

# The Fiscal Implications of ‘Levelling Up’ and UK Governance Devolution

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When we set the UK in the context of other OECD economies, the UK does not have a fiscal equalisation system which is strongly related to the UK inequalities. Nor does the international evidence imply that devolution or decentralisation per se will help to reduce the UK’s interregional inequalities. It depends on the particular design and features of the devolution process.

As such, reforming the UK’s interregional fiscal system in a manner which will help with ‘Levelling Up’ is complicated by the fact that it is in many ways such a strange system by international standards. As well as being a governance system in which local and regional government has amongst the least authority and autonomy in the industrialised world, it is also a system in which the control and accountability systems are almost unique, and there are 9 aspects to this. These 9 features mean that the UK displays a unique sub-central government fiscal and decision-making system in comparison to all other industrialised countries. Moreover, the long-run combination of only mediocre economic growth allied with very high interregional inequalities suggests that this over-centralised system has poorly served the UK.

There is currently widespread enthusiasm for devolution and decentralisation as part of a broader Levelling Up agenda. However, any devolution or decentralisation needs to be undertaken very carefully because if poorly implemented, UK devolution and decentralisation could easily worsen the already-high interregional imbalances. Therefore, any movements towards some forms of greater devolution and decentralisation under the banner of ‘Levelling Up’ must be well thought-out in advance and implemented within a clear long-term strategy which takes on board and constructively builds on the likely impacts of each of the individual governance reforms.

## The 9 features

1. The UK increasingly has more of a cost-based than a revenue-based interregional fiscal equaliser system, and cost-based systems tend to provide much weaker fiscal stabilisation underpinnings than do revenue-based systems
2. The levels of UK sub-central government revenue, expenditure and investment which are decentralised are very low by international standards, as are the levels of sub-central government autonomy and authority
3. The UK distribution of sub-central government liabilities is unusual, in that the only other OECD country with a similar composition of liabilities close to that of the UK is Australia although the sub-central governance systems of the two countries are profoundly different.
4. The shares of UK sub-central government debt which are securitised are amongst the lowest of any OECD country, and are the lowest amongst any large OECD country. As such, the UK is not only unlike federal countries, but also unlike most other unitary countries, especially large unitary countries.
5. The UK central government exerts direct controls on almost all aspects of UK sub-central government, thereby creating distortions in policy objectives and limiting local policy-making discretion.
6. In the UK all sub-central government powers and responsibilities derive from central legislation, leading to a system of very strict rules and regulations. In many other countries, the relevant legislation is local or regional. The UK also differs from most other countries in that its shift to performance budgeting at the sub-central government level, combined with high-powered grant-seeking incentives, tends to skew local decision-making towards meeting the priorities of central government
7. In the UK, one of the most significant obstacles to devolution or decentralisation is the issue of constitutional checks and balances, and this inherently concerns the nature of parliamentary sovereignty and public accountability in the British constitutional worldview
8. The legal changes in Scotland following the recommendations of the Calman & Smith Commissions and in Wales (following the Silk Commission) mean that the UK is now rapidly becoming a quasi-federal state with highly unequal national governance components, each with very different sub-central governance arrangements, and an unclear definition of the centre of government
9. The over-centralised UK governance system militates against both central government learning and local government institutional capacity-building. The reason for this is that the extreme pyramidal nature of the UK governance system, combined with a lack of any meaningful meso-level governance tiers outside of the three devolved administrations or London, automatically disincentivises citizen engagement with government, especially in the weaker parts of the country. At the same time, this strange governance architecture curiously incentivises both short-termism in policy-making and large-scale interventions.