales-call-landmark-6764634](http://www.walesonline.co.uk/news/wales-news/devolve-policing-wales-call-landmark-6764634)

<sup>49</sup> Browne, A., 'Ed Miliband promises to clear up devolution confusion,' *BBC News Online*, 29 March 2014, retrieved 29 August 2014 from [www.bbc.co.uk/news/uk-wales-politics-26777839](http://www.bbc.co.uk/news/uk-wales-politics-26777839)



While Silk II defines the options being considered by the main UK parties, it is not the end-point for proposals for future devolution to Wales. A grander vision has recently been put forward by the leader of Plaid Cymru, in which she rejected the devolution relationship itself in favour of a model of ‘Welsh self-government’. Though somewhat speculative at present, this vision is an interesting extension of the debate over the conferred/reserved powers status of Welsh Assembly. It envisages a Welsh Assembly with responsibility for a written constitution for Wales, which in formal terms does not receive powers from Westminster, but freely associates with the UK government and opts into UK-wide services and functions that are better performed at that level. Plaid Cymru also emphasises that its model is based on partnership between Wales and the other nations of ‘these islands’, and sees the British Irish Council as a suitable forum in which the different governments can work together.

## Northern Ireland

The unique position of the Northern Ireland devolution settlement means that a significant amount of spending control already resides in the Northern Ireland Assembly. This is illustrated by the position of scenario NI1 in Figure 1, which shows that approximately 80 percent of government spending in Northern Ireland is under the control of the Northern Ireland Assembly and local government. It is therefore unsurprising that debate about further devolution there currently centres on fiscal powers – particularly, as described above, the future devolution of corporation tax. However unlike Scotland or Wales, Northern Ireland has no recent experience of an independent commission or review to examine the current devolution settlement and suggest changes. As such there are no real ‘recommendations’ for further reform on which to base an analysis of the options, other than the broadly-held position of the UK government, and statements put out by the different political parties active in Northern Ireland.

The one reform that has significant political backing is the devolution of the ability to vary corporation tax rates (to compete for inward investment with the lower-taxing Republic). The debate on this reform, proposed by a number of bodies over the past decade, has stalled in the context of the Scottish referendum. The idea seems to have a fair wind behind it. In 2011, the Northern Ireland Secretary publicly stated his support for such a move, which also enjoys cross-party support in the NI Assembly. The Prime Minister has stated that a decision on corporation tax will be made after the results of the Scottish referendum are known. If this decision favours devolving the tax, he has committed to introducing the new power through an Act of Parliament before its dissolution for the 2015 election campaign.<sup>50</sup>

The effects of devolving corporation tax are reflected in Figure 1 in scenario NI2, in which Northern Ireland would gain control of an estimated 12% (up from 7%) of taxes raised in the territory. Such a change would naturally have implications for the Treasury and HMRC, which would have to oversee the implementation of this devolution and negotiate the impact on the block grant. There may also be calls for a similar power to be given to the Scottish and Welsh institutions, about which the UK government might have more serious reservations in terms of the potential for cross-border tax competition within Great Britain.

<sup>50</sup> Elliott, D., ‘Countdown to D-Day in Northern Ireland corporation tax battle,’ *Belfast Telegraph*, 18 September 2013 retrieved 29 August 2014 from [www.belfasttelegraph.co.uk/business/news/countdown-to-dday-in-northern-ireland-corporation-tax-battle-29586587.html](http://www.belfasttelegraph.co.uk/business/news/countdown-to-dday-in-northern-ireland-corporation-tax-battle-29586587.html)

The broader future of the devolution settlement remains uncertain. As discussed above, there is increasing tension in managing the so-called ‘parity’ relationship between the Northern Ireland Executive and the UK Government in social security policy – a relationship managed by DWP. However, currently the Northern Ireland National Insurance Fund, from which contributory benefits are paid, is topped up every year by a subvention from the equivalent GB fund. In addition, non-contributory benefits are paid according to demand and come from UK general taxation. Overall this funding comes to approximately £3bn a year – and its continuation relies on maintaining the parity relationship.<sup>51</sup> In practice this means that the costs to the Northern Ireland Assembly budget of breaking parity would be prohibitively high, so even when there are serious tensions about certain aspects of welfare reform (as at present), the financial logic will continue to create strong incentives to maintain parity.

For Northern Ireland intergovernmental relations remains central to the stability of the devolution settlement. To ensure cross-community backing for the Good Friday Agreement of 1998, new institutions were set up to symbolise and facilitate both north-south and east-west relations, meaning Northern Ireland’s relationships with the Republic of Ireland and Great Britain respectively. The key intergovernmental bodies representing these two axes are the North-South Ministerial Council and the British-Irish Council, and a sensitive balance must be maintained between them. Any sign that one is growing more significant at the expense of the other risks upsetting either unionists or nationalists. As a result, significant change to these IGR bodies seems unlikely.

Finally, as in social security administration, the Northern Ireland devolution settlement is unique in that control over the Northern Ireland Civil Service is a devolved function. There are therefore potential scenarios in which the organisation of government in Northern Ireland could start to look radically different to the Home Civil Service that operates across Great Britain. However, there are factors that militate against this kind of divergence. The Northern Ireland Civil Service is set up in a similar manner to Whitehall in terms of its structure and values (indeed the other devolved administrations have in some respects diverged further from Whitehall, for example, in the move away from the departmental structure in Scotland). Given the serious political divisions in Northern Ireland, and the cross-party nature of the Executive, an impartial, professional administration is seen as critical to government functioning effectively. These factors clearly diminish the prospects for any major change in the future.

## Conclusion

This paper does not end with a simple set of research findings to share or recommendations to advocate. Our objective has not been to arrive at a particular conclusion about how the UK does or should work. Rather we have sought to explore the various ways in which the UK’s system of territorial government is in flux, and what this means for how the UK as a whole and its constituent parts are governed, and how the different administrations should work with one another.

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<sup>51</sup> Northern Ireland Assembly, *Parity and Social Security in Northern Ireland*, Research and Information Service Briefing Paper 99/11, Northern Ireland Assembly, 2011, retrieved 29 August 2014 from [www.niassembly.gov.uk/Documents/RaISe/Publications/2011/Social-Development/9911.pdf](http://www.niassembly.gov.uk/Documents/RaISe/Publications/2011/Social-Development/9911.pdf)

As we go to press, the imminent Scottish independence referendum naturally remains at the forefront of the debate. But how to govern after the referendum, whatever the result, is a question that will need to be confronted soon enough. We hope that this paper will both serve as a stimulus to these post-referendum discussions and assist all sides in finding the right answers.

The Institute for Government will itself return to these issues in the next phase of our research in this area.

## Annex 1: Our methodology and data

In this annex we present a summary of the calculations used to model the different scenarios presented in Figure 1 and discussed throughout the paper. As noted above, the lack of complete, comparable data sets for the three governments means that our figures, while comparable across different proposals for the same territory, are not strictly comparable between territories. Care should therefore be taken when using the calculations presented here, and figure 1 should be understood as an illustrative aid only.

### Comparability notes

#### Financial years

All figures for Scottish and Welsh scenarios are calculated using the most recent 2012/13 data, and all figures for Northern Irish scenarios are calculated using 2011/12 data, since this is the most recent data published in the Northern Ireland Department of Finance and Personnel NI *Net Fiscal Balance Report* series (NFBR).

#### Expenditure estimates

Comparability between our estimates of expenditure for scenarios relating to the different territories (the x axis of figure 1) is complicated by the different accounting measures used in the source data. The Scottish Government's *Government Expenditure and Revenue Scotland* (GERS) series uses the Total Managed Expenditure (TME) measure used for the National Accounts. But complete data for Wales and Northern Ireland is not available in this format, so for scenarios for these two territories we use HM Treasury's *Country and Regional Analysis* series data, which is given in Total Expenditure on Services (TES) terms. TES represents the total current and capital spending by the public sector, and is therefore similar to TME, representing about 95 percent of TME.<sup>52</sup>

#### Revenue estimates

For our Scotland and Northern Ireland scenarios we have used good and fairly comparable data to calculate total revenue raised within each territory at present and under the various different proposals for further devolution (the y axis of figure 1). For Scotland we use the data from *GERS 2012-13*, and for Northern Ireland we take revenue figures from *NFBR 2011-12*. Unfortunately there is no equivalent data set for Wales, so we have recreated a *GERS*-like set of revenue figures drawing most of our data from a set of HMRC experimental statistics published in October 2013 – the first in a new *Disaggregated Tax and NICs Receipts* series. This data set contains some discrepancies with *GERS* and *NFBR* revenue figures, the implications of which have been discussed by the two devolved governments elsewhere.<sup>53</sup> For more detailed commentary on individual calculations, please see the notes in the tables below.

<sup>52</sup> National Assembly for Wales, *Public Spending in Wales*, October 2012

<sup>53</sup> Scottish Government, *Government Expenditure and Revenue Scotland 2012-13*, March 2014, Box 3.1; Department of Finance and Personnel NI, *Northern Ireland Net Fiscal Balance Report 2011-12*, March 2014, Table 3.7